Fiduciary Duty to Borrowers and Steering Prohibitions

Real estate licensees (brokers and salespersons/broker-associates working under the supervision of a broker) with a Mortgage Loan Origination (MLO) Endorsement may perform loan origination activities related to residential properties consisting of 1 to 4 units. California law requires that a DRE licensee providing mortgage brokerage services to a borrower act as a fiduciary of that borrower, which includes placing the economic interest of the borrower ahead of their own.

California courts have held that this relationship not only requires the broker to act in the highest good faith toward their client but prohibits the broker from obtaining any advantage over the client by virtue of the fiduciary relationship.

A mortgage broker who violates their fiduciary duties may face discipline by DRE of their underlying real estate license and their MLO Endorsement, as well as expose themselves to civil liability in a legal action from their client.

In light of the requirement to place the borrower's economic interest ahead of the broker's interest, brokers should be aware of all laws, regulations, and rules governing their activities as a real estate licensee and mortgage broker, including the federal Loan Originator Compensation (LO Comp) Rule.

Prescribed by federal law, the LO Comp Rule prohibits loan originators, including brokers, from receiving compensation based on the terms of consumer mortgage transactions.

Prior to this prohibition on terms-based compensation, mortgage brokers often received commissions that varied based on the terms of the mortgage loans they obtained for their clients. In many cases, brokers could receive larger commissions on loans with less advantageous terms for their clients. For example, a loan with a higher interest rate would result in a larger commission to the broker than the same loan with a lower interest rate. Under the LO Comp Rule, however, such practice now is prohibited.

Additionally, receiving compensation where the broker receives greater compensation for acting against the economic interests of the consumer would violate a broker's fiduciary responsibility to place the economic interest of their client ahead of their own if the decision was motivated by a broker's financial desire to increase their compensation.

Further, a broker may not steer or direct a borrower to close a loan with a particular lender based on the fact that the lender will pay the broker a higher commission than other lenders, unless that transaction is, in fact, the best loan for the borrower.

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It is also important that brokers remember to disclose to the borrower the costs and expenses associated with the loan, in addition to disclosing all compensation they received in the transaction. Along these lines, brokers are prohibited from taking any secret or undisclosed compensation, commission, or profit.

While the laws real estate licensees must follow are numerous, it is important to remember that many of these laws are based on the broker's fiduciary duty and responsibility to their client. You can find the California Real Estate law on DRE's website, and the Consumer Financial Protection Bureau (CFPB) website has information about the LO Comp Rule.