

Doing Net Branches Right NAMB conference session / June 11, 2007 By **LISA D. BURDEN**

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The net branch business model provides benefits to both the parent organization and the mortgage broker. But lax management at some companies has tarnished the sector's image, mortgage brokers were recently told at a legal and regulatory conference.

While regulators frown on net branching, the head of a large national net branch operation told attendees at a National Association of Mortgage Brokers conference not to abandon the concept -- just get it right.

Misconceptions about the arrangement as well as legislation opposed to the model are in place because of companies that attempted to circumvent state and federal compliance laws, Daniel Jacobs, chief executive officer for 1st Metropolitan Mortgage Co., said at the conference this spring.

Brokers who don't follow the rules are losing state licenses and lender agreements because of their "lackadaisical" management style and lack of attention to regulatory oversight, Jacobs declared.

Indeed, Jacobs said he's had meetings with industry leaders who don't understand that what they are doing is incorrect or who are mistaken as to what net branching is.

"I have often said there are a lot of companies out there that have committed identity theft of net branching," Jacobs said at the Washington, D.C. conference.

Jacobs said he would rather make certain that mortgage brokers understand what is legitimate in the net branching realm and perform accordingly, rather than come up with a new name for the concept.

"If someone steals my name and credit, I'm not going to change my name, I'm going to regain my reputation," he said.

Net branching has value for mortgage brokers, Jacobs said. It allows them to focus on revenue-generating activities and to let go of dealing with non-revenue generating "back office" infrastructure and activities.

But there are pitfalls that can be avoided.

The licensee is responsible for leases, operating expenses and licensing. Licensee refers to the corporate entity, not the location or the individual. The branch is an extension of the licensee, it is not a separate entity, he reminded. It's a key factor that confuses people, he said. For example, every month Metropolitan Mortgage drops in the mail on the 27th 250 rent checks to the landlords of all of its 250 branches.

"We have to do that because we are on the lease," he said. Some companies say they are net branches and they don't even have a copy of the lease. They have no responsibility for the location. They are not paying for credit reports or requiring individuals to pay for credit reports. The corporation is not paying for basic operating expenses and this is what the regulators don't like to see.

Control is an issue. Branches should not have access to the checkbook, he said. All the accounting should be done by the corporate entity because a lot of state regulators look at whether the branch has its own checkbook.

Regulators look at the degree of control exercised by the branch manager and if the manager is doing all that work, wonder why the branch didn't get licensed.

Jacobs recommended that brokers become familiar with [HUD Mortgagee letter 00-15](#), which was recently incorporated in the HUD handbook. It gives concrete examples of what can be done and what should not be done in the net branching world. In fact, he said, many states have adopted some of the very same language used in the HUD letter, often going into more detail.

The branch manager's compensation may be based on the net profits of the branch. The HUD letter says the FHA approved mortgagee may collect revenues from the branch, pay the branch expenses and then pay the branch manager the remaining revenues. It is an alternative compensation program and is an acceptable arrangement if all the other branch requirements are met.

If the branch loses money, who pays for it? The loss has to reside with the licensee, Jacobs said. The risk has to lay with the licensee. Net branching is not a franchise where the branch manager has his own company and covers losses because that would be counter to the concept of the licensing laws of most states.

Some states require that everyone be paid via W-2, some don't.

Jacobs also discussed how supervision applies to net branching. The corporate entity must have policies and procedures established and that consistently applied consistently in real life, not just on paper.

Quality control has to be in place. While most states don't require quality control, they expect it. It's a best practice, he said, suggesting that a quality control check be run on each file.

Licensing and monitoring have to be in place as twenty-eight states have individual license requirements.

Jacobs said net branch licensees should pay branch employees through a W-2, maintain physical access to the branch and make onsite visits.

For example, he said, his company outsources inspections to a third-party company that uses a 120-point inspection. The inspecting company randomly visits branches, takes pictures and sends the inspection form and back to his company. "This lets us know if something needs attention," he said.

In other cases, Metropolitan Mortgage will send someone out to a branch to handle something that may have been uncovered through a branch visit.

"You have to have supervision," he said. "Supervising means seeing in some way, shape or form what you are operating."

Jacobs advised against branch level lines-of-credit, the payment to companies owned by employees and unlicensed home-based branches -- a mistake being made by many companies, he said, noting that regulators are on to the practice and are fining people for unlicensed activity. Of course, he explained, that's not to say that a loan officer can't perform ancillary activities from a home-based office, but if their primary place of originating and doing business is their home, then that location has to be licensed.

Jacobs believes net branching, when done correctly, can play an important role in fixing what is wrong with the industry as "mom and pop" shops don't have access to full-time compliance staffs and often can't devote the time to the future betterment of the market.

"It really is a game of striking the right balance between entrepreneurship and empowerment with a delicate balance between solid infrastructure and generous empowerment," he said.