

# Lenders Compliance Group

Wednesday, October 10, 2012

## Loan Originator Compensation: Past is Prologue - Part I

In the economic sphere an act, a habit, an institution, a law produces not only one effect, but a series of effects.

Of these effects, the first alone is immediate; it appears simultaneously with its cause; it is seen.

The other effects emerge only subsequently; they are not seen; we are fortunate if we foresee them.

**What Is Seen and What Is Not Seen**<sup>[i]</sup>

Frédéric Bastiat

Since April 6, 2011, mortgage loan originators (MLOs) have struggled to comply with the many requirements imposed on them by the MLO compensation provisions of the Truth in Lending Act (TILA),<sup>[ii]</sup> as amended by Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). That date was the compliance effective date.<sup>[iii]</sup> Prior to that date, however, there were considerable and persistent efforts made to postpone its implementation. I tracked the burgeoning protests and litigation in a series of articles<sup>[iv]</sup> and newsletters.<sup>[v]</sup> Associations resisted these TILA revisions on behalf of their membership. The National Association of Mortgage Brokers (NAMB) and the National Association of Independent Housing Professionals (NAIHP) sued the Federal Reserve Board of Governors (FRB). Amicus briefs were filed. Many members of Congress, from both sides of the aisle, also protested aspects of the new MLO compensation requirements. All for naught!\*

April 6, 2011 arrived. Resistance was futile!

The FRB had issued final rulemaking and official staff commentary with respect to the loan originator compensation rules and anti-steering provisions, but further guidance came to a virtual full stop on January 26, 2011, when the FRB issued its *Compliance Guide for Small Entities on Loan Originator Compensation and Steering*.<sup>[vi]</sup> After that, the FRB offered some conference calls, a webinar - which ostensibly cleared up some confusion, while causing other confusion - and provided occasional updates of the oral, rather than the written, official variety.

In the meantime, the Consumer Financial Protection Bureau (CFPB) received its "enumerated authorities" on July 21, 2011. From that date forward, the CFPB was in charge of promulgating and administering these compensation guidelines.

And on October 6, 2011 - exactly six months to the day when the rule became effective - the first examination guidelines for loan originator compensation were promulgated.<sup>[vii]</sup> In the *State Nondepository Examiner Guidelines for Regulation Z - Loan Originator Compensation Rule*, issued by the Multi-State Mortgage Committee (MMC),<sup>[viii]</sup> we were given a pretty good idea of the direction that federal and state regulators would be taking in their regulatory examinations for loan originator compensation.<sup>[ix]</sup>

For the most part, my firm's clients were prepared for implementation of the compensation rule, but we spent hundreds of hours preparing them for it, consisting of many conferences and meetings, which included very comprehensive reviews of employment agreements, compensation plans, disclosures, policies and procedures, and many other details, both logistical and systemic.

Inevitably, I felt mortgage loan originators needed more information than was readily available. So, we consolidated our knowledgebase and offered the [FAQs Outline - Loan Originator Compensation](#), a compendium of questions and answers about the MLO compensation requirements, first published on March 21, 2011 with 142 FAQs and 35 pages. About a year later, after 20 updates, the FAQs Outline was up to 450 FAQs and 147 pages!<sup>[x]</sup>

In this article, the first in a two-part series, I will consider the recent CFPB proposal, issued on August 17, 2012, which contains certain proposed rules governing mortgage loan originations, especially relating to the MLO compensation guidelines in Regulation Z, the implementing regulation of TILA. Comments for this proposal are due by October 16, 2012.<sup>[xi]</sup>

In the second part of this series, I will explore these proposals in considerable depth, specifically their clarification of and expansion on existing regulations governing MLO compensation and qualifications.

The CFPB does plan to implement new laws, including a restriction on the payment of upfront discount points, origination points, and fees on most mortgage loan transactions. For this reason, I will conclude this article with a brief, generic outline of certain proposals. To some extent, these new proposals exemplify the hurly-burly, roller-coaster ride we've been jaunting about on, in the on-going, elusive quest to implement the MLO compensation rule.

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There is only one difference between a bad economist and a good one:  
the bad economist confines himself to the visible effect;  
the good economist takes into account both the effect that can be seen  
and those effects that must be foreseen.

**What Is Seen and What Is Not Seen**<sup>[xii]</sup>

Frédéric Bastiat

The CFPB is required to certify that a proposed rule will not have a significant, adverse, economic impact on a substantial number of small entities.<sup>[xiii]</sup> The Small Business Regulatory Enforcement Fairness Act (SBREFA) provides the basis for a review, inasmuch as, among other things, "small businesses bear a disproportionate share of regulatory costs and burdens."<sup>[xiv]</sup> In order to comply with this requirement, the CFPB convened and chaired a Small Business Review Panel to consider the impact of the proposal and obtain feedback from representatives of the small entities that would be subject to the rule. When preparing the proposed rule and an initial regulatory flexibility analysis, the CFPB is expected to consider this panel's findings.

The panel consisted of representatives from the CFPB, the Chief Counsel for Advocacy of the Small Business Administration (SBA), and the Administrator of the Office of Information and Regulatory Affairs within the Office of Management and Budget (OMB).<sup>[xv]</sup> On the panel were so-called small entity representatives (SERs), individuals who represent the business entities that would be subject to the CFPB's proposal.<sup>[xvi]</sup> On July 11, 2012, the panel issued its report.<sup>[xvii]</sup>

Here are certain, salient topics that were reviewed by the panel:

- Payment of Discount Points
- Payment of Origination Points and Fees in Creditor-Paid Compensation
- Payment of Origination Points and Fees in Brokerage-Paid Compensation
- MLO Retirement Plans, Profit-Sharing, and Bonuses
- Pricing Concessions and Point Banks
- MLO Qualification and Training Requirements

Let us now consider the panel's suggestions, concerns, resolutions, and recommendations.

**Payment of Discount Points**

It almost always happens that when the immediate consequence is favorable,  
the later consequences are disastrous, and vice versa.

Whence it follows that the bad economist pursues a small present good that will be followed  
by a great evil to come, while the good economist pursues a great good to come,  
at the risk of a small present evil.

**What Is Seen and What Is Not Seen**<sup>[xviii]</sup>

Frédéric Bastiat

**Suggestions and Concerns**

The SERs expressed "puzzlement" about Dodd-Frank's prohibition on points and fees, suggesting that "while there may be some consumer confusion about tradeoffs between rate, points, and fees, such confusion was not central to the mortgage market crisis or current foreclosure issues." It is believed that the prohibition (or other restrictions contemplated by the CFPB) would be "disruptive" to the overall real estate market. Indeed, the view was held that market forces would themselves cause pressure on competition, along with the regulatory compliance requirements of MLO compensation and the integrated mortgage disclosures which the CFPB has designed.<sup>[xix]</sup>

Suggestions for alternative resolutions were offered to the CFPB, such as improving disclosures, supplemental tools, and educational programs to help consumers better understand pricing tradeoffs. A request was urged for the CFPB to delay action until a study could be conducted of the current mortgage market to assess "post crisis" business practices and conditions and the efficacy of recent regulations.

Interesting and insightful concerns expressed by SERs included challenges involving (a) identifying restrictions in the existing rule on MLO concessions to address errors in the Good Faith Estimate or to cover rate lock extension fees, and (b) that MLOs tend to avoid consumers seeking low balance loans because MLOs' compensation is set as a percentage of the loan balance, and (c) that rates and administrative fees have increased since promulgation of the MLO compensation rule.

Finally, the SERs asked the CFPB to not adopt an automatic sunset for at least five years, in connection with any regulation relating to points and fees. Their view was that an automatic sunset would disrupt an already fragile market.

**Resolution**

Although the SERs supported the CFPB in using its exemption authority to allow consumers to pay upfront discount points, there was considerable concern about the specific details of requirements to make these discount points *bona fide*. And there were differing opinions regarding the requirement that lenders offer a no-discount point loan, while indicating that a sizable number already offer such a loan.<sup>[xx]</sup>

**Recommendation**

1. The CFPB should consider a proposal to allow consumers to pay upfront discount points and to solicit comment on mechanisms to ensure that the discount points are *bona fide*.


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▶ August (5)

▶ July (4)

▶ June (2)

▶ May (2)

▶ April (3)

▶ March (5)

▶ February (2)

▶ January (6)

▶ 2011 (106)

▶ 2010 (86)

▶ 2009 (8)

1. The panel recommended that the CFPB should solicit public comment on a proposed requirement that lenders make available a no-discount point loan.

### **Payment of Origination Points and Fees in Creditor-Paid Compensation**

When a man is impressed by the effect that is seen  
and has not yet learned to discern the effects that are not seen,  
he indulges in deplorable habits,  
not only through natural inclination, but deliberately.

**What Is Seen and What Is Not Seen**[xxi]

Frédéric Bastiat

### **Suggestions and Concerns**

There was "significant confusion" about the CFPB's proposal to prohibit origination fees from varying based on the amount of the loan. Several SERs had already "restructured their MLO compensation to provide compensation as a flat percentage of the loan amount to comply with the Loan Originator Rule." Consequently, the changes they had made already eliminated steering incentives.

There seemed to be a disconnect, in effect, between prohibiting overall origination fees from varying based on the amount of the loan and Dodd-Frank, which specifically permits MLO compensation to vary with the amount of the loan.

Some SERs stated that they "generally opposed a flat fee for core underwriting and processing services." It was noted that several types of other origination fees vary with the amount of the loan, including secondary market, loan level pricing adjustments, and on other determinative factors, such as geography and type of loan. Thus, they wanted the CFPB to state explicitly that it will not require a single fee to cover all origination costs, and that variances in particular types of origination fees would still be permitted, based on other factors besides the loan amount. And there are anomalies as well to be considered; for instance, the fact that certain government-sponsored lending programs require origination fees to be charged as a percentage of the loan. Further, it was suggested that an exemption should be provided for any pass-through fees relating to any flat fee requirement.

Clearly, variances were a knotty subject. Prohibiting variances based on the amount of the loan would disadvantage borrowers with smaller loans, particularly low- and moderate-income borrowers. Thus, this led to a prediction that "brokerage firms and creditors would have to set their fees under the new system using some sort of average price that would exceed current fees for smaller amount loans." Ultimately, the outcome of such a prohibition would "negatively impact" access to credit, because shifting costs into the rate would trigger a status as a high-cost mortgage. Some SER panelists suggested that a flat fee requirement should be limited to subprime loans. Other SERs stated that there are certain government loan programs, such as those of the Department of Veterans Affairs, which prohibit fees exceeding one percent of the loan amount. So, if a flat fee exceeded that threshold, then the loan would not be permissible. Furthermore, prohibiting variances based on the amount of the loan would disadvantage smaller lenders, those that do not benefit from the same economies of scale available to larger lenders (i.e., the ability to hedge, or to cross-market other services and products).

The affiliate compensation issue also came up. Clarification was sought for the definition of an "affiliate". Concern was raised about "the idea of subjecting fees paid by consumers to affiliates to the same restrictions as fees paid to MLOs and creditors." The point was made that affiliates have separate operations and pricing and do not share profits with their affiliated MLOs and creditors. Also, it was suggested that particular types of affiliates, such as real estate agents, should not be subject to a 'points and fees' provision.[xxii]

### **Resolution**

There was strong opposition to the requirement that origination fees should not vary with the size of the loan. The opposition stemmed from the fact that the flat fee requirement is supposedly based on the view that the costs of origination varied for loans with different characteristics, such as geography and loan type, and GSE-imposed loan level pricing adjustments that vary by loan size.

Furthermore, the imposition of the flat fee requirement would disproportionately harm small lenders and would be "regressive" because borrowers with smaller loan amounts would likely be charged more than they are typically charged currently.

### **Recommendation**

1. The CFPB should consider the potential costs and unintended consequences associated with a flat fee requirement before determining whether to propose it for comment.
1. The CFPB should propose and seek public comment on alternative approaches to exercising its exemption authority, in order to ensure that consumers are in a position to shop and receive fair value for origination points and fees, and to minimize adverse industry consequences.[xxiii]

### **Payment of Origination Points and Fees in Brokerage-Paid Compensation**

Experience teaches efficaciously but brutally.  
It instructs us in all the effects of an act by making us feel them,  
and we cannot fail to learn eventually,  
from having been burned ourselves, that fire burns.

I should prefer, in so far as possible,  
to replace this rude teacher with one more gentle: foresight.

**What Is Seen and What Is Not Seen**[xxiv]

Frédéric Bastiat

## Suggestions and Concerns

There was strong support for the CFPB's proposal to allow transactions with brokerage-paid compensation. This proposal permits a brokerage firm to pay to its broker employees a commission or other compensation tied to a particular transaction when a consumer pays the brokerage firm. By extension, this proposal would again make it possible for brokerage firms to split commissions with their MLO employees.

The CFPB was considering this exception because it would be difficult for brokerage firms to pay their brokers commissions that varied based on the loan amount (viz., which is expressly permitted by Dodd-Frank), if the brokerage firms had to charge origination fees that do not vary based on loan amount. Although there was not significant comment about this exception, the comments given were not without two interesting insights: (1) such an exception would not fix the broader problems with the general proposal to prohibit fees to vary based on the amount of the loan, and (2) some community banks have been discussing whether to create a separate brokerage firm for each originator.[xxv]

### Resolution

Although there was strong support for the proposal to allow brokerage firms to pay their employee brokers a commission or other compensation tied to a particular transaction when a consumer pays a brokerage firm – while also maintaining a general opposition to the flat fee requirement – nevertheless, there was no specific support for an exception to the requirement that would allow consumers to pay brokerage firms commissions that varied with the size of loans.

### Recommendation

1. The CFPB should proceed with its proposal to allow brokerage firms to allow their employee brokers a commission or other compensation tied to a particular transaction when a consumer pays a brokerage firm.
1. Consider allowing consumers to pay brokerage firms commissions that vary with loan size in transactions with brokerage-paid compensation.[xxvi]

### MLO Retirement Plans, Profit-Sharing, and Bonuses

Society is the aggregate of all the services that men perform  
for one another

by compulsion or voluntarily,

that is to say, public services and private services.

The first, imposed and regulated by the law,

which is not always easy to change when necessary,

can long outlive their usefulness and still retain the name of public services,

even when they are no longer anything but public nuisances.

**What Is Seen and What Is Not Seen**[xxvii]

Frédéric Bastiat

## Suggestions and Concerns

There is some confusion regarding the current standards on whether to segregate MLOs from retirement and profit-sharing plans, and bonuses that use funds derived from mortgage revenue. The view was that it is not "practicable for small companies to maintain two sets of benefits programs for MLOs and non-origiators because of practical limitations on human resources systems and because employees are required to play many roles."

One position asserted that restrictions on bonuses compel businesses to discriminate against their MLOs. Another view stated that using mortgage revenue as a standard would be "over-inclusive," because the standard would capture income from all mortgage loans, including existing portfolio loans, rather than only newly originated loans.

Steering incentives were somewhat controversial, inasmuch as one view asserted that "existing protections were so strong that additional concerns about incentives to steer consumers were not warranted." Furthermore, the CFPB was urged to consider incentives, by questioning whether the incentives were significantly different for benefits structured as qualified plans versus non-qualified plans.

Several observations were made regarding the CFPB's proposal to "relax" requirements for qualified plans, since it was felt that the proposal would not help or would actively disadvantage particular segments of the industry. Amongst the concerns were (1) the proposal under consideration to allow nonqualified plans where a company's revenues from mortgage-related business did not exceed a specified threshold, and thus would not help companies if mortgage revenue increased, (2) options involving qualified plans would not be helpful to small providers because the overhead involved in such plans makes them prohibitive for small companies, and (3) any mortgage-related revenue limit should be no lower than fifty percent.

Suggestions included: (1) there should be no limit because any limit would disadvantage small businesses that only originate mortgages, and that no limit is necessary provided bonuses were not tied to any one particular loan's terms, and (2) the exemption for qualified plans should be expanded to cover all non-qualified plans in the case of small, federally-insured depositories.

### Resolution

Clarification is needed on rules governing compensation to MLOs from retirement plans, profit-sharing, and bonuses. Further, the CFPB should analyze the incentive issues arising from qualified and non-qualified plans carefully before issuing clarifications on existing regulations or proposing new regulations. In addition, the CFPB was urged to consider relaxing the revenue test to exclude revenue derived from existing loans held in portfolio.

## Recommendation

1. The CFPB should solicit public comment on the treatment of qualified and non-qualified plans and whether treating qualified plans differently than non-qualified plans would adversely affect small lenders and brokerages relative to large lenders and brokerages.
1. Moreover, the CFPB should seek public comment on the ramifications for small businesses and other businesses when setting the revenue limit at fifty percent of company revenue or at other levels.

### Pricing Concessions and Point Banks

Schools of thought are vehement in their attack on those they call middlemen.

They would willingly eliminate the capitalist, the banker, the speculator,  
the entrepreneur, the businessman, and the merchant,  
accusing them of interposing themselves between producer and consumer  
in order to fleece them both, without giving them anything of value.

Or rather,  
the reformers would like to transfer to the state  
the work of the middlemen,  
for this work cannot be eliminated.

**What Is Seen and What Is Not Seen**<sup>[xxviii]</sup>

Frédéric Bastiat

## Suggestions and Concerns

We now move to certain issues that have been debated and belabored since the inception of the TILA compensation mandates. Although there was recognition that the CFPB was considering a proposal that would permit "pricing concessions where there are unforeseen circumstances," the panel nevertheless suggested that concessions should be permitted in other situations, such as to correct *bona fide* errors or to compete with another lender's offer.

Some SERs stated that companies should be able to dock MLOs' pay if their errors cost the companies money. There was a request to extend "flexibility" to companies to enable them to meet competing offers. Such flexibility, it was suggested, could be evidenced through the change in circumstances requirements and notices under the Real Estate Settlement Procedures Act (RESPA),<sup>[xxix]</sup> thereby documenting that concessions are being given in appropriate circumstances. Indeed, such flexibility is particularly critical for small businesses to compete with large ones.

A bit of deference to human nature came into discussions when one SER said that "allowing pricing concessions would reduce the current incentive to inflate charges on the Good Faith Estimate." Whether reducing the "current incentive to inflate charges" on the Good Faith Estimate is a viable gambit in the context of such a suggestion to the CFPB is surely but one person's opinion.

Nevertheless, the essential point to be made is that brokers want the CFPB to permit more flexibility on the use of concessions in order to allow them to compete with direct lenders. Some suggested that brokerage firms (rather than their MLO employees) be permitted the flexibility to "grant concessions," which, according to this view, would help provide appropriate controls.

The controversial "point bank" system came through with thumbs-down results. Apparently, there was no SER using a point bank system in its business model. Indeed, the range of opposition to point banks starts with a disclaimer that it might be considered if necessary to be competitive, to concern that point banks create incentives for MLOs to upcharge some consumers in order to create flexibility for themselves to provide concessions to other consumers, to the view that point banks would permit loan officers to treat one consumer better to the detriment of another, leading to fair lending concerns, and across the spectrum to the observation that banks would cause brokers to become excessively bound to a lender that provided them with the most points, thereby creating incentives to steer consumers to that lender.

Needless to say, these sentiments led to the inevitable conclusion that it would be beneficial for the CFPB "to clarify the circumstances in which a factor used to determine compensation for MLOs was prohibited as a proxy for loan terms."<sup>[xxx]</sup>

## Resolution

In general, the SERs supported the CFPB's proposal to permit pricing concessions where there are

"unforeseen circumstances." Companies should have the flexibility to use concessions in other circumstances, including reducing an MLO's compensation where an MLO's error costs the company money.

Point banks could lead to regulatory violations: the use of point banks could legitimize their use in such a way that they would place responsible MLOs on an uneven playing field with less responsible MLOs, including the possibilities of abuse in their use, causing allegations of fair lending and steering violations.

Clarification is needed regarding when factors used to compensate MLOs functioned as proxies for loan terms.

## Recommendation

1. The CFPB should continue to explore the use of pricing concessions and proceed with a proposal to allow pricing concessions where there are changes to terms not controlled by the MLO, the creditor, or affiliates.

1. Comment should be solicited on whether there are other situations where pricing concessions should be allowed to provide MLOs with flexibility where the risk of abuse is low.
1. The CFPB should go forward with its proposal under consideration to clarify that point banks are compensation, specifying that the CFPB should propose limiting their use.
1. Finally, the CFPB should use the proposed rule to clarify when a "factor" used to determine compensation for an MLO serves as a "proxy" for loan terms.[xxxi]

### **MLO Qualification and Training Requirements**

What is not seen counterbalances what is seen;  
and the outcome of the whole operation is an injustice,  
all the more deplorable in having been perpetrated by the law.

**What Is Seen and What Is Not Seen**[xxxii]

Frédéric Bastiat

### **Suggestions and Concerns**

Brokers expressed strong support for consistent MLO qualification standards, noting that many MLOs had switched to bank employment when the SAFE Act (SAFE) took effect, because they did not want to take tests under the new system. Therefore, a suggestion was put forward to develop a "single national platform" rather than allowing each state to set separate requirements.

Indeed, it was further asserted that the CFPB's proposal under consideration did not go far enough and should also impose the "same testing, training, and state licensing requirements on depository institution MLOs that were already imposed on nondepository institution MLOs." One SER broker even stated that non-depository, institution-employed MLOs should not be permitted to "self-certify" that they are qualified.

In response, the SERs from depository institutions stated that they are already required by their prudential regulators to engage in vigorous screening of and training programs for their MLOs, and that "current standards are equivalent to the ones in the proposal under consideration." So, in their view, the CFPB "should avoid layering on duplicative regulations and to coordinate closely with prudential regulators." In fact, one depository SER opposed any requirement for loan officers of a depository institution to have to take the same training as that required for non-depository institution MLOs.

Non-depository institution lenders stated that an exemption for *bona fide* non-profit organizations under SAFE granted by the Department of Housing and Urban Development (HUD) had not actually helped non-profits, because many states had already decided to regulate them when the exemption was issued and had not repealed these regulations.[xxxiii]

### **Resolution**

There was support by broker SERS for the same testing, training, and state licensing standards for depositories and non-depositories, especially since many MLOs had switched to bank employment because they did not want to take tests under the new system when SAFE took effect.

The CFPB should be urged to consider developing a single national platform rather than allowing each state to set separate requirements. Clearly, this is an area of considerable disagreement between depository and non-depository institutions. The depository institutions urged the CFPB to avoid imposing new or adding "duplicative or ambiguous" requirements.

### **Recommendation**

1. The CFPB should solicit comment on ways to provide greater clarity about what is actually required for a MLO to meet the financial responsibility, character, and fitness criteria.
1. Clarification should be provided regarding what role, if any, an individual's credit score should have in the required financial responsibility determination.[xxxiv]
1. Further, the CFPB should consider ways to ensure that depository institution and non-profit organizations are not required to provide training that is duplicative of training they are already required to provide to their MLOs.[xxxv]

### **Proposals**

It is absolutely necessary to forget money,  
coins, bank notes, and the other media  
by which products pass from hand to hand,  
in order to see only the products themselves,  
which constitute the real substance of a loan.

**What Is Seen and What Is Not Seen**[xxxvi]

Frédéric Bastiat

I will touch briefly on certain proposals set forth by the CFPB in response to taking into consideration the recommendations of the Small Business Review Panel.[xxxvii] My outline is meant to be not comprehensive, but suggestive of the overall direction of the CFPB's views at this time.

### **Restriction on Upfront Points and/or Fees**

- Before a lender or mortgage broker may impose upfront points and/or fees on a consumer, the lender must make available to the consumer a comparable, "alternative loan" with no upfront discount points, origination points, or fees that are retained by

the creditor, broker, or an affiliate of either (a "zero-zero alternative"). [This requirement would not be triggered by pass-through fees to independent third parties that are not affiliated with the lender or mortgage broker.] The requirement would not apply where the consumer is unlikely to qualify for the zero-zero alternative.

- In transactions that do not involve a mortgage broker, there would be a safe harbor if, any time prior to application, the lender provides a consumer an individualized quote for a loan that includes upfront points and/or fees, and the lender also provides a quote for a zero-zero alternative. In transactions that do involve mortgage brokers, a safe harbor is provided under which lenders provide mortgage brokers with the pricing for all of their zero-zero alternatives. Mortgage brokers then would provide quotes to consumers for the zero-zero alternatives when presenting different loan options to consumers.
- Related issues requiring comment include:
  - Whether the CFPB should adopt a *bona fide* requirement to ensure that consumers receive value in return for paying upfront points and/or fees, and different options for structuring such a requirement.
  - Whether additional adjustments to the proposal concerning the treatment of affiliate fees would make it easier for consumers to compare offers between two or more creditors.
  - Whether to take a different approach concerning situations in which a consumer does not qualify for the zero-zero alternative.
  - Whether to require information about zero-zero alternatives to be provided not just in connection with informal quotes, but also in advertising and at the time that consumers are provided disclosures within three days after application.

### **Restrictions on Loan Originator Compensation**

Adjust existing rules governing compensation to loan officers and mortgage brokers to account for Dodd-Frank mandates and to provide greater clarity and flexibility. Specifically, the proposal would:

- Continue the general ban on paying or receiving commissions or MLO compensation based on the terms of the transaction (other than loan amount), with some refinements:

Allow reductions in MLO compensation to cover unanticipated increases in closing costs from non-affiliated third parties under certain circumstances.

Clarify when a factor used as a basis for compensation is prohibited as a "proxy" for a transaction term.

- Clarify and revise restrictions on pooled compensation, profit-sharing, and bonus plans for loan originators, depending on the potential incentives to steer consumers to different transaction terms.
- Permit employers to make contributions from general profits derived from mortgage activity to 401(k) plans, employee stock plans, and other "qualified plans" under tax and employment law.
- Permit employers to pay bonuses or make contributions to non-qualified profit-sharing or retirement plans from general profits derived from mortgage activity if either: (1) the loan originator affected has originated five or fewer mortgage transactions during the last 12 months; or (2) the company's mortgage business revenues are limited. The Bureau is proposing two alternatives, twenty-five (25) percent or fifty (50) percent of total revenues, as the applicable test.
- The amounts of contributions and bonuses could not be based on the terms of the transactions that the individual had originated, even though contributions and bonuses could be funded from general mortgage profits.

Continue the general prohibition on loan originators being compensated by both consumers and other parties, with some refinements:

- Allow mortgage brokerage firms that are paid by the consumer to pay their individual broker employees a commission on the transaction, so long as the commission is not based on the terms of the transaction.
- The proposal would clarify that certain funds contributed toward closing costs by sellers, home builders, home improvement contractors, or similar parties, are considered payments made directly to the loan originator by the consumer, when used to compensate a loan originator.

### **Loan Originator Qualification Requirements**

- Implement a Dodd-Frank provision that requires both individual loan originators and their employers to be "qualified" and to include their license or registration numbers on certain specified loan documents.

◦ Where a loan originator is not already required to be licensed under SAFE, the proposal would require the employer to ensure that the loan originator meets character, fitness, and criminal background check standards that are equivalent to SAFE requirements and receives training commensurate with the loan originator's duties.

◦ Employers would be required to ensure that their MLO employees are licensed or registered under SAFE, as applicable.

o Employers and the individual loan originators who are primarily responsible for a particular transaction would be required to list their license or registration numbers on certain key loan documents.

### Past is Prologue

Let us accustom ourselves, then,  
not to judge things solely by what is seen,  
but rather by what is not seen.

#### What Is Seen and What Is Not Seen<sup>[xxxviii]</sup>

Frédéric Bastiat

Whether deserved or not, the mortgage and real estate crisis focused attention on the roles of loan officers and mortgage brokers in the loan origination process. Prior to the crisis, according to the CFPB, "training and qualification standards for loan originators varied widely, and compensation structures frequently gave loan originators incentives to steer consumers into loans with higher rates or other unfavorable terms."<sup>[xxxix]</sup>

Now the CFPB is proposing new rules to implement Dodd-Frank requirements, as well as to revise and clarify existing regulations and guidance on loan originator compensation. In addition, the proposals are meant to address "broader consumer confusion about the relationship between certain upfront charges and loan interest rates."<sup>[xl]</sup>

Certain proposals, such as allowing lenders to continue making available loans with upfront points and/or fees, so long as they also make available an "alternative loan," seem to be an attempt by the CFPB to be responsive to all market participants.

The CFPB plans to issue final rules by January 2013. We will soon find out if, and the extent to which, the public comments influence final rules that may be considered beneficial to the stability of residential mortgage lenders and originators.

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[i] Bastiat, Frédéric, *What Is Seen and What Is Not Seen*, § 1.1, July 1850. "Ce qu'on voit et ce qu'on ne voit pas", *Oeuvres complètes de Frédéric Bastiat, mises en ordre, revues et annotées d'après les manuscrits de l'auteur: Harmonies économiques*, 1864. Translations, where needed, are mine. See also Cain, Seymour, and George B. de Huszar, Irvington-on-Hudson, NY: The Foundation for Economic Education, Inc., 1995. Bastiat (1801-1850), political economist, proposed that "that which is not seen" is often the less desirable side of the issue in relation to making laws or economic decisions.

[ii] On August 26, 2009, the Federal Reserve Board published a Proposed Rule in the Federal Register pertaining to closed-end credit. As part of that proposal, the FRB sought to prohibit certain compensation payments to loan originators and steering consumers to loans not in their interest because it would result in greater compensation for the loan originator. On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was enacted into law. Among other provisions, Title XIV of Dodd-Frank amended the Truth in Lending Act (TILA) to establish certain mortgage loan origination standards. And on July 21, 2011, pursuant to Title X of the Dodd-Frank, the Consumer Financial Protection Bureau received its exclusive rulemaking and examination authority from the Federal Reserve Board over Truth in Lending Act and its implementing regulation, Regulation Z.

[iii] Due to litigation, the April 1, 2011 implementation date was temporarily stayed. The stay was dissolved. The effective compliance implementation date of the Rule was April 6, 2011

[iv] For instance, Foxx, Jonathan, *Landmark Financial Legislation: New Rules for Mortgage Originators - Part I: Reformation and Regulations*, National Mortgage Professional Magazine, August 2010, Volume 2, Issue 8, pp 28-42; Foxx, Jonathan, *A New Era of Mortgage Reform - Part II: Legislation - Reactive or Proactive*, National Mortgage Professional Magazine, September 2010, Volume 2, Issue 9, pp 22-28; Foxx, Jonathan, *A New Era of Mortgage Reform - Part III: Consumer Financial Protection - Bureau and Bureaucracy*, October 2010, Volume 2, Issue 10, pp 22-40; Foxx, Jonathan, *The Birth of an Agency*, in *National Mortgage Professional Magazine*, September 2009, Volume 1, Issue 5, pp 24-27; and, Foxx, Jonathan, *The CFPB Controversy: Asking the Tough Questions*, in *National Mortgage Professional Magazine*, October 2009, Volume 1, Issue 6, pp 22-25. All Newsletters and Articles through 2011 are available at: <http://Publications.LendersComplianceGroup.com>.

[v] Visit my firm's Library at [www.Publications.LendersComplianceGroup.com](http://www.Publications.LendersComplianceGroup.com), in the Mortgage Compliance and Compliance Alerts sections. See also, the Commentaries section: *The Smoking Gun - Loan Originator Compensation* (4/26/2011), *First They Came For The Brokers!* (4/12/2011), *Lawsuit Gets An Assist!* (3/28/2011), *NAILTA Supports Goliath* (3/21/2011), *COMES NOW the House!* (3/16/2011), *COMES NOW the Senate!* (3/14/2011), *NAMB v. FRB: David 2.0 v. Goliath* (3/11/2011), *NAIHP v. FRB: David v. Goliath* (3/10/2011), *FRB: Mangles Affiliate Compensation* (3/3/2011), *Compensation: Coming or Going?* (2/24/2011), *Compensation: One Statute Too Many?* (2/15/2011)

[vi] *Compliance Guide to Small Entities*, Regulation Z: Loan Originator Compensation and Steering, 12 CFR 226, Federal Reserve Board, January 26, 2011

[vii] *The State Nondepository Examiner Guidelines for Regulation Z - Loan Originator Compensation Rule* is dated October 6, 2011, although the announcement of its issuance was on October 7, 2011.

[viii] The Multi-State Mortgage Committee (MMC) is a ten-state representative body created by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR). The MMC released this set of examiner guidelines to assist state regulators in implementing the FRB's loan originator compensation restrictions under Regulation Z [12 C.F.R. § 226.36(d), (e)]. The MMC also issued the *Mortgage Examination Manual*, which provides information and criteria for the examination of multistate mortgage entities, and further provides guidance on examination planning and administration.

[ix] See, Foxx, Jonathan, *Loan Originator Compensation: The Regulatory Examination*



[ix] See Foxx, Jonathan, *Loan Originator Compensation: The Regulatory Examination*, National Mortgage Professional Magazine, November 2011, Volume 3, Number 11, pp 6-34

[x] For more information about the *FAQs Outline – Loan Originator Compensation*, visit the Compensation section of my firm’s Library at [www.LendersComplianceGroup.com](http://www.LendersComplianceGroup.com).

[xi] 12 CFR Part 1026, Bureau of Consumer Financial Protection, Truth in Lending Act (Regulation Z), Loan Originator Compensation, Proposed Rule with Request for Public Comment, Federal Register, Volume 77, Number 174, September 7, 2012

[xii] Op.cit. 1, § 1.2

[xiii] See the Regulatory Flexibility Act (RFA), Pub. L. 96-354, September 19, 1980, 94 Stat. 1164 (codified at 5 U.S.C. §§ 601-612)

[xiv] Title II, Small Business Regulatory Enforcement Fairness Act of 1996, Section 202 (2), P.L. 104-121, March 29, 1996, as Amended by P.L. 110-28, May 25, 2007

[xv] See Section 609(b) of the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) and the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[xvi] There were 17 SERs selected for the SBREFA process. The CFPB convened the Panel on May 9, 2012. The CFPB provided the SERs with an opportunity to submit written feedback or comments. The original due date was June 4, 2012, but at the request of several SERs, and in light of the additional calls, the deadline was extended to June 11, 2012. The CFPB received written comments from 11 of the SERs and shared these comments with the other members of the Panel. SERs were from commercial banks, credit unions, mortgage companies, mortgage brokers, and non-profit housing organizations.

[xvii] Final Report of the Small Business Review Panel on CFPB’s Proposals Under Consideration for Residential Mortgage Loan Origination Standards Rulemaking, July 11, 2012

[xviii] Op.cit. 1, § 1.3

[xix] Op.cit. 17, pp 20-21

[xx] Op.cit. 17, p 28

[xxi] Op.cit. 1, § 1.4

[xxii] Op.cit. 17, pp 23-24

[xxiii] Op.cit. 17, p 28

[xxiv] Op.cit. 1, § 1.5

[xxv] Op.cit. 17, p 24

[xxvi] Op.cit. 17, p 28

[xxvii] Op.cit. 1, § 1.95-1.96

[xxviii] Op.cit. 1, § 1.99

[xxix] *Real Estate Settlement Procedures Act (RESPA): Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs*, Final Rule, 24 CFR Parts 203 and 3500, Department of Housing and Urban Development, Federal Register, Volume 73, Number 222, November 17, 2008

[xxx] Op.cit. 17, pp 25-26

[xxxi] Op.cit. 17, p 29

[xxxii] Op.cit. 1, § 1.138

[xxxiii] Op.cit. 17, p 26

[xxxiv] Credit scores may be considered in the criteria for evaluating a MLO’s financial responsibility.

[xxxv] Op.cit. 17, p 30

[xxxvi] Op.cit. 1, § 1.205

[xxxvii] See also: *Summary of Proposed Loan Originator Rules*, Consumer Financial Protection Bureau, August 17, 2012

[xxxviii] Op.cit. 1, § 1.47

[xxxix] Op.cit. 37, *Background*

[xl] Ibid.

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