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The CFPB Loan Originator Compensation Rule

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Introduction

- August 26, 2009 – Federal Reserve Board (FRB) issues proposed LO compensation rule
- July 21, 2010 – Dodd-Frank Act amends Truth in Lending Act to codify significant elements of the FRB proposal
- April 6, 2011 – FRB’s final LO compensation rule goes into effect
- July 21, 2011 – Responsibility for Regulation Z and LO Compensation passes from the FRB to the Consumer Financial Protection Bureau (CFPB)

Introduction

- September 7, 2012 – CFPB issues a proposed LO compensation rule
- January 2013 – CFPB issues several other final rules relating to mortgage credit, including rules relating to Ability to Repay/QM, Mortgage Servicing, Escrows and Appraisals
- January 20, 2013 – CFPB issues final LO compensation rule, published at 78 Fed. Reg. 11280 (February 15, 2013)

FRB Final Rule

Substantially restricted the payments to loan originators that create incentives for them to steer consumers to more expensive loans

- Prohibited certain payments to a mortgage broker or loan officer based on the transaction's terms or conditions
- Prohibited dual compensation (i.e., mortgage broker or loan officer receives compensation from both the consumer and the creditor in a transaction)
- Prohibited a mortgage broker or loan officer from "steering" consumers to transactions not in their interest in order to increase mortgage broker or loan officer compensation

CFPB Proposal

- Adjusted FRB Final Rule and implements Dodd Frank requirements
- Continued the general ban on paying or receiving commissions or other loan originator compensation based on the terms of the transaction (other than loan amount)
- Continued the general ban on dual compensation
- Would have allowed pricing concessions under certain circumstances
- Clarified when a factor would be considered a “proxy” for a transaction term

CFPB Proposal

- Placed restrictions on pooled compensation, profit-sharing, and bonus plans for loan originators
- Required a zero-zero alternative to upfront points and fees
- Implemented Dodd Frank provisions on LO qualifications
- Implemented Dodd Frank provisions prohibiting mandatory arbitration clauses and financing of premiums for credit insurance

Final Rule Highlights

- Prohibits LO compensation based on loan term and defines “term of a transaction”
- Prohibits compensation based on a “proxy” for a term of a transaction and clarifies the definition of “proxy”
- Generally prohibits pricing concessions, except for unexpected increases in estimated settlement costs
- Generally prohibits LO compensation based upon the profitability of a transaction or a pool of transactions
- Continues the restriction on dual compensation but allows mortgage brokers to pay commissions to their employees or contractors

Final Rule Highlights

- Drops the zero-zero proposal and the prohibition on payment of upfront points and fees, subject to further review by CFPB
- Imposes new duties on LO organizations to ensure that their individual LOs are licensed or registered as required by the SAFE Act
- Required background checks, credit reports, and periodic training for LO organizations whose employees are not required to be licensed (e.g., banks)
- Prohibits mandatory arbitration and financing of credit insurance premiums

Scope and Effective Dates

- Generally applies to closed-end consumer credit transactions secured by a dwelling
- Generally does not apply to HELOCs and timeshares, although the prohibitions on mandatory arbitration clauses and financing of credit insurance premiums apply to HELOCs secured by a consumer's principal dwelling
- Most provisions are effective January 10, 2014. The prohibitions on mandatory arbitration clauses and financing of credit insurance premiums are effective June 1, 2013

Definition of “Loan Originator”

Person who for direct or indirect compensation or other monetary gain:

- Takes an application
- Offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person”
- Through advertising or other means of communication represents to the public that such person can or will perform any of these activities
- Includes an employee, agent, or contractor of the creditor or loan originator organization if the employee, agent, or contractor meets this definition

Definition of “Loan Originator”

- Includes creditors engaged in table funding transactions
- A loan originator organization is a loan originator other than a natural person – e.g., mortgage broker firms and creditors acting as brokers

Persons Who are not Loan Originators

- A person who does not take a consumer credit application or offer or negotiate credit terms available from a creditor, but who performs purely administrative or clerical tasks on behalf of a person who does engage in such activities
- Certain employees of manufactured home retailers
- Licensed or registered real estate brokers, unless compensated by a creditor or loan originator for a particular consumer credit transaction

Persons who are not Loan Originators

- Certain seller financiers who meet annual sales and other restrictions
- Servicer or their employees, agents, and contractors who offer or negotiate terms for loan modifications where consumers are behind in their payments, in default, or have a reasonable likelihood of defaulting or falling behind; does not apply to a servicer who offers or negotiates a refinancing transaction or obligates a different consumer on the existing debt.

The Seller Financer Exclusion

- Seller financiers are not LOs if they finance fewer than 3 properties in any 12-month period and
 - have not constructed or acted as contractor for construction of a residential property and
 - the seller financing is fully amortizing, the financier determines in good faith that the consumer has a reasonable ability to repay and financing has fixed rate or features an adjustable rate that is adjustable after five or more years, subject to reasonable annual and lifetime adjustment limitations
- Seller financiers are not LOs if they finance 1 property in any 12-month period and satisfy the same requirements, minus the determination that consumer has reasonable ability to repay loan

Taking an Application

- Referring a consumer to an LO
- Arranging a credit transaction, including initially contacting and orienting the consumer to a particular loan originator's or creditor's origination process or credit terms
- Advising on specific credit terms (including rates, fees, and other costs), filling out an application form, preparing application packages (such as a credit application or pre-approval application or supporting documentation), or collecting application and supporting information on behalf of the consumer to submit to a loan originator or creditor
- Does not include persons who, on behalf of creditor, collect information or verifies information provided by the consumer, such as by asking for documentation for the consumer's authorization to obtain supporting documents from third parties

Managers, Administrative and Clerical Staff

- Managers, administrative and clerical staff, and similar individuals who are employed by (or contractor or agent of) a creditor or loan originator organization and conduct LO activities are loan originators
- Exempt activities:
 - Application-related administrative and clerical tasks
 - Responding to consumer inquiries and providing general information
 - Loan processing
 - Underwriting, credit approval, and credit pricing
 - Producing managers

Basic Prohibition

- No LO may receive and no person may pay an LO, directly or indirectly, compensation in an amount that is based on a term of a transaction, the terms of multiple transactions by an individual loan originator, or the terms of multiple transactions by multiple individual loan originators.
- “Term of a transaction” is any right or obligation of the parties to a credit transaction
- The amount of credit extended is not a term of a transaction or a proxy for a term of a transaction, as long as compensation paid to LO is based on a fixed percentage of the amount of credit (may be subject to minimum or maximum dollar amount)

Basic Prohibition

- If an LO's compensation is based in whole or in part on a factor that is a proxy for a term of a transaction, the loan originator's compensation is based on a term of a transaction
- A factor is a proxy for a term of the transaction if the factor consistently varies with that term over a significant number of transactions, and the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating the transaction

Pricing Concessions

- Creditor and LO may not agree to set the LO's compensation at a certain level and then subsequently lower it in selective cases (such as where the consumer is offered a reduced rate to meet a quote from another creditor).
- The final rule provides a limited exception to this prohibition
- LO may decrease its compensation to defray the cost, in whole or part, of an unforeseen increase in an actual settlement cost over an estimated settlement cost disclosed to the consumer under RESPA or an unforeseen actual settlement cost not disclosed to the consumer under RESPA.
- An increase in an actual settlement cost over an estimated settlement cost or a cost not disclosed is unforeseen if the increase occurs even though the estimate provided to the consumer is consistent with the best information reasonably available to the disclosing person at the time of the estimate.

Bonuses, Profit-Sharing, Pooled Compensation

- The rule generally prohibits LO compensation based upon the profitability of a transaction or a pool of transactions
- Employers may make mortgage-related business profits to make contributions to qualified plans such as 401(k) plans, employee stock option plans, other "defined contribution plans," and "designated tax-advantaged plans" under the Internal Revenue Code; such contributions for an individual loan originator cannot be directly or indirectly based on terms of that originator's transactions

Bonuses, Profit-Sharing, Pooled Compensation

- Employers may also make profit-based payments to non-qualified plans on behalf of an LO provided such payments are not directly or indirectly based on the terms of that originator's transactions; and either
 - do not exceed 10% of the individual loan originator's total compensation for the applicable period; or
 - are made on behalf of an individual loan originator who originated 10 or fewer mortgage transactions during the preceding 12 months

Dual Compensation

- If an LO receives compensation directly from a consumer in transaction, no other person may provide any compensation to any loan originator, directly or indirectly, in connection with that particular credit transaction, whether before, at, or after consummation
- The restrictions relate only to payments, such as commissions, that are specific to, and paid solely in connection with, the transaction in which the consumer has paid compensation directly to a loan originator

Dual Compensation

- In a transaction where a loan originator receives compensation directly from a consumer, a creditor still may provide funds for the benefit of the consumer in that transaction, provided such funds are applied solely toward costs of the transaction other than loan originator compensation
- If a loan originator organization receives compensation directly from a consumer, the loan originator organization may provide compensation to individual loan originators, and the individual loan originator may receive compensation from the loan originator organization

Zero-Zero Proposal is Dropped

- Zero-Zero Proposal: Dodd-Frank bans the imposition of discount points, origination points, or other upfront origination fees on a consumer that are retained by the creditor, broker or an affiliate of either, where a brokerage firm or creditor pays transaction specific compensation to an LO
- Proposed rule would have established an exemption from this prohibition provided the creditor also offers an alternative loan with no points and fees
- CFPB exercises its exemption authority to exempt LOs from the Dodd Frank prohibition and dropped its zero-zero proposal
- CFPB may revisit after consumer testing and other research

Loan Originator Qualification Requirements

- LO organizations must ensure that individual LOs who work for it (including brokers who are independent contractors) are licensed or registered in compliance with the SAFE Act and other applicable law
- Employers, such as banks, whose employees are not required to be licensed must
 - Determine that employees meet the requirements of financial responsibility, character, and general fitness
 - Obtain criminal background checks, credit reports, and information related to any administrative, civil, or criminal determinations
 - Provide periodic training to their LO employees
- LOs must provide their unique identifiers under the Nationwide Mortgage Licensing System and Registry (NMLSR) on loan

Mandatory Arbitration Clauses and Credit Insurance Premiums

- Dodd-Frank prohibits terms in residential mortgage contracts that require arbitration or other non-judicial procedure to resolve claims and also prohibit contracts and agreements from being applied or interpreted to bar consumer from bringing claim in court
- Does not prevent the consumer and creditor from agreeing to arbitration after dispute or claim arises
- Dodd-Frank prohibits creditors from financing premiums or fees for credit insurance in connection with a residential mortgage transaction
- Does not apply to premiums calculated and paid in full on a monthly basis
- Mandatory arbitration and credit insurance premium prohibitions apply to HELOCs secured by a consumer's principal dwelling

Liability Provisions

- Actual damages
- Statutory damages of up to \$4,000
- The sum of all finance charges and fees paid by the consumer; and
- Court costs and reasonable attorney's fees associated with action
- Dodd-Frank extended time to bring claim -statute of limitations for action based on a violation from one year for violations to three years from date of occurrence of violation
- Consumer may assert violation as defense to foreclosure by recoupment or set off without regard to three year time limit
- Such claim may be made against any creditor, assignee or other holder of a residential mortgage loan

Record Retention

- Records showing compensation to loan originators and compensation agreements in effect at time of compensation must be retained for three years after the payments
- A disclosure of compensation or other broker agreement required by applicable State law is presumed to be a record of the amount actually paid to the loan originator in connection with the transaction
- LO organizations (i.e., generally, mortgage broker companies) must also maintain certain compensation-related records for three
- If compensation has been decreased to defray the cost of an unforeseen increase in actual settlement cost over an estimated settlement cost disclosed under RESPA, records must be maintained documenting the decrease and the reasons for it documents.

Conclusion/Questions

