Thursday, March 10, 2011

NAIHP v. FRB: David v. Goliath

COMMENTARY: by JONATHAN FOXX

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On March 7, 2011, the National Association of Independent Housing Professionals (NAIHP) filed suit against the Federal Reserve System (FRB). This lawsuit has been filed in United States District Court for DC. The complete filing, including exhibits, comes to 106 pages. The NAIHP seeks a temporary restraining order and a motion for a preliminary injunction that would prevent the FRB from enforcing the loan originator compensation rule, scheduled for implementation on April 1, 2011.

If successful, the filing will prevent the FRB from enforcing the rule while the court considers the case. There are just a few days remaining for a rapid response.

Lawsuit Arguments - A Salient Selection

This Commentary offers a brief outline of selected arguments against the TILA Loan Originator Compensation rule (Rule). I am leaving out citations, where possible, for ease of reading. This outline is not meant to be comprehensive, authoritative, or relied upon for legal advice. It offers only a brief synopsis of the argumentation. For citations, exhibits, and argumentation, I suggest that you read the lawsuit. (See Below)

FRB Lacks Statutory Authority

The FRB lacks statutory authority under TILA to regulate loan originator compensation in the manner prescribed by the Rule. TILA's primary purpose is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." [15 U.S.C. § 1601(a)] Therefore, the FRB is overreaching.

FRB Improperly Uses TILA § 129 For Authority

The FRB is relying on its authority under TILA Section § 129 (1) (2) (A) and (B) to prohibit acts or practices relating to mortgage loans that are unfair or deceptive, but an assertion of being "unfair" or "deceptive" practices does not make it so, since there is a long-standing, lawful practice of permitting consumers to defray a portion of the closing costs associated with home mortgages, including loan originator compensation, through a mortgage interest rate adjustment.

The FRB's assertion is put forward "without citing any evidence" to support it. Instead, the FRB states that "paying loan originators based on the terms or conditions of the loan, other than the amount of credit extended, or steering consumers to loans that are not in their interest to maximize loan originator compensation, are unfair practices."

In other words, by asserting Section 129 (cited) the FRB relies on "unsubstantiated allegations and supposition rather (sic) of empirical evidence supporting its finding that the current long-standing practice of compensating loan originators is unfair, deceptive or abusive."

Disadvantages Mortgage Brokers

The Rule "treats loan originators differently from other providers of real estate settlement services" such that "loan originators and mortgage brokers in particular will be at a permanent disadvantage in the marketplace, thereby reducing healthy competition to the detriment of consumers."

SRP Advantages Banks and Creditors

There is "no practical difference" between a yield spread premium (YSP) and the service release premium (SRP) that a bank, which originates a loan, receives when it sells that loan into the secondary market. But the FRB has excluded loan originating banks, as creditors; that is, consequently, "banks are free to charge consumers interest rates higher than their par rates with impunity and receive compensation from both the consumer and the purchaser in the secondary market."

The Rule has the effect of limiting the compensation of loan originators who are independent mortgage brokers (and those who are employed by banks), while "leaving the banks free to charge with impunity interest rates substantially above their par rate." Thus, eliminating banks from the requirements of the Rule creates a *de facto* "exemption [from] consumer protection for the vast majority of the mortgage origination market."

Therefore, there is constructively a "creditor exemption" favoring creditors and banks, but disadvantaging mortgage brokers. The notion that the Rule must become effective on April 1, 2011 in order to protect consumers is simply not credible, inasmuch as the FRB's Rule would exempt from coverage lenders - the banks, the creditors - who control 90% of the loan origination market place.

FRB Erroneously Denies That Disclosures Are Remedial

The FRB has erroneously concluded that, according to the suit, "the alleged harm of the current, long-standing loan originator compensation system cannot be remedied by disclosures and that current disclosures leave consumers confused about how the loan originator is compensated."

The FRB's position is derived from a limited study of the nature of the relationship between the consumer and the loan originator, a study that involves only 35 (sic) participants - and "that study actually contradicts the FRB's conclusion that disclosures are ineffective."

Arbitrary and Capricious

The Rule is arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with law, and in excess of statutory jurisdiction, and authority. Indeed, it has been adopted in contravention of the Regulatory Flexibility Act (RFA) which, among other things, requires agencies to consider the economic impact that a proposed rulemaking will have on small entities.

Among the arbitrary and capricious interpretations of the Rule, FRB Staff Comments on certain TILA revisions are "in direct conflict with the requirements of RESPA and ... effectively prevent mortgage brokers from competing for business in certain instances." This conflict leads to brokers having to "choose which regulations to violate in other instances."

The FRB has already deferred to the Consumer Financial Protection Bureau (CFPB) certain decisions regarding other Dodd-Frank requirements, rather than proceeding with implementation of these other provisions at this time. Dodd-Frank provides for the CFPB to consider and resolve the complexities addressed and created by FRB's "ill-considered Final Rule."

Dodd-Frank also addresses comprehensively, *inter alia,* the issue of loan originator compensation and the interrelationship between the disclosure, and substantive requirements of TILA, and the disclosure and substantive requirements of the Real Estate Settlement Procedures Act (RESPA) and to that end transferred the FRB's authority over such matters to the CFPB.

The FRB has failed to comply with the RFA requirements. Specifically, the Office of Advocacy of the Small Business Administration (SBA) has noted that "the Board acknowledges that the proposed rule will have a significant economic impact on a substantial number of small entities" and concedes that "there is not a reliable source for the number of small entities that will be impacted." But rather than undertaking "any type of impact analysis, the Board summarily concludes that any such adverse impact will be offset by consumer benefits." The SBA has stated that it is "concerned with [the Rule] going forward when so little is known about its potential costs, at a time when other major changes to the industry are on the horizon."

The FRB's action is arbitrary and capricious because the FRB insists on implementation of the Rule on April 1, 2011, even though (1) it has admitted the Rule will have "significant economic impact on small entities," but no impact study has been done pursuant to RFA requirements; and (2) there is a requirement for an "impending congressionally mandated broad regulatory review of the conflicting requirements of RESPA and TILA in connection with the implementation of the Dodd-Frank Act," but no such review has been consummated; and (3) the FRB's insistence upon going forward with the Rule is being taken prematurely, especially in view of its recent decision to defer to the CFPB other provisions of TILA currently under consideration.

David versus Goliath

The NAIHP seeks declaratory judgment that the Rule is contrary to law, arbitrary and capricious, unenforceable, and otherwise unlawful and that the Court grant permanent injunctive relief enjoining FRB from enforcing the Rule. This is a well crafted suit, with statutory support coming from many laws. Citing the RFA and the SBA's wish to properly implement it brings interagency scrutiny to the forefront and compels interpretation.

I suggest you visit the NAIHP website for more information. The organization is run by Marc Savitt, who has worked mightily on behalf of industry interests to delay and, if possible, eliminate the adverse features of the loan originator compensation issue.

Many other organizations have been involved in this dispute through negotiations with, and letters to, the FRB, as well as through meetings with politicians and their staff - but, up to the date of its filing, the NAIHP is the only organization to have actually taken up the challenge to resolve this matter in a judicial proceeding.

Our Library contains a copy of the lawsuit.

Labels: CFPB, Consumer Financial Protection Bureau, FRB, IMMAAG, Loan Officer Compensation, Loan Originator Compensation, NAIHP, NAMB, National Association of Independent Housing Professionals, RESPA, TILA

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