© 2012 Thomson Reuters. Originally appeared in the Winter 2013 issue of Real Estate Finance Journal. For more information on that publication, please visit store.westlaw.com. Reprinted with permission.

CFPB Addresses Loan Originator Compensation and Origination Fees

*Richard J. Andreano, Jr.**

The author reviews the much-anticipated proposal to integrate the Dodd-Frank loan originator compensation provisions with the existing Regulation Z provisions and to implement Dodd-Frank loan originator requirements.

Upon further review, the concept of a flat loan origination fee was deemed to be a bad idea by the Consumer Financial Protection Bureau ("CFPB"). Recently, the CFPB issued the much-anticipated proposal to integrate the Dodd-Frank loan originator compensation provisions with the existing Regulation Z provisions and to implement Dodd-Frank loan originator requirements.

Points and Fees

In May 2012 the CFPB provided insight into loan originator rules under consideration as part of the formation of a SBREFA panel to obtain input from small business entities. One item under consideration that caught the attention of the industry was a requirement that if a creditor paid loan originator compensation, any discount points imposed on the loan would have to be bona fide and any origination points or fees imposed would have to be a flat amount that did not vary with the loan balance.

It appears the input from the industry was effective, as the CFPB takes a different approach in the proposed rule. If the creditor pays loan originator compensation, the CFPB proposes that the creditor may not impose any discount points or origination points or fees unless the creditor makes available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees to the creditor, broker, or affiliate of either ("points and fees"), unless the consumer is unlikely to qualify for such a loan. The requirement would apply only when a consumer is provided with pricing information specific to that consumer, and the information is provided before the consumer receives a Good Faith Estimate under RESPA.

As proposed, points and fees must include origination-related fees paid to the creditor, broker, or affiliate of either, such as fees for a credit report, appraisal, and title insurance. As a result, when an affiliate of the creditor or broker will provide services in connection with a transaction, the interest rate quoted for a loan with no points and fees would need to be high enough to provide a credit that covers the fees of the creditor, broker, and affiliated service provider. The CFPB asks for

*Richard J. Andreano, Jr., is a partner in the Business and Finance Department at Ballard Spahr LLP, practice leader of the firm's Mortgage Banking Group, and a member of its Consumer Financial Services and Privacy and Data Security Groups. He can be reached at andreanor@ballardspahr.com.

© 2012 Thomson Reuters

comment on whether certain fees, such as fees for title insurance, should be excluded from the finance charge regardless of whether the service is rendered by an affiliate or non-affiliate.

Any discount points imposed would have to provide for a bona fide reduction in the interest rate compared with the transaction without points and fees. If the creditor's pricing for a particular loan product did not include a rate at which there were no points and fees and no rebate to the consumer, the pricing option with the lowest rebate to the consumer would be the alternative that is offered.

Based on a concern that a creditor opposed to offering a loan without any points and fees would set the interest rate at a level to preclude a consumer from qualifying for such a loan, the CFPB is considering a requirement that a creditor could not offer a loan with points and fees to a consumer if the consumer did not qualify for a comparable loan without points and fees. The CFPB's consideration of such an approach based on a theory of measures that some creditors might take to end-run the rule is troubling.

The CFPB notes a concern raised by industry members that to offer a loan with no points or fees, the creditor may have to set the interest rate at a level that may trigger federal or state high-cost loan laws, and many creditors will not make loans subject to such laws. The CFPB requests comment and data on this issue.

The CFPB also requests comment on three approaches that it is considering to require that the "trade-off" between a loan with points and fees and a loan without points and fees be bona fide. The CFPB is considering a pricing policy approach, a minimum rate reduction approach, and a market-based benchmark approach.

Proxies

Regulation Z currently prohibits the compensation of a loan originator based on the terms or conditions of a loan, or a proxy for the terms or conditions of a loan. In an effort to address the uncertainty created by the proxy concept, the CFPB proposes to define a "proxy" as a factor that is not itself a term of a transaction originated by a loan originator if (1) the factor substantially correlates with the term(s) of the transaction and (2) the loan originator can directly or indirectly add, drop, or change the factor when originating the transaction. The CFPB proposes certain examples of what would and would not be considered a proxy. Even with the examples, the guidance may not be clear enough to provide the certainty sought by the industry on what is a proxy.

Compensation Based on Profits

Consistent with a concept announced in May, the CFPB proposes to allow individuals who are loan originators to receive payments based on profits in the form of a contribution to a defined contribution plan or defined benefit plan that is a qualified plan, as long as the contribution is not based on the terms of the individual's transactions.

The CFPB also proposes that under certain conditions a loan originator who is an individual could receive compensation in the form of a bonus or other payment under a profit-sharing plan or contribution to a defined contribution plan or defined benefit plan that is not a qualified plan. The conditions are that (1) the compensation may not be based on the terms of the individual's transactions and (2) either (a) the individual was a loan origina-

© 2012 Thomson Reuters

tor for five or fewer transactions during the 12 month period preceding the date of the decision to make the payment or contribution, or (b) not more than a certain percentage of the applicable revenues for purposes of the bonus or plan are derived from mortgage business. The CFPB proposes two alternative percentage caps—25% and 50%.

Point Banks

In May the CFPB advised that it was considering guidance that would permit a creditor to contribute to a "point bank" under certain conditions. The CFPB considers a point bank to be an arrangement in which a certain amount, such as 15 basis points, is contributed to a loan originator's point bank account per transaction, and the originator may use the account to provide pricing concessions to consumers in future transactions. After analysis and industry input the CFPB determined "that there are no circumstances under which point banks are permissible, and they therefore continue to be prohibited."

Pricing Concessions

Although the CFPB decided not to adopt an exception for point banks, it decided to propose a limited exception to the restriction under Regulation Z that the compensation of a loan originator may not be adjusted to pay for a borrower cost. As proposed, loan originators could reduce their compensation to cover unanticipated increases in non-affiliated third-party closing costs if (1) the increase results in the actual amount of the costs exceeding limits imposed by applicable law (such as tolerances under RESPA) and (2) the "creditor or loan originator does not know or should not reasonably be expected to know the amount of any third-party closing costs in advance." It appears clarification is needed regarding the second condition.

Originator Qualifications/ID Number of Loan Documents

Dodd-Frank amended the Truth in Lending Act to require that loan originators (1) be "qualified" and, where applicable, registered or licensed under the SAFE Act and other applicable law, and (2) include their identification number assigned by the National Mortgage Licensing System and Registry ("NMLSR") on loan documents.

The CFPB proposes that each loan originator who is not required to be licensed and is not licensed as a loan originator under federal or state regulations implementing the SAFE Act (e.g., a loan originator employed by a depository institution) must be subject to criminal background standards and financial responsibility, character, and general fitness standards that apply to licensed loan originators, and receive training similar to the training that is required for licensed loan originators.

The CFPB also proposes the inclusion of a loan originator's NMLSR identification number on the following documents:

(1) the credit application,

(2) the Good Faith Estimate and Settlement Statement,

(3) the early and final Truth In Lending Act disclosure statements,

(4) the note or loan contract, and

(5) the security instrument.

Mandatory Arbitration

The CFPB proposes to implement the

© 2012 Thomson Reuters

Dodd-Frank prohibition on the inclusion of a mandatory arbitration requirement in any contract or other agreement for a consumer credit transaction secured by a dwelling.

© 2012 Thomson Reuters