CFPB video guidance to the 2013 Loan Originator Compensation and Qualifying Rule

Transcript

Hello my name is Paul Mondor, I am managing counsel in the CFPB Office of Regulations. I'm going to take you through the bureau's new Loan Originator Compensation and Qualification Rule. This is staff guidance, and not any official interpretation of the bureau or legal advice.

This is the master slide, or roadmap. Following slides will elaborate on each of these major points. By way of background, this is a series of requirements designed to address concerns that loan officers, mortgage brokers, and others have incentives to steer borrowers to potentially harmful loans. Federal Reserve Board rulemaking regarding compensation preceded Dodd-Frank and then Dodd-Frank essentially codified most of the board rules' requirements, but with some differences that led to the need for an additional rulemaking. That was this new final rule, just issued in January. It builds on the Federal Reserve Board's rule, but it clarifies certain aspects and it picks up the additional tweaks and twists that Dodd-Frank added.

There are two primary provisions to the rule, and they correspond to the first two bullets on this slide: the prohibition on compensation based on terms, and the prohibition on what we call dual compensation. The rule also clarifies the application of the existing rule concerning pricing concessions and profit-sharing plans as it expands the record-keeping requirement by applying it to non-creditor loan originators and extending it from two years to three years for compensation records. In addition, the rule has provisions concerning qualification of loan originators. It builds on the SAFE Act requirements but adds TILA liability for failing to comply and also requires that loan originator organizations ensure that the loan originators who work for them comply with the SAFE Act and other state laws on licensing and registration. And for those organizations with originators not subject to the SAFE Act, they must perform background checks on their employees that are similar to the SAFE Act requirements.

Another requirement is the identifier disclosure. Loan originators must disclose their nationwide mortgage licensing system and registry, or NMLSR, ID number on loan documents.

Mandatory arbitration clauses mean clauses requiring the consumer to submit disputes to binding arbitration, or the application or interpretation of an agreement so as to bar a consumer from bringing a claim in court in connection with any alleged violation of federal law. As for single premium credit insurance, the rule prohibits a creditor's financing of any premiums or fees for credit insurance, such as credit life. One last thing not on this slide is the statutory prohibition on upfront points and fees when loan originator compensation is paid by anyone other than the consumer. This rule does not implement that requirement. The Dodd-Frank Act gave us authority to waive it if doing so is in the interest of consumers and public interest. The bureau believes that a total ban would be not consistent with those interests but that we need to study it in light of new requirements: all the new mortgage rules that are taking effect over the next year. So we exercised the waiver authority to delay rulemaking on this issue. The next step will be to research consumer interaction with all the new protections and review the effects of the regulations in the market.

We'll talk about the definition of Loan Originator. It's a very broad definition which we believe is in line with the definition of Mortgage Originator in the Dodd-Frank Act, and also with the rather broad Loan Originator definition already in the existing federal reserve rule. It includes direct or indirect compensation or monetary gain. Some examples of Loan Originator include persons who fill out application for a consumer, persons who advise on terms, persons who refer a consumer to another loan originator or creditor, and, by the way, a person includes not only natural persons but virtually all business forms such as trusts, LLCs, corporations, etc. There are however certain exclusions from the meaning of loan originator and these are largely statutory from the Dodd-Frank Act. Some of those include manufactured home employees who do not take a credit application or advise a consumer on loan terms, servicers, including their employees, contractors, or agents if they are not replacing and satisfying an existing obligation, that is not doing a refinancing, real estate brokers who do not also act as mortgage brokers in the transaction, managers who do not originate loans, or administrative and clerical staff who process loans on behalf of creditors and loan originators without offering or negotiating transaction terms.

This is the start of a couple of slides that will drill down more on the first of the two principal prohibitions, that is compensation that is based on a term of a transaction. Compensation is defined very broadly to include any incentive. Terms of a transaction include the rights and obligations in the note or other credit contract and in the security instrument, as well as any document incorporated in those by reference, any loan originator or creditor fees or charges imposed on the consumer for the credit or for any product or service connected to the credit, any fees or charges for any product or service required to be obtained as a condition of the credit, but all of this is limited to fees or charges required to be disclosed in the RESPA disclosures, the good faith estimate, and the HUD-1.

Some examples of terms, then, include the interest rate, the annual percentage rate, the type of collateral, such as a condominium, cooperative, detached home, and the existence of a prepayment penalty, or lack thereof.

There is a new clarification in this rule of an existing provision in the original Loan Originator compensation rule having to do with proxies. The rule also prohibits compensation based not only on a transaction term, but on any factor that is a proxy for a transaction term. Originally, the rule basically provided only that much. This final rule expands and clarifies by defining what constitutes a proxy, and it's essentially a two-part test that you can see at the bottom of this slide. If the factor consistently varies with a term or terms of the transaction over a significant number of transactions and the loan originator has the ability, directly or indirectly, to add, drop, or change that factor when originating that transaction, then that factor is a proxy for one or more terms.

Still on the first principal prohibition of compensation based on terms. Two major clarification under the existing rule were included in the new final rule, as I alluded to earlier: pricing concessions and profit-sharing plans. So first on pricing concessions, the first main block on this slide. We have the baseline rule: although creditors may grant pricing concessions to consumers, they may not require a loan originator to bear the cost of that concession through reduced compensation. This rule introduces a new exception to that: when the RESPA estimates are exceeded for unforeseen reasons, not only beyond tolerance, but any charge that is in excess for the estimate, a consumer may be granted a concession to defray the cost of that increase and the creditor may require the loan originator to bear the cost through reduced compensation.

The second and third blocks of this slide describe the additional clarification on profit-sharing plans. The middle block is about specific designated tax advantaged plans. Designated means any defined benefit plan or defined contribution plan that meets any of several Internal Revenue Code definitions, and you see them listed there: a qualified plan, employee annuity plans, simple retirement accounts, simple employee pensions and annuity contracts, or eligible deferred compensation plans. Designated defined benefit plans are expressly permitted without further inquiry, while designated defined contribution plans are permitted as long as the contribution isn't directly or indirectly based on the terms of that individual loan originator's transactions.

The other block gets a little more complicated: it's for non-designated plans. The baseline rule here is that no loan originator may receive or be paid compensation in an amount that is based on a term of a transaction, the terms of multiple transactions by that loan originator, or the terms of multiple transactions by multiple individual loan originators. The commentary clarifies that loan originator compensation based on mortgage-related business profits amounts to compensation that is based on terms of transactions of multiple loan originators. But the rule also creates a couple of new exceptions. First, non-deferred profits based compensation is permissible if it equals ten percent or less of that loan originator's total compensation. Second, it's permissible if the loan originator has de minimus originations, which is defined as 10 or fewer transactions in a year. But there's a general caveat to all of this, which is that distributions or payments to a loan originator under these non-designated plans still may not be based on the terms of the transactions originated by that loan originator.

We go now to the second principal prohibition, dual compensation. The baseline rule here is that a mortgage broker may not receive compensation from both a consumer and the creditor in the same transaction. Because the rule provides that no loan originator may receive compensation from other than the consumer, if a consumer pays a brokerage, that brokerage may not pay its individual loan officer, or the individual broker, any commission on the same transaction. This final rule provides an exception. It permits the brokerage to pay the individual broker that originated the transaction a commission even though the consumer has paid a commission to the brokerage. Again, however, such payments are subject to the basic rule against compensation based on terms, so the individual loan originator's commission may not be based on the terms of the transaction.

We come to the loan originator qualification and identifier requirements. Qualification requirements are essentially not new: they amount to complying with the SAFE Act for the most part. So this means that individual loan originators must comply with, in the case of depository's employees, state registration requirements, or applicable registration requirements under the SAFE Act and for non-depository employees, the state licensing created under the SAFE Act.

But there is some element of leveling of the field here for employers who have loan originator employees not required to be licensed under the SAFE Act or other applicable law. Those employers must ensure that their employees meet character fitness and criminal background standards similar to existing SAFE Act licensing standards. They also must provide training to loan originator employees that is appropriate and consistent with those loan originator's origination activities. The unique identifier requirement: the rule provides clarification on the statutory requirement that the unique identifier appear on all loan documents. Obviously, the statutory provision that it be disclosed on all loan documents leaves open the question of what is and is not a loan document. The rule clarifies that loan documents means the credit application, the note or other loan contract, and the security instrument.

Questions?
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