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BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

Docket No. CFPB-2012- 0037

RIN 3170-AA13

Loan Originator Compensation Requirements under the Truth in Lending Act (Regulation Z)

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule; official interpretations.

SUMMARY: The Bureau of Consumer Financial Protection (Bureau) is amending Regulation Z to implement amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The final rule implements requirements and restrictions imposed by the Dodd-Frank Act concerning loan originator compensation; qualifications of, and registration or licensing of loan originators; compliance procedures for depository institutions; mandatory arbitration; and the financing of single-premium credit insurance. The final rule revises or provides additional commentary on Regulation Z's restrictions on loan originator compensation, including application of these restrictions to prohibitions on dual compensation and compensation based on a term of a transaction or a proxy for a term of a transaction, and to recordkeeping requirements. The final rule also establishes tests for when loan originators can be compensated through certain profits-based compensation arrangements. At this time, the Bureau is not prohibiting payments to and receipt of payments by loan originators when a consumer pays upfront points or fees in the mortgage transaction. Instead the Bureau will first study how points and fees function in the

market and the impact of this and other mortgage-related rulemakings on consumers' understanding of and choices with respect to points and fees. This final rule is designed primarily to protect consumers by reducing incentives for loan originators to steer consumers into loans with particular terms and by ensuring that loan originators are adequately qualified.

DATES: The amendments to § 1026.36(h) and (i) are effective on June 1, 2013. All other provisions of the rule are effective on January 10, 2014.

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SUPPLEMENTARY INFORMATION:

I. Summary of the Final Rule

The mortgage market crisis focused attention on the critical role that loan officers and mortgage brokers play in the loan origination process. Because consumers generally take out only a few home loans over the course of their lives, they often rely heavily on loan officers and brokers to guide them. But prior to the crisis, training and qualification standards for loan originators varied widely, and compensation was frequently structured to give loan originators strong incentives to steer consumers into more expensive loans. Often, consumers paid loan originators an upfront fee without realizing that the creditors in the transactions also were paying the loan originators commissions that increased with the interest rate or other terms.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) expanded on previous efforts by lawmakers and regulators to strengthen loan originator qualification requirements and regulate industry compensation practices. The Bureau of Consumer Financial Protection (Bureau) is issuing new rules to implement the Dodd-Frank Act requirements, as well as to revise and clarify existing regulations and commentary on loan originator compensation. The rules also implement Dodd-Frank Act provisions that prohibit certain arbitration agreements and the financing of certain credit insurance in connection with a mortgage loan.

The final rule revises Regulation Z to implement amendments to the Truth in Lending Act (TILA). It contains the following key elements:

Prohibition Against Compensation Based on a Term of a Transaction or Proxy for a Term of a Transaction. Regulation Z already prohibits basing a loan originator's compensation on "any of the transaction's terms or conditions." The Dodd-Frank Act codifies this prohibition. The final rule implements the Dodd-Frank Act and clarifies the scope of the rule as follows:

- The final rule defines "a term of a transaction" as "any right or obligation of the parties to a credit transaction." This means, for example, that a mortgage broker cannot receive compensation based on the interest rate of a loan or on the fact that the loan officer steered a consumer to purchase required title insurance from an affiliate of the broker, since the consumer is obligated to pay interest and the required title insurance in connection with the loan.
- To prevent evasion, the final rule prohibits compensation based on a "proxy" for a term of a transaction. The rule also further clarifies the definition of a proxy to focus on whether: (1) the factor consistently varies with a transaction term over a significant number of transactions; and (2) the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating the transaction.
- To prevent evasion, the final rule generally prohibits loan originator compensation from being reduced to offset the cost of a change in transaction terms (often called a

"pricing concession"). However, the final rule allows loan originators to reduce their compensation to defray certain unexpected increases in estimated settlement costs.

- To prevent incentives to "up-charge" consumers on their loans, the final rule generally prohibits loan originator compensation based upon the profitability of a transaction or a pool of transactions. However, subject to certain restrictions, the final rule permits certain bonuses and retirement and profit-sharing plans to be based on the terms of multiple loan originators' transactions. Specifically, the funds can be used for: (1) contributions to or benefits under certain designated tax-advantaged retirement plans, such as 401(k) plans and certain pension plans; (2) bonuses and other types of non-deferred profits-based compensation if the individual loan originator originated ten or fewer mortgage transactions during the preceding 12 months; and (3) bonuses and other types of non-deferred profits-based compensation that does not exceed 10 percent of the individual loan originator's total compensation.

Prohibition Against Dual Compensation. Regulation Z already provides that where a loan originator receives compensation directly from a consumer in connection with a mortgage loan, no loan originator may receive compensation from another person in connection with the same transaction. The Dodd-Frank Act codifies this prohibition, which was designed to address consumer confusion over mortgage broker loyalties where the brokers were receiving payments both from the consumer and the creditor. The final rule implements this restriction but provides an exception to allow mortgage brokers to pay their employees or contractors commissions, although the commissions cannot be based on the terms of the loans that they originate.

No Prohibition on Consumer Payment of Upfront Points and Fees. Section 1403 of the Dodd-Frank Act contains a section that would generally have prohibited consumers from paying upfront points or fees on transactions in which the loan originator compensation is paid by a person other than the consumer (either to the creditor's own employee or to a mortgage broker). However, the Dodd-Frank Act also authorizes the Bureau to waive or create exemptions from the prohibition on upfront points and fees if the Bureau determines that doing so would be in the interest of consumers and in the public interest.

The Bureau had proposed to waive the ban so that creditors could charge upfront points and fees in connection with a mortgage loan, so long as they made available to consumers an alternative loan that did not include upfront points and fees. The proposal was designed to facilitate consumer shopping, enhance consumer decision-making, and preserve consumer choice and access to credit. The Bureau has decided not to finalize this part of the proposal at this time, however, because of concerns that it would have created consumer confusion and other negative outcomes. The Bureau has decided instead to issue a complete exemption to the prohibition on upfront points and fees pursuant to its exemption authority under section 1403 and other authority while it scrutinizes several crucial issues relating to the proposal's design, operation, and possible effects in a mortgage market undergoing regulatory overhaul. The Bureau is planning consumer testing and other research to understand how new Dodd-Frank Act requirements affect consumers' understanding of and choices with respect to points and fees, so that the Bureau can determine whether further regulation is appropriate to facilitate consumer shopping and enhanced decision-making while protecting access to credit.

Loan Originator Qualifications and Identifier Requirements. The Dodd-Frank Act imposes a duty on individual loan officers, mortgage brokers, and creditors to be "qualified" and, when applicable, registered or licensed to the extent required under State and Federal law. The final rule imposes duties on loan originator organizations to make sure that their individual loan originators are licensed or registered as applicable under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) and other applicable law. For loan originator employers whose employees are not required to be licensed, including depository institutions and bona fide nonprofits, the rule requires them to: (1) ensure that their loan originator employees meet character, fitness, and criminal background standards similar to existing SAFE Act licensing standards; and (2) provide training to their loan originator employees that is appropriate and consistent with those loan originators' origination activities. The final rule contains special provisions with respect to criminal background checks and the circumstances in which a criminal conviction is disqualifying, and with respect to situations in which a credit check on a loan originator is required.

The final rule also implements a Dodd-Frank Act requirement that loan originators provided their unique identifiers under the Nationwide Mortgage Licensing System and Registry (NMLSR) on loan documents. Accordingly, mortgage brokers, creditors, and individual loan originators that are primarily responsible for a particular origination will be required to list on enumerated loan documents their NMLSR unique identifiers (NMLSR IDs), if any, along with their names.

Prohibition on Mandatory Arbitration Clauses and Single Premium Credit Insurance. The final rule also contains language implementing two other Dodd-Frank Act provisions concerning mortgage loan originations. The first prohibits the inclusion of clauses requiring the consumer to submit disputes concerning a residential mortgage loan or home equity line of credit to binding arbitration. It also prohibits the application or interpretation of provisions of such loans or related agreements so as to bar a consumer from bringing a claim in court in connection with any alleged violation of Federal law. The second provision prohibits the financing of any premiums or fees for credit insurance (such as credit life insurance) in connection with a consumer credit transaction secured by a dwelling, but allows credit insurance to be paid for on a monthly basis.

Other Provisions. The final rule also extends existing recordkeeping requirements concerning loan originator compensation so that they apply to both creditors and mortgage brokers for three years. The rule also clarifies the definition of "loan originator" for purposes of the compensation and qualification rules, including exclusions for certain employees of manufactured home retailers, servicers, seller financers, and real estate brokers; management, clerical, and administrative staff; and loan processors, underwriters, and closers.

II. Background

A. The Mortgage Market

Overview of the Market and the Mortgage Crisis

The mortgage market is the single largest market for consumer financial products and services in the United States, with approximately $9.9 trillion in mortgage loans outstanding.[1] During the last decade, the market went through an unprecedented cycle of expansion and contraction that was fueled in part by the securitization of mortgages and creation of increasingly sophisticated derivative products. So many other parts of the American financial system were

[1] Fed. Reserve Sys., *Flow of Funds Accounts of the United States*, at 67 tbl.L.10 (2012), *available at* http://www.federalreserve.gov/releases/z1/Current/z1.pdf (as of the end of the third quarter of 2012).

drawn into mortgage-related activities that, when the housing market collapsed in 2008, it sparked the most severe recession in the United States since the Great Depression.[2]

The expansion in this market is commonly attributed to both particular economic conditions (including an era of low interest rates and rising housing prices) and to changes within the industry. Interest rates dropped significantly—by more than 20 percent—from 2000 through 2003.[3] Housing prices increased dramatically—about 152 percent—between 1997 and 2006.[4] Driven by the decrease in interest rates and the increase in housing prices, the volume of refinancings increased rapidly, from about 2.5 million loans in 2000 to more than 15 million in 2003.[5]

Growth in the mortgage loan market was particularly pronounced in what are known as "subprime" and "Alt-A" products. Subprime products were sold primarily to borrowers with poor or no credit history, although some borrowers who would have qualified for "prime" loans were steered into subprime loans instead.[6] The Alt-A category of loans permitted borrowers to take out mortgage loans while providing little or no documentation of income or other evidence

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[2] *See* Thomas F. Siems, *Branding the Great Recession*, Fin. Insights (Fed. Reserve Bank of Dall.) May 13, 2012, at 3, *available at* http://www.dallasfed.org/assets/documents/banking/firm/fi/fi1201.pdf (stating that the great recession "was the longest and deepest economic contraction, as measured by the drop in real GDP, since the Great Depression.").

[3] *See* U.S. Dep't of Hous. & Urban Dev., *An Analysis of Mortgage Refinancing, 2001–2003*, at 2 (2004) ("An Analysis of Mortgage Refinancing, 2001–2003"), *available at* www.huduser.org/Publications/pdf/MortgageRefinance03.pdf; Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 Fed. Res. Bank of St. Louis Rev. 31, 48 (2006), *available at* http://research.stlouisfed.org/publications/review/article/5019.

[4] U.S. Fin. Crisis Inquiry Comm'n, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* 156 (Official Gov't ed. 2011) (''FCIC Report''), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[5] An Analysis of Mortgage Refinancing, 2001–2003, at 1.

[6] For example, the Federal Reserve Board on July 20, 2011, issued a consent cease and desist order and assessed an $85 million civil money penalty against Wells Fargo & Company of San Francisco, a registered bank holding company, and Wells Fargo Financial, Inc., of Des Moines. The order addresses allegations that Wells Fargo Financial employees steered potential prime borrowers into more costly subprime loans and separately falsified income information in mortgage applications. In addition to the civil money penalty, the order requires that Wells Fargo compensate affected borrowers. *See* http://www.federalreserve.gov/newsevents/press/enforcement/20110720a.htm.

of repayment ability. Because these loans involved additional risk, they were typically more expensive to borrowers than "prime" mortgages, although many of them had very low introductory interest rates. In 2003, subprime and Alt-A origination volume was almost $400 billion; in 2006, it had reached $1 trillion.[7]

So long as housing prices were continuing to increase, it was relatively easy for borrowers to refinance their existing loans into more affordable products to avoid interest rate resets and other adjustments. When housing prices began to decline in 2005, refinancing became more difficult and delinquency rates on these subprime and Alt-A products increased dramatically.[8] More and more consumers, especially those with subprime and Alt-A loans, were unable or unwilling to make their mortgage payments. An early sign of the mortgage crisis was an upswing in early payment defaults—generally defined as borrowers being 60 or more days delinquent within the first year. Prior to 2006, 1.1 percent of mortgages would end up 60 or more days delinquent within the first year.[9] Taking a more expansive definition of early payment default to include 60 days delinquent within the first two years, this figure was double the historic average during 2006, 2007, and 2008.[10] In 2006, 2007, and 2008, 2.3 percent, 2.1 percent, and 2.3 percent of mortgages ended up 60 or more days delinquent within the first two years, respectively. In addition, as the economy worsened, the rates of serious delinquency (90 or more days past due or in foreclosure) for the subprime and Alt-A products began a steep

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[7] Inside Mortg. Fin., *Mortgage Originations by Product, in* 1 The 2011 Mortgage Market Statistical Annual 20 (2011).
[8] FCIC Report at 215-217.
[9] CoreLogic's TrueStandings Servicing (reflects first-lien mortgage loans) (data service accessible only through paid subscription).
[10] *Id.*

increase from approximately 10 percent in 2006, to 20 percent in 2007, to more than 40 percent in 2010.[11]

The impact of this level of delinquencies was severe on creditors who held loans on their books and on private investors who purchased loans directly or through securitized vehicles. Prior to and during the housing bubble, the evolution of the securitization of mortgages attracted increasing involvement from financial institutions that were not directly involved in the extension of credit to consumers and from investors worldwide. Securitization of mortgages allows originating creditors to sell off their loans (and reinvest the funds earned in making new ones) to investors who want an income stream over time. Securitization had been pioneered by what are now called government-sponsored enterprises (GSEs), including the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). But by the early 2000s, large numbers of private financial institutions were deeply involved in creating increasingly complex mortgage-related investment vehicles through securities and derivative products. The private securitization-backed subprime and Alt-A mortgage market ground to a halt in 2007 in the face of the rising delinquencies on subprime and Alt-A products.[12]

Six years later, the United States continues to grapple with the fallout. The fall in housing prices is estimated to have resulted in about $7 trillion in household wealth losses.[13] In addition, distressed homeownership and foreclosure rates remain at unprecedented levels.[14]

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[11] *Id.* at 217.
[12] *Id.* at 124.
[13] *The U.S. Housing Market: Current Conditions and Policy Considerations*, 3 (Fed. Reserve Bd., White Paper, 2012), *available at* http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf.
[14] Lender Processing Servs., PowerPoint Presentation, *LPS Mortgage Monitor: December 2012 Mortgage Performance Observations, Data as of November 2012 Month End*, 3, 11 (December 2012), *available at*

Response and Government Programs

In light of these conditions, the Federal Government began providing support to the mortgage markets in 2008 and continues to do so at extraordinary levels today. The Housing and Economic Recovery Act of 2008 (HERA), which became effective on October 1, 2008, provided both new safeguards and increased regulation for Fannie Mae and Freddie Mac, as well as provisions to assist troubled borrowers and the hardest hit communities. Fannie Mae and Freddie Mac, which supported the mainstream mortgage market, experienced heavy losses and were placed in conservatorship by the Federal government in 2008 to support the collapsing mortgage market.[15] Because private investors have withdrawn from the mortgage securitization market and there are no other effective secondary market mechanisms in place, the GSEs' continued operations help ensure that the secondary mortgage market continues to function and to assist consumers in obtaining new mortgages or refinancing existing mortgages. The Troubled Asset Relief Program (TARP), created to implement programs to stabilize the financial system during the financial crisis, was authorized through the Emergency Economic Stabilization Act of 2008 (EESA), as amended by the American Recovery and Reinvestment Act of 2009, and includes programs to help struggling homeowners avoid foreclosure.[16] Since 2008, several other

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http://www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/Pages/Mortgage-Monitor.aspx.

[15] HERA, which created the Federal Housing Finance Agency (FHFA), granted the Director of FHFA discretionary authority to appoint FHFA conservator or receiver of the Enterprises "for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity." Housing and Economic Recovery Act of 2008, section 1367(a)(2), amending the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, 12 U.S.C. 4617(a)(2). On September 6, 2008, FHFA exercised that authority, placing Fannie Mae and Freddie Mac into conservatorships. The two GSEs have since received more than $180 billion in support from the Department of the Treasury. Through the second quarter of 2012, Fannie Mae has drawn $116.1 billion and Freddie Mac has drawn $71.3 billion, for an aggregate draw of $187.5 billion from the Department of the Treasury. Fed. Hous. Fin. Agency, *Conservator's Report on the Enterprises' Financial Performance*, at 17 (Second Quarter 2012), *available at* http://www.fhfa.gov/webfiles/24549/ConservatorsReport2Q2012.pdf.

[16] The Making Home Affordable Program (MHA) is the umbrella program for Treasury's homeowner assistance and foreclosure mitigation efforts. The main MHA components are the Home Affordable Modification Program (HAMP), a Treasury program that uses TARP funds to provide incentives for mortgage servicers to modify eligible

Federal government efforts have endeavored to keep the country's housing finance system functioning, including the Treasury Department's and the Federal Reserve System's mortgage-backed securities (MBS) purchase programs to help keep interest rates low and the Federal Housing Administration's (FHA's) increased market presence. As a result, mortgage credit has remained available, albeit with more restrictive underwriting terms that limit or preclude some consumers' access to credit. These same government agencies together with the GSEs and other market participants have also undertaken a series of efforts to help families avoid foreclosure through loan-modification programs, loan-refinance programs and foreclosure alternatives.[17]

Size and Volume of the Current Mortgage Origination Market

Even with the economic downturn and tightening of credit standards, approximately $1.28 trillion in mortgage loans were originated in 2011.[18] In exchange for an extension of mortgage credit, consumers promise to make regular mortgage payments and provide their home or real property as collateral. The overwhelming majority of homebuyers continue to use mortgage loans to finance at least some of the purchase price of their property. In 2011, 93 percent of all home purchases were financed with a mortgage credit transaction.[19]

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first-lien mortgages, and two initiatives at the GSEs that use non-TARP funds. Incentive payments for modifications to loans owned or guaranteed by the GSEs are paid by the GSEs, not TARP. Treasury over time expanded MHA to include sub-programs designed to overcome obstacles to sustainable HAMP modifications. Treasury also allocated TARP funds to support two additional housing support efforts: an FHA refinancing program and TARP funding for 19 state housing finance agencies, called the Housing Finance Agency Hardest Hit Fund. In the first half of 2012, Treasury extended the application period for HAMP by a year to December 31, 2013, and opened HAMP to non-owner-occupied rental properties and to consumers with a wider range of debt-to-income ratios under "HAMP Tier 2."

[17] The Home Affordable Refinance Program (HARP) is designed to help eligible homeowners refinance their mortgage. HARP is designed for those homeowners who are current on their mortgage payments but have been unable to get traditional refinancing because the value of their homes has declined. For a mortgage to be considered for a HARP refinance, it *must* be owned or guaranteed by the GSEs. HARP ends on December 31, 2013.

[18] Moody's Analytics, *Credit Forecast 2012* (2012) ("Credit Forecast 2012"), *available at* http://www.economy.com/default.asp (reflects first-lien mortgage loans) (data service accessible only through paid subscription).

[19] Inside Mortg. Fin., *New Homes Sold by Financing*, *in* 1 The 2012 Mortgage Market Statistical Annual 12 (2012).

Consumers may obtain mortgage credit to purchase a home, to refinance an existing mortgage, to access home equity, or to finance home improvement. Purchase loans and refinancings together produced 6.3 million new first-lien mortgage loan originations in 2011.[20] The proportion of loans that are for purchases as opposed to refinances varies with the interest rate environment and other market factors. In 2011, 65 percent of the market was refinance transactions and 35 percent was purchase loans, by volume.[21] Historically the distribution has been more even. In 2000, refinances accounted for 44 percent of the market while purchase loans comprised 56 percent; in 2005, the two products were split evenly.[22]

With a home equity transaction, a homeowner uses his or her equity as collateral to secure consumer credit. The credit proceeds can be used, for example, to pay for home improvements. Home equity credit transactions and home equity lines of credit resulted in an additional 1.3 million mortgage loan originations in 2011.[23]

GSE-eligible loans, together with the other federally insured or guaranteed loans, cover the majority of the current mortgage market. Since entering conservatorship in September 2008, the GSEs have bought or guaranteed roughly three of every four mortgages originated in the country. Mortgages guaranteed by FHA make up most of the rest.[24] Outside of the securitization available through the Government National Mortgage Association (Ginnie Mae)

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[20] Credit Forecast 2012.
[21] Inside Mortg. Fin., *Mortgage Originations by Product*, *in* 1 The 2012 Mortgage Market Statistical Annual 17 (2012).
[22] *Id.* These percentages are based on the dollar amount of the loans.
[23] Credit Forecast 2012 (reflects open-end and closed-end home equity loans).
[24] Fed. Hous. Fin. Agency, *A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending*, at 14 (2012) ("FHFA Report"), *available at* http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf.

for loans primarily backed by FHA, there are very few alternatives in place today to assume the secondary market functions served by the GSEs.[25]

Continued Fragility of the Mortgage Market

The current mortgage market is especially fragile as a result of the recent mortgage crisis. Tight credit remains an important factor in the contraction in mortgage lending seen over the past few years. Mortgage loan terms and credit standards have tightened most for consumers with lower credit scores and with less money available for a down payment. According to CoreLogic's TrueStandings Servicing, a proprietary data service that covers about two-thirds of the mortgage market, average underwriting standards have tightened considerably since 2007. Through the first nine months of 2012, for consumers that have received closed-end first-lien mortgages, the weighted average FICO[26] score was 750, the loan-to-value (LTV) ratio was 78 percent, and the debt-to-income (DTI) ratio was 34.5 percent.[27] In comparison, in the peak of the housing bubble in 2007, the weighted average FICO score was 706, the LTV was 80 percent, and the DTI was 39.8 percent.[28]

In this tight credit environment, the data suggest that creditors are not willing to take significant risks. In terms of the distribution of origination characteristics, for 90 percent of all the Fannie Mae and Freddie Mac mortgage loans originated in 2011, consumers had a FICO

[25] FHFA Report at 8-9. Secondary market issuance remains heavily reliant upon the explicitly government guaranteed securities of Fannie Mae, Freddie Mac, and Ginnie Mae. Through the first three quarters of 2012, approximately $1.2 trillion of the $1.33 trillion in mortgage originations have been securitized, less than $10 billion of the $1.2 trillion were non-agency mortgage backed securities. Inside Mortg. Fin. (Nov. 2, 2012) at 4.
[26] FICO is a type of credit score that makes up a substantial portion of the credit report that lenders use to assess an applicant's credit risk and whether to extend a loan
[27] CoreLogic, TrueStandings Servicing Database, *available at* http://www.truestandings.com (data reflects first-lien mortgage loans) (data service accessible only through paid subscription). According to CoreLogic's TrueStandings Servicing, FICO reports that in 2011, approximately 38 percent of consumers receiving first-lien mortgage credit had a FICO score of 750 or greater.
[28] *Id.*

score over 700 and a DTI less than 44 percent.[29] According to the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices, in April, 2012 nearly 60 percent of creditors reported that they would be much less likely, relative to 2006, to originate a conforming home-purchase mortgage[30] to a consumer with a 10 percent down payment and a credit score of 620—a traditional marker for those consumers with weaker credit histories.[31] The Federal Reserve Board calculates that the share of mortgage borrowers with credit scores below 620 has fallen from about 17 percent of consumers at the end of 2006 to about 5 percent more recently.[32] Creditors also appear to have pulled back on offering these consumers loans insured by the FHA, which provides mortgage insurance on loans made by FHA-approved creditors throughout the United States and its territories and is especially structured to help promote affordability.[33]

The Bureau is acutely aware of the high levels of anxiety in the mortgage market today. These concerns include the continued slow pace of recovery, the confluence of multiple major regulatory and capital initiatives, and the compliance burdens of the various Dodd-Frank Act rulemakings (including uncertainty on what constitutes a qualified residential mortgage (QRM), which relates to the Dodd-Frank Act's credit risk retention requirements and mortgage securitizations). The Bureau acknowledges that it will likely take some time for the mortgage market to stabilize and that creditors will need to adjust their operations to account for several major regulatory and capital regime changes.

The Mortgage Origination Process and Origination Channels

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[29] *Id.*

[30] A conforming mortgage is one that is eligible for purchase or credit guarantee by Fannie Mae or Freddie Mac.

[31] Fed. Reserve Bd., *Senior Loan Officer Opinion Survey on Bank Lending Practices*, *available at* http://www.federalreserve.gov/boarddocs/SnLoanSurvey/default.htm.

[32] Federal Reserve Board staff calculations based on the Federal Reserve Bank of New York Consumer Credit Panel. The 10th percentile of credit scores on mortgage originations rose from 585 in 2006 to 635 at the end of 2011.

[33] FHA insures mortgages on single family and multifamily homes including manufactured homes and hospitals. It is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934.

As discussed above, the mortgage market crisis focused attention on the critical role that loan officers and mortgage brokers play in guiding consumers through the loan origination process. Consumers must go through a mortgage origination process to obtain a mortgage loan. There are many actors involved in a mortgage origination. In addition to the creditor and the consumer, a transaction may involve a loan officer employed by a creditor, a mortgage broker, settlement agent, appraiser, multiple insurance providers, local government clerks and tax offices, and others. Purchase money loans involve additional parties such as sellers and real estate agents. These third parties typically charge fees or commissions for the services they provide which may be paid directly by the consumer or from loan proceeds, or indirectly through a creditor or broker.

Application. To obtain a mortgage loan, consumers must first apply through a loan originator. There are three different "channels" for mortgage loan origination in the current market:

- **Retail**: The consumer deals with a loan officer that works directly for the mortgage creditor, such as a bank, credit union, or specialized mortgage finance company. The creditor typically operates a network of branches, but may also communicate with consumers through mail and the internet. The entire origination transaction is conducted within the corporate structure of the creditor, and the loan is closed using funds supplied by the creditor. Depending on the type of creditor, the creditor may hold the loan in its portfolio or sell the loan to investors on the secondary market, as discussed further below.
- **Wholesale:** The consumer deals with an independent mortgage broker, which may be an individual or a mortgage brokerage firm. The broker may seek offers from

many different creditors, and then acts as a liaison between the consumer and whichever creditor ultimately closes the loan. At closing, the loan is consummated by using the creditor's funds, and the mortgage note is written in the creditor's name.[34] Again, the creditor may hold the loan in its portfolio or sell the loan on the secondary market.

- **Correspondent:** The consumer deals with a loan officer that works directly for a "correspondent lender" that does not deal directly with the secondary market. At closing, the correspondent lender closes the loans using its own funds, but then immediately sells the loan to an "acquiring creditor," which in turn either holds the loan in portfolio or sells it on the secondary market.

Both loan officers and mortgage brokers generally provide information to consumers about different types of loans and advise consumers on choosing a loan. Consumers rely on loan officers and mortgage brokers to determine what kind of loan best suits the consumers' needs. Loan officers and mortgage brokers also take a consumers' completed loan application for submission to the creditor's loan underwriter. The applications include consumers' credit and income information, along with information about the home to be purchased. Consumers can work with multiple loan originators to compare the loan offers that loan originators may obtain on their behalf from creditors. Once the consumers have decided to move forward with a loan, the loan originator may request additional information or documents from the consumers to support the information in the application and obtain an appraisal of the property.

[34] In some cases, mortgage brokers use a process called "table funding," in which the transaction is closed using the wholesale creditor's funds at the settlement table, but the loan is closed in the broker's name. The broker simultaneously assigns the closed loan to the creditor. These types of transactions generally require the use of approved title companies or title attorneys of the creditor to assure strict adherence to the creditor's closing instructions. Such transactions are only valid in those states that allow "wet closings." These types of closings are not as common today.

Underwriting. Historically, the creditor's loan underwriter used the application and additional information to confirm initial information provided by the consumer. The underwriter assessed whether the creditor should take on the risk of making the mortgage loan. To make this decision, the underwriter considered whether the consumer could repay the loan and whether the home was worth enough to serve as collateral for the loan. If the underwriter found that the consumer and the home qualified, the underwriter would approve the consumer's mortgage application.

During the years preceding the mortgage crisis, much of this process broke down as previously discussed. Underwriting today appears to have largely returned to these historical norms. The Bureau's 2013 Ability To Repay (ATR) Final Rule is designed, in substantial part, to assure that as credit continues improve, creditors do not return to the problematic practices of the last decade.

Closing. After being approved for a mortgage loan, completing any closing requirements, and receiving necessary disclosures, the consumer can close on the loan. Multiple parties participate at closing, including the consumer, the creditor, and the settlement agent. In some instances, the loan originator also functions as the settlement agent. More commonly, a separate individual handles the settlement, although that individual may be an employee of the creditor or brokerage firm or of an affiliate of one of those.

Loan Pricing and Disposition of Closed Loans

From the consumer's perspective, loan pricing depends on several elements:

- *Loan terms*. The loan terms affect consumer costs and how the loan is to be repaid, including the type of loan "product," the method of calculating monthly payments and repayment (for example, whether the payments are fully amortizing) and the length of the loan term. [35] The most important single term in determining the price is, of course, the interest rate (and for adjustable rate mortgages the index and margin).

- *Discount points and cash rebates.* Discount points are paid by consumers to the creditor to purchase a lower interest rate. Conversely, creditors may offer consumers a cash rebate at closing which can help cover upfront closing costs in exchange for paying a higher rate over the life of the loan. Both discount points and creditor rebates involve an exchange of cash now (in the form of a payment or credit at closing) for cash over time (in the form of a reduced or increased interest rate). Consumers will also incur some third-party fees in connection with a mortgage application such as the fee for an appraisal or for a credit report. These may be paid at origination or, in some cases, at closing.
- *Origination points or fees.* Creditors and loan originators also sometimes charge origination points or fees, which are typically presented as charges to apply for the loan. Origination fees can take a number of forms: a flat dollar amount, a percentage of the loan amount (*i.e.*, an "origination point"), or a combination of the two. Origination points or fees may also be framed as a single lump sum or as several different fees (*e.g.*, application fee, underwriting fee, document preparation fee).
- *Closing costs*. Closing costs are the additional upfront costs of completing a mortgage transaction, including appraisal fees, title insurance, recording fees, taxes, and homeowner's insurance, for example. These closing costs, as distinct from upfront discount points and origination charges, often are paid to third parties other

[35] The meaning of loan "product" is not firmly established and varies with the person using the term, but it generally refers to various combinations of features such as the type of interest rate and the form of amortization. Feature distinctions often thought of as distinct "loan products" include, for example, fixed rate versus adjustable rate loans and fully amortizing versus interest-only or negatively amortizing loans.

than the creditor or loan originator.

In practice, both discount points and origination points or fees are revenue to the lender or loan originator, and that revenue is fungible. The existence of two types of fees and the many names lenders use for origination fees—some of which may appear to be more negotiable than others—has the potential to confuse consumers.

Determining the appropriate trade-off between payments now and payments later requires a consumer to have a clear sense of how long he or she expects to stay in the home and in the particular loan. If the consumer plans to stay in the home for a number of years without refinancing, paying points to obtain a lower rate may make sense because the consumer will save more in monthly payments than he or she pays up front in discount points. If the consumer expects to move or refinance within a few years, however, then agreeing to pay a higher rate on the loan to reduce out of pocket expenses at closing may make sense because the consumer will save more up front than he or she will pay in increased monthly payments before moving or refinancing. There is a break-even moment in time where the present value of a reduction/increase to the rate just equals the corresponding upfront points/credits. If the consumer moves or refinances earlier (in the case of discount points) or later (in the case of creditor rebates) than the break-even moment, then the consumer will lose money compared to a consumer that neither paid discount points nor received creditor rebates.

The creditor's assessment of pricing—and in particular what different combinations of points, fees, and interest rates it is willing to offer particular consumers—is also driven by the trade-off between upfront and long-term payments. Creditors in general would prefer to receive as much money as possible up front, because having to wait for payments to come in over the life of the loan increases the level of risk. If consumers ultimately pay off a loan earlier than expected or cannot pay off a loan due to financial distress, the creditors will not earn the overall expected return on the loan. However, for creditors, as for consumers, there is a break-even point where the present value of a reduction/increase to the rate just equals the corresponding upfront points/credits. If the creditor reduces the upfront costs in return for a higher interest rate and the consumer continues to make payments on the loan beyond the break-even points, the creditor will come out ahead.

The creditor's calculation of these tradeoffs is generally heavily influenced by the secondary market, which allows creditors to sell off their loans to investors, recoup the capital they have invested in the loans, and recycle that capital into new loans. The investors then benefit from the payment streams over time, as well as bearing the risk of early payment or default. As described above, the creditor can benefit from going on to make additional money from additional loans. Thus, although some banks[36] and credit unions hold some loans in portfolio over time, many creditors prefer not to hold loans until maturity.[37]

When a creditor sells a loan into the secondary market, the creditor is exchanging an asset (the loan) that produces regular cash flows (principal and interest) for an upfront cash payment from the buyer.[38] That upfront cash payment represents the buyer's present valuation of the loan's future cash flows, using assumptions about the rate of prepayments due to moves and

[36] As used throughout this document, the term "banks" also includes "savings associations."
[37] For companies that are affiliated with securitizers, the processing fees involved in creating investment vehicles on the secondary market can itself become a distinct revenue stream. Although the secondary market was originally created by government-sponsored enterprises Fannie Mae and Freddie Mac to provide liquidity for the mortgage market, over time, Wall Street companies began packaging mortgage loans into private-label mortgage-backed securities. Subprime and Alt-A loans, in particular, were often sold into private-label securities. During the boom, a number of large creditors started securitizing the loans themselves in-house, thereby capturing the final piece of the loan's value.
[38] For simplicity, this discussion assumes that the secondary market buyer is a person other than the creditor, such as Fannie Mae, Freddie Mac, or a Wall Street investment bank. In practice, during the mortgage boom, some creditors securitized their own loans. In this case, the secondary market price for the loans was effectively determined by the price investors were willing to pay for the subsequent securities.

refinancings, the rate of expected defaults, the rate of return relative to other investments, and other factors. Secondary market buyers assume considerable risk in determining the price they are willing to pay for a loan. If, for example, loans prepay faster than expected or default at higher rates than expected, the investor will receive a lower return than expected. Conversely, if loans prepay more slowly than expected, or default at lower rates than expected, the investor will earn a higher return over time than expected.[39]

Secondary market mortgage prices are typically quoted in relation to the principal loan amount and are specific to a given interest rate and other factors that are correlated with default risk. For illustrative purposes, at some point in time, a loan with an interest rate of 3.5 percent might earn 102.5 in the secondary market. This means that for every $100 in initial loan principal amount, the secondary market buyer will pay $102.50. Of that amount, $100 is to cover the principal amount and $2.50 is revenue to the creditor in exchange for the rights to the future interest payments on the loan.[40] The secondary market price of a loan increases or decreases along with the loan's interest rate, but the relationship is not typically linear. In other words, using the above example at the same point in time, loans with interest rates higher than 3.5 percent will typically earn more than 102.5, and loans with interest rates less than 3.5 percent will typically earn less than 102.5. However, each subsequent 0.125 percent increment in interest rate above or below 3.5 percent may not be associated with the same size increment in

[39] For simplicity, these examples do not take into account the use of various risk mitigation techniques, such as risk-sharing counterparties and loan level mortgage or other security credit enhancements.
[40] The creditor's profit is equal to secondary market revenue plus origination fees collected by the creditor (if any) plus value of the mortgage servicing rights (MSRs) less origination expenses.

secondary market price.[41] The same style of pricing is used when correspondent lenders sell loans to acquiring creditors.

In some cases, secondary market prices can actually be less than the principal amount of the loan. A price of 98.75, for example, means that for every $100 in principal, the selling creditor receives only $98.75. This represents a loss of $1.25 per $100 of principal just on the sale of the loan, before the creditor takes its expenses into account. This usually happens when the interest rate on the loan is below prevailing interest rates. But so long as discount points or other origination charges can cover the shortfall, the creditor will still make its expected return on the loan.

Discount points are also valuable to creditors (and secondary market investors) for another reason: because payment of discount points signals the consumer's expectations about how long he or she expects to stay in the loan, they make prepayment risk easier to predict. The more discount points a consumer pays, the longer the consumer likely expects to keep the loan in place. This fact mitigates a creditor's or investor's uncertainty about how long interest payments can be expected to continue, which facilitates assigning a present value to the loan's yield and, therefore, setting the loan's price.

Loan Originator Compensation

Brokerage firms and loan officers are typically paid a commission that is a percentage of the loan amount. Prior to 2010, it was common for the percentage to vary based upon the interest rate of the loan: commissions on loans with higher interest rates were higher than commission on loans with lower interest rates (just as the premiums paid by the secondary

[41] Susan E. Woodward, Urban Inst., *A Study of Closing Costs for FHA Mortgages*10-11 (U.S. Dep't of Hous. & Urban Dev. 2008), *available at*: http://www.huduser.org/publications/pdf/FHA_closing_cost.pdf.

market for loans vary with the interest rate). This was typically called a "yield spread premium."[42] In the wholesale context, the loan originator might keep the entire yield spread premium as a commission, or he or she might provide some of the yield spread premium to the borrower as a credit against closing costs.[43]

While this system was in place, it was common for loan originator commissions to mirror secondary market pricing closely. The "price" that the creditor offered to its brokers was somewhat lower than the price that the creditor expected to receive from the secondary market—the creditor kept the difference as corporate revenue. However, the underlying mechanics of the secondary market flowed through to the loan originator's compensation. The higher the interest rate on the loan or the more in upfront charges the consumer pays to the creditor (or both), the greater the compensation available to the loan originator. This created a situation in which the loan originator had a financial incentive to steer consumers into the highest interest rate possible or to impose on the consumer additional upfront charges payable to the creditor.

In a perfectly competitive and transparent market, competition would ensure that this incentive would be countered by the need to compete with other loan originators to offer attractive loan terms to consumers. However, the mortgage origination market is neither always perfectly competitive nor always transparent, and consumers (who take out a mortgage only a few times in their lives) may be uninformed about how prices work and what terms they can

[42] Some commenters use the term "yield spread premium" to refer to any payment from a creditor to a mortgage broker that is funded by increasing the interest rate that would otherwise be charged to the consumer in the absence of that payment. These commenters generally assume that any payment to the brokerage firm by the creditor is funded out of the interest rate, reasoning that had the consumer paid the brokerage firm directly, the creditor would have had lower expenses and would have been able to charge a lower rate. Other commenters use the term "yield spread premium" more narrowly to refer only to a payment from a creditor to a mortgage broker that is based on the interest rate, i.e., the mortgage broker receives a larger payment if the consumer agrees to a higher interest rate. To avoid confusion, the Bureau is limiting its use of the term and is instead more specifically describing the payment at issue.

[43] Mortgage brokers, and some retail loan officers, were compensated in this fashion. Some retail loan officers may have been paid a salary with a bonus for loan volume, rather than yield spread premium-based commissions.

expect.[44] Moreover, prior to 2010, mortgage brokers were free to charge consumers directly for additional origination points or fees, which were generally described to the consumer as compensating for the time and expense of working with the consumer to submit the loan application. This compensation structure was problematic both because the loan originator had an incentive to steer borrowers into less favorable pricing terms while the consumer may have paid origination fees to the loan originator believing that the loan originator was working for the borrower, without knowing that the loan originator was receiving compensation from the creditor as well.

B. TILA and Regulation Z

Congress enacted the TILA based on findings that the informed use of credit resulting from consumers' awareness of the cost of credit would enhance economic stability and would strengthen competition among consumer credit providers. 15 U.S.C. 1601(a). One of the purposes of TILA is to provide meaningful disclosure of credit terms to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit. *Id.* TILA's disclosures differ depending on whether credit is an open-end (revolving) plan or a closed-end (installment) loan. TILA also contains procedural and substantive protections for consumers. TILA is implemented by the Bureau's Regulation Z, 12 CFR part

[44] James Lacko and Janis Pappalardo, *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms*, Federal Trade Commission, ES-12 (June 2007), *available at* http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf, Brian K. Bucks and Karen M. Pence, *Do Borrowers Know their Mortgage Terms?*, J. of Urban Econ. (2008), *available at* http://works.bepress.com/karen_pence/5, Hall and Woodward, *Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory and Mortgage-Market Evidence* (2012), *available at* http://www.stanford.edu/~rehall/DiagnosingConsumerConfusionJune2012.

1026, though historically the Board of Governors of the Federal Reserve System (Board) Regulation Z, 12 CFR part 226, had implemented TILA.[45]

In the aftermath of the mortgage crisis, regulators and lawmakers began focusing on concerns about the steering of consumers into less favorable loan terms than those for which they otherwise qualified. Both the Board and the Department of Housing and Urban Development (HUD) had explored the use of disclosures to inform consumers about loan originator compensation practices. HUD adopted a new disclosure regime under the Real Estate Settlement Procedures Act (RESPA), in a 2008 final rule, which addressed among other matters the disclosure of mortgage broker compensation. 73 FR 68204, 68222-27 (Nov. 17, 2008). The Board also proposed a disclosure-based approach to addressing concerns with mortgage broker compensation. 73 FR 1672, 1698 (Jan. 9, 2008). The Board later determined, however, that the proposed approach presented a significant risk of misleading consumers regarding both the relative costs of brokers and creditors and the role of brokers in their transactions and, consequently, withdrew that aspect of the 2008 proposal as part of its 2008 Home Ownership and Equity Protection Act (HOEPA) Final Rule.[46] 73 FR 44522, 44564 (July 30, 2008).

The Board in 2009 proposed new rules addressing in a more substantive fashion loan originator compensation practices. The Board's proposal included, among other provisions, proposed rules prohibiting certain payments to a mortgage broker or loan officer based on the transaction's terms or conditions, prohibiting dual compensation as described above, and prohibiting a mortgage broker or loan officer from "steering" consumers to transactions not in their interest, to increase mortgage broker or loan officer compensation. The Board based that

[45] The Board's rule remains applicable to certain motor vehicle dealers. *See* 12 U.S.C. 5519 (Section 1029 of the Dodd-Frank Act).
[46] The Board indicated that it would continue to explore available options to address potential unfairness associated with loan originator compensation practices. 73 FR 44522, 44565 (July 30, 2008).

proposal on its authority to prohibit acts or practices in the mortgage market that the Board found to be unfair, deceptive, or (in the case of refinancings) abusive under TILA section 129(l)(2) (now redesignated as TILA section 129(p)(2), 15 U.S.C. 1639(p)(2)). 74 FR 43232, 43279-286 (Aug. 26, 2009). Although the Board issued its proposal prior to the enactment of the Dodd-Frank Act, Congress subsequently amended TILA to codify significant elements of the Board's proposal. *See*, *e.g.*, 15 U.S.C. 1639b (Section 1403 of the Dodd-Frank Act). The Board therefore decided in 2010 to finalize the rules it had proposed under its preexisting TILA powers, while acknowledging that further rulemaking would be required to address certain issues and adjustments made by the Dodd-Frank Act.[47] 75 FR 58509 (Sept. 24, 2010) (2010 Loan Originator Final Rule). The Board's 2010 Loan Originator Final Rule took effect in April 2011.

Most notably, the Board's 2010 Loan Originator Final Rule substantially restricted the payments to loan originators which create incentives for them to steer consumers to more expensive loans. Under this rule, creditors may not base a loan originator's compensation on the transaction's terms or conditions, other than the mortgage loan amount. In addition, the rule prohibits "dual compensation," in which a loan originator is paid compensation by both the consumer and the creditor (or any other person). *See generally* 12 CFR 226.36(d). After authority for Regulation Z transferred from the Board, the Bureau republished the rule at 12 CFR 1026.36(d). 76 FR 79768 (Dec. 22, 2011).

[47] As the Board explained: "The Board has decided to issue this final rule on loan originator compensation and steering, even though a subsequent rulemaking will be necessary to implement Section 129B(c). The Board believes that Congress was aware of the Board's proposal and that in enacting TILA Section 129B(c), Congress sought to codify the Board's proposed prohibitions while expanding them in some respects and making other adjustments. The Board further believes that it can best effectuate the legislative purpose of the [Dodd-Frank Act] by finalizing its proposal relating to loan origination compensation and steering at this time. Allowing enactment of TILA Section 129B(c) to delay final action on the Board's prior regulatory proposal would have the opposite effect intended by the legislation by allowing the continuation of the practices that Congress sought to prohibit." 75 FR 58509 (Sept. 24, 2010).

C.   The SAFE Act

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act), 12 U.S.C. 5106-5116, generally prohibits an individual from engaging in the business of a loan originator without first obtaining, and maintaining annually, a unique identifier from the NMLSR and either a registration as a registered loan originator or a license and registration as a State-licensed loan originator. 12 U.S.C. 5103. Loan originators who are employees of depository institutions are generally subject to the registration requirement, which is implemented by the Bureau's Regulation G, 12 CFR part 1007. Other loan originators are generally subject to the State licensing requirement, which is implemented by the Bureau's Regulation H, 12 CFR part 1008, and by State law.

D.   The Dodd-Frank Act

The Dodd-Frank Act expanded on previous efforts by lawmakers and regulators to strengthen loan originator qualification requirements and regulate industry compensation practices. Public Law 111–203, 124 Stat. 1376 (approved July 21, 2010). The Dodd-Frank Act adopted several new provisions concerning the compensation and qualifications of mortgage originators, defined related terms, and prohibited certain arbitration and credit insurance financing practices. *See* Dodd-Frank Act sections 1401, 1402, 1403, and 1414. Section 1401 of the Dodd-Frank Act amended TILA section 103 to add definitions of the term "mortgage originator" and of other terms relating to mortgage loan origination. 15 U.S.C. 1602. Section 1402 of the Dodd-Frank Act amended TILA section 129 by redesignating existing text and adding section 129B to require mortgage originators to meet qualification standards and depository institutions to establish and maintain procedures reasonably designed to assure compliance with these qualification standards, the loan originator registration procedures established pursuant to the SAFE Act, and the other requirements of TILA section 129B. TILA section 129B also requires mortgage originators to provide their license or registration number on loan documents. 15 U.S.C. 1639b. Section 1403 of the Dodd-Frank Act amended new TILA section 129B to prohibit loan originator compensation that varies based on the terms of the loan, other than the amount of the principal, and generally to prohibit loan originators from being compensated simultaneously by both the consumer and a person other than the consumer. Section 1403 of the Dodd-Frank Act also added new TILA section 129B(c)(2), which would generally have prohibited consumers from paying upfront points or fees on transactions in which the loan originator compensation is paid by the creditor (either to the creditor's own employee or to a mortgage broker). However, TILA section 129B(c)(2) also authorized the Bureau to waive or create exemptions from the prohibition on upfront points and fees if the Bureau determines that doing so would be in the interest of consumers and in the public interest. Section 1414 of the Dodd-Frank Act amended new TILA section 129C, in part to prohibit certain financing practices for single-premium credit insurance and debt cancellation or suspension agreements and to restrict mandatory arbitration agreements.

III. Summary of Rulemaking Process

A. Pre-Proposal Outreach

In developing a proposal to implement sections 1401, 1402, 1403, and 1414 of the Dodd-Frank Act, the Bureau conducted extensive outreach. Bureau staff met with and held in-depth conference calls with large and small bank and non-bank mortgage creditors, mortgage brokers, trade associations, secondary market participants, consumer groups, nonprofit organizations, and State regulators. Discussions covered existing business models and compensation practices and the impact of the existing 2010 Loan Originator Compensation Final Rule. They also covered the Dodd-Frank Act provisions and the impact on consumers, loan originators, lenders, and secondary market participants of various options for implementing the statutory provisions. The Bureau developed several of the proposed clarifications of existing regulatory requirements in response to compliance inquiries and with input from industry participants.

In addition, the Bureau held roundtable meetings with other Federal banking and housing regulators, consumer groups, and industry representatives regarding the Small Business Review Panel Outline. At the Bureau's request, many of the participants provided feedback, which the Bureau considered in preparing the proposed rule as well as this final rule.

B. Small Business Review Panel

In May 2012, the Bureau convened a Small Business Review Panel with the Chief Counsel for Advocacy of the Small Business Administration (SBA Advocacy) and the Administrator of the Office of Information and Regulatory Affairs within the Office of Management and Budget (OMB).[48] As part of this process, the Bureau prepared an outline of the proposals then under consideration and the alternatives considered (Small Business Review Panel Outline), which the Bureau posted on its website for review by the general public as well as the small entities participating in the panel process.[49] The Small Business Review Panel gathered information from representatives of small creditors, mortgage brokers, and not-for-profit organizations and made findings and recommendations regarding the potential compliance costs and other impacts of the proposed rule on those entities. These findings and recommendations were set forth in the Small Business Review Panel Report, which was made

[48] The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) requires the Bureau to convene a Small Business Review Panel before proposing a rule that may have a substantial economic impact on a significant number of small entities. *See* Pub. L. 104-121, tit. II, 110 Stat. 847, 857 (1996) (as amended by Pub. L. 110-28, section 8302 (2007)).

[49] U.S. Consumer Fin. Prot. Bureau, *Outline of Proposals under Consideration and Alternatives Considered* (May 9, 2012), available at: http://files.consumerfinance.gov/f/201205_cfpb_MLO_SBREFA_Outline_of_Proposals.pdf .

part of the administrative record in this rulemaking.[50] The Bureau carefully considered these findings and recommendations in preparing the proposed rule.

C. Proposed Rule

On September 7, 2012, the Bureau published a proposed rule in the Federal Register to implement the Dodd-Frank Act requirements, as well as to revise and clarify existing regulations and commentary on loan originator compensation. 77 FR 55272 (Sept. 7, 2012) (the "2012 Loan Originator Compensation Proposal"). The proposal included the following main provisions:

1. Restrictions on Loan Originator Compensation

The proposal would have adjusted existing rules governing compensation to loan officers and mortgage brokers in connection with closed-end mortgage transactions to account for the Dodd-Frank Act and to provide greater clarity and flexibility. Specifically, the proposal would have 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), with some refinements.

Pricing Concessions: The proposal would have allowed loan originators to reduce their compensation to cover unanticipated increases in closing costs from non-affiliated third parties under certain circumstances.

Proxies: The proposal would have clarified when a factor used as a basis for compensation is prohibited as a "proxy" for a transaction term.

Profit-sharing: The proposal would have clarified and revised restrictions on pooled compensation, profit-sharing, and bonus plans for loan originators by permitting contributions

[50] U.S. Consumer Fin. Prot. Bureau, U.S. Small Bus. Admin., and U.S. Office of Mgmt. and Budget, *Final Report of the Small Business Review Panel on CFPB's Proposals Under Consideration for Residential Mortgage Loan Origination Standards Rulemaking* (July 11, 2012) (Small Business Review Panel Final Report), *available at* http://files.consumerfinance.gov/f/201208_cfpb_LO_comp_SBREFA.pdf.

from general profits derived from mortgage activity to 401(k) plans, employee stock plans, and other "qualified plans" under tax and employment law. The proposal would have permitted payment of bonuses or 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 a limited percentage of its total revenues. The proposal solicited comment on other alternatives to the measure based on company revenue, including an individual loan originator total compensation test.

Dual Compensation: The proposal would have continued the general ban on loan originators being compensated by both consumers and other persons but would have allowed mortgage brokerage firms that are paid by the consumer to pay their individual brokers a commission, so long as the commission is not based on the terms of the transaction.

2. Restriction on Upfront Points and Fees

The Bureau proposed to use its exemption authority under the Dodd-Frank Act to allow creditors and loan originator organizations to continue making available loans with consumer-paid upfront points or fees, so long as they also make available a comparable, alternative loan without those points or fees. The proposal generally would have required that, before a creditor or loan originator organization may impose upfront points or fees on a consumer in a closed-end mortgage transaction, the creditor must make available to the consumer a comparable, alternative loan with no upfront discount points, origination points, or origination fees that are retained by the creditor, broker, or an affiliate of either (a "zero-zero alternative"). The requirement would not have applied where the consumer is unlikely to qualify for the zero-zero alternative. The Bureau solicited comments on variations and alternatives to this approach.

3. Loan Originator Qualification Requirements

The proposal would have implemented the Dodd-Frank Act provision requiring each loan originator both to be "qualified" and to include his or her NMLSR ID on certain specified loan documents. The proposal would have required loan originator organizations to ensure their loan originators not already required to be licensed under the SAFE Act meet character, fitness, and criminal background check standards that are similar to SAFE Act requirements and receive training commensurate with their duties. The loan originator organization and the individual loan originators that are primarily responsible for a particular transaction would have been required to list their NMLSR ID and names on certain key loan documents.

4. Other Provisions

The proposal would have banned both agreements requiring consumers to submit any disputes that may arise to mandatory arbitration rather than filing suit in court, and the financing of premiums for credit insurance.

D. Overview of Public Comments

The Bureau received 713 comments on the 2012 Loan Originator Compensation Proposal. The comments came from individual consumers, consumer groups, community banks, large banks, large bank holding companies, secondary market participants, credit unions, nonbank servicers, State and national trade associations for financial institutions, local and national community groups, Federal and State regulators, academics, and other interested parties. Although some commenters provided comments on all of the major provisions of the 2012 Loan Originator Compensation Proposal, most commenters focused on specific aspects of the proposal, as discussed in greater detail in the section-by-section analysis below.

Many commenters addressed the proposed provisions regarding records that creditors and loan originator organizations would have been required to maintain to demonstrate compliance with the compensation-related provisions of the proposal. The majority of commenters agreed with the Bureau's belief that the proposed increase in the recordkeeping period from two years to three years would not significantly increase costs. Some commenters asked for clarification regarding what types of records would be required to be maintained.

Numerous commenters addressed the proposed definition of "loan originator," which determines which persons would be subject to several of the provisions in the proposal. The topic that the largest number of commenters addressed was the exception from the definition of "loan originator" for certain persons who provide financing to consumers who purchase a dwelling from these persons (*i.e.*, "seller financing"). Individuals, industry professionals, and small business owners commented that the Bureau had overlooked the impact that the proposal would have on consumers, stating that it would reduce access to credit for some while eliminating a reliable retirement vehicle for others.

A large number of commenters addressed the Bureau's proposal to allow creditors to charge upfront origination points, discounts, and fees in transactions in which someone other than the consumer pays compensation to a loan originator, provided that the creditor make available to the consumer loan terms without upfront origination points, discount points, or fees (*i.e.*, the zero-zero alternative). One of the most common assertions from commenters relating to points and fees was that the zero-zero alternative restrictions were duplicative of other regulations, or that the restrictions being implemented in other rules were sufficient and more effective at protecting consumers.

Many banks, credit unions, and mortgage professionals expressed concern that prohibiting discount points would result in higher interest rates, could reduce access to credit for consumers, and would subject the creditors to higher-priced mortgage rules. Banks and credit unions opined that complying with the proposal would make lower-value loans unprofitable and banks and credit unions would no longer be able to profitably serve that segment of the market.

A significant number of commenters asserted that the proposal would have a negative impact on affiliated businesses, namely inconvenience, reduced pricing advantages, and duplicative processes. Other commenters advocated exempting fees for title services from the types of compensation treated as loan originator compensation when it is paid to an affiliate. Several commenters asserted that a restriction on title services would not benefit consumers and could detrimentally limit consumers' credit options.

There was no consensus among consumer groups on whether, or how, the Bureau should use its exemption authority regarding the statutory ban on consumers paying upfront points and fees. Some industry commenters advocated adjustments or alternatives to the zero-zero proposal, rather than a complete exemption, although the approaches varied by commenter.

A large number of comments addressed qualification standards for loan originators who are not subject to State licensing requirements. Representatives of banks stated that the proposed requirements were duplicative of existing requirements. Representatives of nonbank creditors and brokers argued that the proposal was too lenient, would allow for unqualified loan originators to work at depository institutions, and would create an unfair competitive advantage for these institutions.

E. Post-Proposal Outreach

After the proposal was issued, the Bureau held roundtable meetings with other Federal banking and housing regulators, consumer groups, and industry representatives to discuss the proposal and the final rule. At the Bureau's request, many of the participants provided feedback, which the Bureau has considered in preparing the final rule.

F. Other Rulemakings

In addition to this final rule, the Bureau is adopting several other final rules and issuing one proposal, all relating to mortgage credit to implement requirements of title XIV of the Dodd-Frank Act. The Bureau is also issuing a final rule jointly with other Federal agencies to implement requirements for mortgage appraisals in title XIV. Each of the final rules follows a proposal issued in 2011 by the Board or in 2012 by the Bureau alone or jointly with other Federal agencies. Collectively, these proposed and final rules are referred to as the Title XIV Rulemakings.

- *Ability to Repay*: The Bureau recently issued a rule, following a May 2011 proposal issued by the Board (the Board's 2011 ATR Proposal), 76 FR 27390 (May 11, 2011), to implement provisions of the Dodd-Frank Act (1) requiring creditors to determine that a consumer has a reasonable ability to repay covered mortgage loans and establishing standards for compliance, such as by making a "qualified mortgage," and (2) establishing certain limitations on prepayment penalties, pursuant to TILA section 129C as established by Dodd-Frank Act sections 1411, 1412, and 1414. 15 U.S.C. 1639c. The Bureau's final rule is referred to as the 2013 ATR Final Rule. Simultaneously with the 2013 ATR Final Rule, the Bureau issued a proposal to amend the final rule implementing the ability-to-repay requirements, including by the addition of exemptions for certain nonprofit creditors and certain homeownership stabilization programs and a definition of a "qualified mortgage" for certain loans made and held in portfolio by small creditors (the 2013 ATR Concurrent Proposal). The Bureau expects to act on the 2013 ATR Concurrent Proposal on an expedited basis, so that any exceptions or adjustments to the 2013 ATR Final Rule can take effect simultaneously with that rule.

- *Escrows*: The Bureau recently issued a rule, following a March 2011 proposal issued by the Board (the Board's 2011 Escrows Proposal), 76 FR 11598 (Mar. 2, 2011), to implement certain provisions of the Dodd-Frank Act expanding on existing rules that require escrow accounts to be established for higher-priced mortgage loans and creating an exemption for certain loans held by creditors operating predominantly in rural or underserved areas, pursuant to TILA section 129D as established by Dodd-Frank Act sections 1461. 15 U.S.C. 1639d. The Bureau's final rule is referred to as the 2013 Escrows Final Rule.
- *HOEPA*: Following its July 2012 proposal (the 2012 HOEPA Proposal), 77 FR 49090 (Aug. 15, 2012), the Bureau recently issued a final rule to implement Dodd-Frank Act requirements expanding protections for "high-cost mortgages" under the Homeownership and Equity Protection Act (HOEPA), pursuant to TILA sections 103(bb) and 129, as amended by Dodd-Frank Act sections 1431 through 1433. 15 U.S.C. 1602(bb) and 1639. The Bureau recently issued rules to implement certain title XIV requirements concerning homeownership counseling, including a requirement that lenders provide lists of homeownership counselors to applicants for federally related mortgage loans, pursuant to RESPA section 5(c), as amended by Dodd-Frank Act section 1450. 12 U.S.C. 2604(c). The Bureau's final rule is referred to as the 2013 HOEPA Final Rule.

- *Servicing*: Following its August 2012 proposals (the 2012 RESPA Servicing Proposal and 2012 TILA Servicing Proposal), 77 FR 57200 (Sept. 17, 2012) (RESPA); 77 FR 57318 (Sept. 17, 2012) (TILA), the Bureau recently issued final rules to implement Dodd-Frank Act requirements regarding force-placed insurance, error resolution, information requests, and payment crediting, as well as requirements for mortgage loan periodic statements and adjustable-rate mortgage reset disclosures, pursuant to section 6 of RESPA and sections 128, 128A, 129F, and 129G of TILA, as amended or established by Dodd-Frank Act sections 1418, 1420, 1463, and 1464. 12 U.S.C. 2605; 15 U.S.C. 1638, 1638a, 1639f, and 1639g. The Bureau also recently finalized rules on early intervention for troubled and delinquent borrowers, and loss mitigation procedures, pursuant to the Bureau's authority under section 6 of RESPA, as amended by Dodd-Frank Act section 1463, to establish obligations for mortgage servicers that it finds to be appropriate to carry out the consumer protection purposes of RESPA, and its authority under section 19(a) of RESPA to prescribe rules necessary to achieve the purposes of RESPA. The Bureau's final rule under RESPA with respect to mortgage servicing also establishes requirements for general servicing standards policies and procedures and continuity of contact pursuant to its authority under section 19(a) of RESPA. The Bureau's final rules are referred to as the 2013 RESPA Servicing Final Rule and the 2013 TILA Servicing Final Rule, respectively.
- *Appraisals*: The Bureau, jointly with other Federal agencies,[51] is issuing a final rule implementing Dodd-Frank Act requirements concerning appraisals for higher-risk mortgages, pursuant to TILA section 129H as established by Dodd-Frank Act section 1471.

[51] Specifically, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Federal Housing Finance Agency.

15 U.S.C. 1639h. This rule follows the agencies' August 2012 joint proposal (the 2012 Interagency Appraisals Proposal). 77 FR 54722 (Sept. 5, 2012). The agencies' joint final rule is referred to as the 2013 Interagency Appraisals Final Rule. In addition, following its August 2012 proposal (the 2012 ECOA Appraisals Proposal), 77 FR 50390 (Aug. 21, 2012), the Bureau is issuing a final rule to implement provisions of the Dodd-Frank Act requiring that creditors provide applicants with a free copy of written appraisals and valuations developed in connection with applications for loans secured by a first lien on a dwelling, pursuant to section 701(e) of the Equal Credit Opportunity Act (ECOA) as amended by Dodd-Frank Act section 1474. 15 U.S.C. 1691(e). The Bureau's final rule is referred to as the 2013 ECOA Appraisals Final Rule.

The Bureau is not at this time finalizing proposals concerning various disclosure requirements that were added by title XIV of the Dodd-Frank Act, integration of mortgage disclosures under TILA and RESPA, or a simpler, more inclusive definition of the finance charge for purposes of disclosures for closed-end mortgage transactions under Regulation Z. The Bureau expects to finalize these proposals and to consider whether to adjust regulatory thresholds under the Title XIV Rulemakings in connection with any change in the calculation of the finance charge later in 2013, after it has completed quantitative testing, and any additional qualitative testing deemed appropriate, of the forms that it proposed in July 2012 to combine TILA mortgage disclosures with the good faith estimate (RESPA GFE) and settlement statement (RESPA settlement statement) required under RESPA, pursuant to Dodd-Frank Act section 1032(f) and sections 4(a) of RESPA and 105(b) of TILA, as amended by Dodd-Frank Act sections 1098 and 1100A, respectively (the 2012 TILA-RESPA Proposal). 77 FR 51116 (Aug. 23, 2012). Accordingly, the Bureau already has issued a final rule delaying implementation of various affected title XIV disclosure provisions. 77 FR 70105 (Nov. 23, 2012). The Bureau's approaches to coordinating the implementation of the Title XIV Rulemakings and to the finance charge proposal are discussed in turn below.

G. Coordinated Implementation of Title XIV Rulemakings

As noted in all of its foregoing proposals, the Bureau regards each of the Title XIV Rulemakings as affecting aspects of the mortgage industry and its regulations. Accordingly, as noted in its proposals, the Bureau is coordinating carefully the Title XIV Rulemakings, particularly with respect to their effective dates. The Dodd-Frank Act requirements to be implemented by the Title XIV Rulemakings generally will take effect on January 21, 2013, unless final rules implementing those requirements are issued on or before that date and provide for a different effective date. *See* Dodd-Frank Act section 1400(c), 15 U.S.C. 1601 note. In addition, some of the Title XIV Rulemakings are to take effect no later than one year after they are issued. *Id.*

The comments on the appropriate implementation date for this final rule are discussed in detail below in part VI of this notice. In general, however, consumer groups requested that the Bureau put the protections in the Title XIV Rulemakings into effect as soon as practicable. In contrast, the Bureau received some industry comments indicating that implementing so many new requirements at the same time would create a significant cumulative burden for creditors. In addition, many commenters also acknowledged the advantages of implementing multiple revisions to the regulations in a coordinated fashion.[52] Thus, a tension exists between

[52] Of the several final rules being adopted under the Title XIV Rulemakings, six entail amendments to Regulation Z, with the only exceptions being the 2013 RESPA Servicing Final Rule (Regulation X) and the 2013 ECOA Appraisals Final Rule (Regulation B); the 2013 HOEPA Final Rule also amends Regulation X, in addition to Regulation Z. The six Regulation Z final rules involve numerous instances of intersecting provisions, either by cross-references to each other's provisions or by adopting parallel provisions. Thus, adopting some of those

coordinating the adoption of the Title XIV Rulemakings and facilitating industry's implementation of such a large set of new requirements. Some have suggested that the Bureau resolve this tension by adopting a sequenced implementation, while others have requested that the Bureau simply provide a longer implementation period for all of the final rules.

The Bureau recognizes that many of the new provisions will require creditors and loan originators to make changes to automated systems and, further, that most administrators of large systems are reluctant to make too many changes to their systems at once. At the same time, however, the Bureau notes that the Dodd-Frank Act established virtually all of these changes to institutions' compliance responsibilities, and contemplated that they be implemented in a relatively short period of time. And, as already noted, the extent of interaction among many of the Title XIV Rulemakings necessitates that many of their provisions take effect together. Finally, notwithstanding commenters' expressed concerns for cumulative burden, the Bureau expects that creditors and loan originators actually may realize some efficiencies from adapting their systems for compliance with multiple new, closely related requirements at once, especially if given sufficient overall time to do so.

Accordingly, the Bureau is requiring that, as a general matter, creditors, loan originators, and other affected persons begin complying with the final rules on January 10, 2014. As noted above, section 1400(c) of the Dodd-Frank Act requires that some provisions of the Title XIV Rulemakings take effect no later than one year after the Bureau issues them. Accordingly, the Bureau is establishing January 10, 2014, one year after issuance of the Bureau's 2013 ATR, Escrows, and HOEPA Final Rules (*i.e.*, the earliest of the title XIV final rules), as the baseline

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amendments without also adopting certain other, closely related provisions would create significant technical issues, *e.g.*, new provisions containing cross-references to other provisions that do not yet exist, which could undermine the ability of creditors and other parties subject to the rules to understand their obligations and implement appropriate systems changes in an integrated and efficient manner.

effective date for most of the Title XIV Rulemakings. The Bureau believes that, on balance, this approach will facilitate the implementation of the rules' overlapping provisions, while also affording creditors sufficient time to implement the more complex or resource-intensive new requirements.

The Bureau has identified certain rulemakings or selected aspects thereof, however, that do not present significant implementation burdens for industry, including § 1026.36(h) and (i) of this final rule. Accordingly, the Bureau is setting earlier effective dates for these paragraphs and certain other final rules or aspects thereof, as applicable. The effective dates for this final rule are set forth and explained in part VI. The effective dates for the other final rules are discussed in the Federal Register notices for those rules.

More Inclusive Finance Charge Proposal

As noted above, the Bureau proposed in the 2012 TILA-RESPA Proposal to make the definition of finance charge more inclusive, thus rendering the finance charge and annual percentage rate a more useful tool for consumers to compare the cost of credit across different alternatives. 77 FR 51116, 51143 (Aug. 23, 2012). Because the new definition would include additional costs that are not currently counted, it would cause the finance charges and APRs on many affected transactions to increase. This in turn could cause more such transactions to become subject to various compliance regimes under Regulation Z. Specifically, the finance charge is central to the calculation of a transaction's "points and fees," which in turn has been (and remains) a coverage threshold for the special protections afforded "high-cost mortgages" under HOEPA. Points and fees also will be subject to a 3-percent limit for purposes of determining whether a transaction is a "qualified mortgage" under the 2013 ATR Final Rule. Meanwhile, the APR serves as a coverage threshold for HOEPA protections as well as for certain protections afforded “higher-priced mortgage loans” under § 1026.35, including the mandatory escrow account requirements being amended by the 2013 Escrows Final Rule. Finally, because the 2013 Interagency Appraisals Final Rule uses the same APR-based coverage test as is used for identifying higher-priced mortgage loans, the APR affects that rulemaking as well. Thus, the proposed more inclusive finance charge would have had the indirect effect of increasing coverage under HOEPA and the escrow and appraisal requirements for higher-priced mortgage loans, as well as decreasing the number of transactions that may be qualified mortgages – even holding actual loan terms constant – simply because of the increase in calculated finance charges, and consequently APRs, for closed-end mortgage transactions generally.

As noted above, these expanded coverage consequences were not the intent of the more inclusive finance charge proposal. Accordingly, as discussed more extensively in the Escrows Proposal, the HOEPA Proposal, the ATR Proposal, and the Interagency Appraisals Proposal, the Board and subsequently the Bureau (and other agencies) sought comment on certain adjustments to the affected regulatory thresholds to counteract this unintended effect. First, the Board and then the Bureau proposed to adopt a “transaction coverage rate” for use as the metric to determine coverage of these regimes in place of the APR. The transaction coverage rate would have been calculated solely for coverage determination purposes and would not have been disclosed to consumers, who still would have received only a disclosure of the expanded APR. The transaction coverage rate calculation would exclude from the prepaid finance charge all costs otherwise included for purposes of the APR calculation except charges retained by the creditor, any mortgage broker, or any affiliate of either. Similarly, the Board and Bureau proposed to reverse the effects of the more inclusive finance charge on the calculation of points and fees; the points and fees figure is calculated only as a HOEPA and qualified mortgage coverage metric and is not disclosed to consumers. The Bureau also sought comment on other potential mitigation measures, such as adjusting the numeric thresholds for particular compliance regimes to account for the general shift in affected transactions' APRs.

The Bureau's 2012 TILA-RESPA Proposal sought comment on whether to finalize the more inclusive finance charge proposal in conjunction with the Title XIV Rulemakings or with the rest of the TILA-RESPA Proposal concerning the integration of mortgage disclosure forms. 77 FR 51116, 51125 (Aug. 23, 2012). Upon additional consideration and review of comments received, the Bureau decided to defer a decision whether to adopt the more inclusive finance charge proposal and any related adjustments to regulatory thresholds until it later finalizes the TILA-RESPA Proposal. 77 FR 54843 (Sept. 6, 2012); 77 FR 54844 (Sept. 6, 2012).[53] Accordingly, the 2013 Escrows, HOEPA, ATR, and Interagency Appraisals Final Rules all are deferring any action on their respective proposed adjustments to regulatory thresholds.

IV. Legal Authority

On July 21, 2011, section 1061 of the Dodd-Frank Act transferred to the Bureau the "consumer financial protection functions" previously vested in certain other Federal agencies, including the Board. The term "consumer financial protection function" is defined to include "all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines." 12 U.S.C. 5581(a)(1). TILA is a Federal consumer financial law. Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining "Federal consumer financial law" to include the "enumerated consumer laws" and the provisions of title X of the Dodd-Frank

[53] These notices extended the comment period on the more inclusive finance charge and corresponding regulatory threshold adjustments under the 2012 TILA-RESPA and HOEPA Proposals. They did not change any other aspect of either proposal.

Act); Dodd-Frank Act section 1002(12), 12 U.S.C. 5481(12) (defining “enumerated consumer laws’’ to include TILA). Accordingly, the Bureau has authority to issue regulations pursuant to TILA. This final rule is issued on January 20, 2013, in accordance with 12 CFR 1074.1.

A. The Truth in Lending Act

TILA Section 103(cc)(2)(E)(v)

As added by the Dodd-Frank Act, TILA section 103(cc)(2)(E)(v), 15 U.S.C. 1602(cc)(2)(E)(v) authorizes the Bureau to prescribe other criteria that seller financers need to meet, aside from those enumerated in the statute, to qualify for the seller financer exclusion from the definition of the term “mortgage originator. The Bureau’s exercise of that authority is discussed in the section-by-section analysis of the seller financer exclusion.

TILA Section 105(a)

As amended by the Dodd-Frank Act, TILA section 105(a), 15 U.S.C. 1604(a), directs the Bureau to prescribe regulations to carry out the purposes of TILA, and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. The purpose of TILA 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.” TILA section 102(a); 15 U.S.C. 1601(a). These stated purposes are tied to Congress’s finding that “economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit.” TILA section 102(a). Thus, strengthened competition among financial institutions is a goal of TILA, achieved through the effectuation of TILA's purposes. In addition, TILA section 129B(a)(2) establishes a purpose of TILA sections 129B and 129C to "assure consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive." 15 U.S.C. 1639b(a)(2).

Historically, TILA section 105(a) has served as a broad source of authority for rules that promote the informed use of credit through required disclosures and substantive regulation of certain practices. However, Dodd-Frank Act section 1100A clarified the Bureau's section 105(a) authority by amending that section to provide express authority to prescribe regulations that contain "additional requirements" that the Bureau finds are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. This amendment clarified the authority to exercise TILA section 105(a) to prescribe requirements beyond those specifically listed in the statute that meet the standards outlined in section 105(a). The Dodd-Frank Act also clarified the Bureau's rulemaking authority over certain high-cost mortgages pursuant to section 105(a). As amended by the Dodd-Frank Act, the Bureau's TILA section 105(a) authority to make adjustments and exceptions to the requirements of TILA applies to all transactions subject to TILA, except with respect to the substantive protections of TILA section 129, 15 U.S.C. 1639,[54] which apply to the high-cost mortgages referred to in TILA section 103(bb), 15 U.S.C. 1602(bb).

This final rule implements the Dodd-Frank Act requirements and establishes such additional requirements, adjustments, and exceptions as, in the Bureau's judgment, are necessary and proper to carry out the purposes of TILA, prevent circumvention or evasion thereof, or to

[54] TILA section 129 contains requirements for certain high-cost mortgages, established by HOEPA, which are commonly called HOEPA loans.

facilitate compliance. In developing these aspects of the final rule pursuant to its authority under TILA section 105(a), the Bureau has considered the purposes of TILA, including ensuring meaningful disclosures, facilitating consumers' ability to compare credit terms, and helping consumers avoid the uninformed use of credit, as well as ensuring consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive. In developing this final rule and using its authority under TILA section 105(a), the Bureau also has considered the findings of TILA, including strengthening competition among financial institutions and promoting economic stabilization.

TILA Section 129B(c)

Dodd-Frank Act section 1403 amended TILA section 129B by imposing two limitations on loan originator compensation to reduce or eliminate steering incentives for residential mortgage loans.[55] 15 U.S.C. 1639b(c). First, it generally prohibits loan originators from receiving compensation for any residential mortgage loan that varies based on the terms of the loan, other than the amount of the principal. Second, TILA section 129B generally allows only consumers to compensate loan originators, though an exception permits other persons to pay "an origination fee or charge" to a loan originator, but only if two conditions are met: (1) the loan originator does not receive any compensation directly from a consumer; and (2) the consumer does not make an upfront payment of discount points, origination points, or fees (other than bona

[55] Section 1403 of the Dodd-Frank Act also added new TILA section 129B(c)(3), which requires the Bureau to prescribe regulations to prohibit certain kinds of steering, abusive or unfair lending practices, mischaracterization of credit histories or appraisals, and discouraging consumers from shopping with other mortgage originators. 15 U.S.C. 1639b(c)(3). This final rule does not address those provisions. Because they are structured as a requirement that the Bureau prescribe regulations establishing the substantive prohibitions, notwithstanding Dodd-Frank Act section 1400(c)(3), 15 U.S.C. 1601 note, the Bureau believes that the substantive prohibitions cannot take effect until the regulations establishing them have been prescribed and taken effect. The Bureau intends to prescribe such regulations in a future rulemaking. Until such time, no obligations are imposed on mortgage originators or other persons under TILA section 129B(c)(3).

fide third-party fees that are not retained by the creditor, the loan originator, or the affiliates of either). The Bureau has authority to prescribe regulations to prohibit the above practices. In addition, TILA section 129B(c)(2)(B)(ii) authorizes the Bureau to create exemptions from the exception's second prerequisite, that the consumer must not make any upfront payments of points or fees, where the Bureau determines that doing so "is in the interest of consumers and in the public interest."

TILA Section 129(p)(2)

The Dodd-Frank Act amended TILA by adding, in new section 129, a broad mandate to prohibit certain acts and practices in the mortgage industry. In particular, TILA section 129(p)(2), as redesignated by Dodd-Frank Act section 1433(a) and amended by Dodd-Frank Act section 1100A, requires the Bureau to prohibit, by regulation or order, acts or practices in connection with mortgage loans that the Bureau finds to be unfair, deceptive, or designed to evade the provisions of HOEPA. 15 U.S.C. 1639(p)(2). Likewise, TILA requires the Bureau to prohibit, by regulation or order, acts or practices in connection with the refinancing of mortgage loans that the Bureau finds to be associated with abusive lending practices, or that are otherwise not in the interest of the consumer. *Id.*

The authority granted to the Bureau under TILA section 129(p)(2) is broad. It reaches mortgage loans with rates and fees that do not meet HOEPA's rate or fee trigger in TILA section 103(bb), 15 U.S.C. 1602(bb), as well as mortgage loans not covered under that section. TILA section 129(p)(2) is not limited to acts or practices by creditors, or to loan terms or lending practices.

TILA Section 129B(e)

Dodd-Frank Act section 1405(a) amended TILA to add new section 129B(e), 15 U.S.C. 1639b(e). That section, as amended by Dodd-Frank Act section 1100A, provides for the Bureau to prohibit or condition terms, acts, or practices relating to residential mortgage loans on a variety of bases, including when the Bureau finds the terms, acts, or practices are not in the interest of the consumer. In developing proposed rules under TILA section 129B(e), the Bureau has considered all of the bases for its authority set forth in that section.

TILA Section 129C(d)

Dodd-Frank Act section 1414(a) amended TILA to add new section 129C(d), 15 U.S.C. 1639c(d). That section prohibits the financing of certain single-premium credit insurance products. As discussed more fully in the section-by-section analysis below, the Bureau is proposing to implement this prohibition in new § 1026.36(i).

TILA Section 129C(e)

Dodd-Frank Act section 1414(a) amended TILA to add new section 129C(e), 15 U.S.C. 1639c(e). That section restricts mandatory arbitration agreements in residential mortgage loans and extensions of open-end credit secured by the consumer's principal dwelling. It also prohibits provisions of these loans and related agreements from being applied or interpreted to bar a consumer from bringing a Federal claim in court. As discussed more fully in the section-by-section analysis below, the Bureau is proposing to implement these restrictions in new § 1026.36(h).

B. The Dodd-Frank Act

Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof." 12

U.S.C. 5512(b)(1). TILA and title X of the Dodd-Frank Act are Federal consumer financial laws. Accordingly, the Bureau is exercising its authority under Dodd-Frank Act section 1022(b)(1) to prescribe rules that carry out the purposes and objectives of TILA and title X and prevent evasion of those laws.

V. Section-by-Section Analysis of the Final Rule

This final rule implements new TILA sections 129B(b)(1), (b)(2), (c)(1), and (c)(2) and 129C(d) and (e), as added by sections 1402, 1403, and 1414(a) of the Dodd-Frank Act. As discussed in more detail in the section-by-section analysis of § 1026.36(f) and (g), TILA section 129B(b)(1) requires each mortgage originator to be qualified and include unique identification numbers on loan documents. As discussed in more detail in the section-by-section analysis of § 1026.36(d)(1) and (2), TILA section 129B(c)(1) and (2) prohibits “mortgage originators” in “residential mortgage loans” from receiving compensation that varies based on loan terms and from receiving origination charges or fees from persons other than the consumer except in certain circumstances. Additionally, as discussed in more detail in the section-by-section analysis of § 1026.36(i), TILA section 129C(d) creates prohibitions on single-premium credit insurance. As discussed in the section-by-section analysis of § 1026.36(h), TILA section 129C(e) provides restrictions on mandatory arbitration agreements and waivers of Federal claims. Finally, as discussed in more detail in the section-by-section analysis of §1026.36(j), TILA section 129B(b)(2), requires the Bureau to prescribe regulations requiring depository institutions to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions, the subsidiaries of such institutions, and the employees of such institutions or subsidiaries with the requirements of TILA section 129B and the registration procedures established under section 1507 of the SAFE Act, 12 U.S.C. 5101 *et seq*.

Section 1026.25 Record Retention

Existing § 1026.25 requires creditors to retain evidence of compliance with Regulation Z. The Bureau proposed adding § 1026.25(c)(2) to establish record retention requirements for compliance with the loan originator compensation restrictions in TILA section 129B as implemented by § 1026.36(d). Proposed section 1026.25(c)(2) would have: (1) extended the time period for retention by creditors of compensation-related records from two years to three years; (2) required loan originator organizations (*i.e.*, generally, mortgage broker companies) to maintain certain compensation-related records for three years; and (3) clarified the types of compensation-related records that are required to be maintained under the rule. Proposed § 1026.25(c)(3) would have required creditors to maintain records evidencing compliance with the requirements related to discount points and origination points or fees set forth in proposed § 1026.36(d)(2)(ii).

25(a) General Rule

Existing comment 25(a)-5 clarifies the nature of the record retention requirements under § 1026.25 as applied to Regulation Z's loan originator compensation provisions. The comment provides that, for each transaction subject to the loan originator compensation provisions in § 1026.36(d)(1), a creditor should maintain records of the compensation it provided to the loan originator for the transaction as well as the compensation agreement in effect on the date the interest rate was set for the transaction. The comment also states that where a loan originator is a mortgage broker, a disclosure of compensation or other broker agreement required by applicable

State law that complies with § 1026.25 is presumed to be a record of the amount actually paid to the loan originator in connection with the transaction.

The Bureau proposed new § 1026.25(c)(2), which sets forth certain new record retention requirements for compensation paid to loan originators, as discussed below. The Bureau also proposed new comments 25(c)(2)-1 and -2, which incorporate substantially the same interpretations as existing comment 25(a)-5. For the sake of improved organization of the commentary and to prevent duplication, the Bureau proposed to remove existing comment 25(a)-5. No substantive change was intended by this proposal. The Bureau received no public comments on the proposal to remove comment 25(a)-5. Therefore, this final rule is removing comment 25(a)-5 as unnecessary, consistent with the proposed rule.

25(c) Records Related to Certain Requirements for Mortgage Loans

25(c)(2) Records Related to Requirements for Loan Originator Compensation

Three-Year Record Retention

TILA does not contain requirements to retain specific records, but § 1026.25 requires creditors to retain evidence of compliance with Regulation Z for two years after the date disclosures are required to be made or action is required to be taken. Section 1404 of the Dodd-Frank Act amended TILA section 129B, which imposes substantive restrictions on loan originator compensation and provides civil liability for any mortgage originator for failure to comply with the requirements of TILA section 129B and any of its implementing regulations. 15 U.S.C. 1639b(d). Section 1416(b) of the Dodd-Frank Act amended section 130(e) of TILA to provide a three-year limitations period for civil actions alleging a violation of certain sections of TILA, including section 129B concerning loan originator compensation, beginning on the date of the occurrence of the violation. 15 U.S.C. 1640(e). Prior to amendment by the Dodd-Frank Act, the limitations period for individual actions alleging violations of TILA was generally one year. 15 U.S.C. 1640(e) (2008). In view of the statutory changes to TILA, the provisions of existing § 1026.25, which impose a two-year record retention period, do not reflect the applicable limitations period for causes of action that may be brought under TILA section 129B. Moreover, the record retention provisions in § 1026.25 currently are limited to creditors, whereas the compensation restrictions in TILA section 129B, as added by the Dodd-Frank Act, cover all mortgage originators and not solely creditors.

To reflect these statutory changes, the Bureau proposed § 1026.25(c)(2), which would have made two changes to the existing record retention provisions. First, the proposed rule would have required that a creditor maintain records sufficient to evidence the compensation it pays to a loan originator and the governing compensation agreement, for three years after the date of payment. Second, the proposed rule would have required a loan originator organization to maintain for three years records of the compensation: (1) it receives from a creditor, a consumer, or another person; and (2) it pays to any individual loan originators. The loan originator organization also must maintain the compensation agreement that governs those receipts or payments for three years after the date of the receipts or payments. The Bureau proposed these changes pursuant to its authority under section 105(a) of TILA to prevent circumvention or evasion of TILA by requiring records that can be used to establish compliance. The Bureau stated its belief that these proposed modifications would ensure records associated with loan originator compensation are retained for a time period commensurate with the statute of limitations for causes of action under TILA section 130 and are readily available for examination. In addition, the Bureau stated its belief that the modifications are necessary to prevent circumvention of and to facilitate compliance with TILA.

The Bureau recognized that increasing the period a creditor must retain records for specific information related to loan originator compensation from two years, as currently provided in Regulation Z, to three years may impose some marginal increase in the creditor's compliance burden in the form of incremental cost of storage. The Bureau stated its belief, however, that creditors should be able to use existing recordkeeping systems to maintain the records for an additional year at minimal cost. Similarly, although loan originator organizations would incur some costs to establish and maintain recordkeeping systems, the Bureau expected that loan originator organizations would be able to adopt at minimal cost their existing recordkeeping systems to serve these newly required purposes. During the Small Business Review Panel, the Small Entity Representatives were asked about their current record retention practices and the potential impact of the proposed enhanced record retention requirements. Of the few Small Entity Representatives that provided feedback on the issue, one creditor Small Entity Representative stated that it maintained detailed records of compensation paid to all of its employees and that a regulator already reviews its compensation plans regularly. Another creditor Small Entity Representative reported that it did not believe that the proposed record retention requirement would require it to change its current practices.

In addition, the Bureau recognized that applying the existing two-year record retention period to information specified in § 1026.25(c)(2) could adversely affect the ability of consumers to bring actions under TILA. As the Bureau stated in the proposal, the extension also would serve to reduce litigation risk and maintain consistency between creditors and loan originator organizations. The Bureau therefore believed that it was appropriate to expand the time period for record retention to effectuate the three-year statute of limitations period established by Congress for actions against loan originators under section 129B of TILA.

Most commenters agreed that extending the retention period from two years to three years would not significantly increase the cost of compliance. Though some commenters opined that the changes in § 1026.25(c) would significantly increase their compliance burden, those comments appeared to be directed to the proposed record retention provisions related to proposed restrictions on discount points and origination points or fees in proposed § 1026.36(d)(2)(ii). Because the Bureau is not finalizing in this rule the points and fees proposal (or the attendant record retention requirement), the additional record retention requirement imposed by this final rule is minimal.

The Bureau invited public comment on whether a record retention period of five years, rather than three years, would be appropriate. The Bureau explained that relevant actions and compensation practices that must be evidenced in retained records may in some cases occur prior to the beginning of the three-year period of enforceability that applies to a particular transaction. In addition, the running of the three-year period may be tolled under some circumstances, resulting in a period of enforceability that ends more than three years following an occurrence of a violation of applicable requirements. Accordingly, the proposal stated that a record retention period that is longer than three years may help ensure that consumers are able to avail themselves of TILA protections while imposing minimal incremental burden on creditors and loan originators. The Bureau noted that many State and local laws related to transactions involving real property may set a record retention period, or may depend on the information being available, for five years. Additionally, a five-year record retention period would be consistent with proposed provisions in the Bureau's 2012 TILA-RESPA Proposal.

Most commenters objected to a five-year record retention period as overly burdensome. In addition, the implementing regulations of the Paperwork Reduction Act (PRA) require that there be a showing of “substantial need” to impose a record retention requirement of longer than three years. 5 CFR 1320.5(d)(2)(iv). Given the PRA’s preference for retention periods of three years or less, the Bureau is adopting § 1026.25(c)(2)’s three-year retention period as proposed, notwithstanding some of the noted advantages of a longer retention period.[56]

Application to Loan Originator Organizations

The Bureau stated in the proposal that it would be necessary to require both creditors and loan originator organizations to retain for three years evidence of compliance with the requirements of § 1026.36(d)(1). Although creditors would retain some of the records needed to demonstrate compliance with TILA section 129B and its implementing regulations, in some circumstances, the records would be available solely from the loan originator organization. For example, if a creditor compensates a loan originator organization for originating a transaction and the loan originator organization in turn allocates a portion of that compensation to an individual loan originator as a commission, the creditor may not possess a copy of the commission agreement setting forth the arrangement between the loan originator organization and the individual loan originator or any record of the payment of the commission. The Bureau stated that applying this requirement to both creditors and loan originator organizations would prevent circumvention of and facilitate compliance with TILA, as amended by the Dodd-Frank Act.

The Bureau did not receive any comments regarding the extension of the record retention requirements to loan originator organizations. Because the Bureau continues to believe that requiring loan originator organizations to retain records related to compensation will facilitate

[56] The language of §1025(c)(2)(i) is revised slightly from the proposal for the sake of simplicity. The proposal would have required a creditor to maintain records reflecting compensation paid to “a loan originator organization or the creditor’s individual loan originators.” The final rule requires a creditor to maintain records reflecting compensation paid “to a loan originator, as defined in § 1026.36(a)(1).” No substantive change is intended.

compliance with TILA, the Bureau is adopting § 1026.25(c)(2)'s applicability to loan originator organizations as proposed.

Exclusion of Individual Loan Originators

Proposed § 1026.25(c)(2) would not have applied Regulation Z recordkeeping requirements to individual loan originators. Although section 129B(d) of TILA, as added by the Dodd-Frank Act, permits consumers to bring actions against mortgage originators (which include individual loan originators), the Bureau stated its belief that applying the record retention requirements of § 1026.25 to individual loan originators is unnecessary. Under § 1026.25 as proposed, loan originator organizations and creditors would have been required to retain certain records regarding all of their individual loan originators. The preamble stated that applying the same record retention requirements to the individual loan originator employees themselves would be duplicative. In addition, such a requirement might not be feasible in all cases, because individual loan originators might not have access to the types of records required to be retained under § 1026.25, particularly after they cease to be employed by the creditor or loan originator organization. Under the proposal, an individual loan originator who is a sole proprietor, however, would have been responsible for compliance with provisions that apply to the proprietorship (which is a loan originator organization) and, as a result, is responsible for compliance with the record retention requirements. Similarly, a natural person who is a creditor would have been subject to the requirements that apply to creditors.

The Bureau did not receive comments on the exclusion of individual loan originators. For the reasons discussed above, the Bureau is adopting § 1026.25(c)(2) without making it applicable to individual loan originators, as proposed. The Bureau notes that while the preamble to the proposal discussed individual loan originator employees, the exclusion applies to all individual loan originators, as that term is defined in § 1026.36(a)(1), whether or not employees.

Substance of Record Retention Requirements

As discussed above, proposed § 1026.25(c)(2) would have made two changes to the existing record retention provisions. First, § 1026.25(c)(2)(i) would have required a creditor to maintain for three years records sufficient to evidence all compensation it pays to a loan originator and a copy of the governing compensation agreement. Second, § 1026.25(c)(2)(ii) would have required a loan originator organization to maintain for three years records of all compensation that it receives from a creditor, a consumer, or another person or that it pays to its individual loan originators and a copy of the compensation agreement that governs those receipts or payments.

Proposed comment 25(c)(2)-1.i would have clarified that, under § 1026.25(c)(2), records are sufficient to evidence that compensation was paid and received if they demonstrate facts enumerated in the comment. The comment gives examples of the types of records that, depending on the facts and circumstances, may be sufficient to evidence compliance. One commenter expressed concern that the comment could be read to require retention of *all* records listed; however, the comment clearly states that the records listed are examples only and what records would be sufficient would be dependent on the facts and circumstances and would vary on a case-by-case basis. To prevent any uncertainty, however, the comment is clarified to describe which records might be sufficient depending on the type of compensation at issue in certain circumstances. For example, the comment explains that, for compensation in the form of a contribution to or benefit under a designated tax-advantaged retirement plan, records to be maintained might include copies of required filings under other applicable statutes relating to such plans, copies of the plan and amendments thereto and the names of any loan originators covered by such plans, or determination letters from the Internal Revenue Service (IRS) regarding such plans. The Bureau is also clarifying the comment by removing the reference to certain agreements being "presumed" to be a record of the amount of compensation actually paid to the loan originator. Instead, as revised, the comment provides that such agreements are a record of the amount actually paid to the loan originator unless actual compensation deviates from the amount in the disclosure or agreement.

The Bureau is further revising comment 25(c)(2)-1.i to indicate that if compensation has been decreased 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 pursuant to section 5(c) of RESPA (or omitted from that disclosure), records to be maintained are those documenting the decrease in compensation and the reasons for it. This revision corresponds with changes to the commentary to § 1026.36(d)(1) clarifying that the section prohibits a loan originator from reducing its compensation to bear the cost of a change in transaction terms except to defray such unforeseen increases in settlement cost. Retaining these records will allow for agency examination about whether a particular decrease in loan originator compensation is truly based on unforeseen increases to settlement costs, *i.e.*, whether it indicates a pattern or practice of the loan originator repeatedly decreasing loan originator compensation to defray the costs of pricing concessions for the same categories of settlement costs across multiple transactions. Like other records sufficient to evidence compensation paid to loan originators, the Bureau believes that records of decreases in loan originator compensation in unforeseen circumstances to defray the costs of increased settlement cost above those estimated should be retained for a time period commensurate with the statute of limitations for causes of action under

TILA section 130 and be readily available for examination, which is necessary to prevent circumvention of and to facilitate compliance with TILA.

Proposed comment 25(c)(2)-1.ii would have clarified that the compensation agreement, evidence of which must be retained under 1026.25(c)(2), is any agreement, written or oral, or course of conduct that establishes a compensation arrangement between the parties. Proposed comment 25(c)(2)-1.iii provided an example where the expiration of the three-year retention period varies depending on when multiple payments of compensation are made. Proposed comment 25(c)(2)-2 provided an example of retention of records sufficient to evidence payment of compensation. The Bureau did not receive any public comment on these proposed comments. The Bureau is adopting comments 25(c)(2)-1.iii and 25(c)(2)-2 as proposed. Comment 25(c)(2)-1.ii is revised slightly from the proposal to clarify that where a compensation agreement is oral or based on a course of conduct and cannot itself be maintained, the records to be maintained are those, if any, evidencing the existence or terms of the oral or course of conduct compensation agreement.

25(c)(3) Records Related to Requirements for Discount Points and Origination Points or Fees

Proposed § 1026.25(c)(3) would have required creditors to retain records pertaining to compliance with the provisions of proposed § 1026.36(d)(2)(ii), regarding the payment of discount points and origination points or fees. Because the Bureau is not adopting proposed § 1026.36(d)(2)(ii), as discussed in the section-by-section analysis of that section, below, the Bureau is not adopting proposed § 1026.25(c)(3).

Section 1026.36 Prohibited Acts or Practices and Certain Requirements for Credit Secured by a Dwelling

The Bureau is redesignating comment 36-1 as comment 36(b)-1. The analysis of § 1026.36(b) discusses comment 36(b)-1 in further detail.

Existing comment 36-2 provides that the final rules on loan originator compensation in § 1026.36(d) and (e), which were originally published in the Federal Register on September 24, 2010, apply to transactions for which the creditor receives an application on or after the effective date, which was in April 2011. The comment further provides an example for the treatment of applications received on March 25 or on April 8 of 2011. The Bureau is removing this comment because it is no longer relevant.

36(a) Definitions

TILA section 103(cc), which was added by section 1401 of the Dodd-Frank Act, contains definitions of "mortgage originator" and "residential mortgage loan." These definitions are important to determine the scope of new substantive TILA requirements added by the Dodd-Frank Act, including, the scope of restrictions on loan originator compensation; the requirement that loan originators be "qualified;" policies and procedures to ensure compliance with various requirements; and the prohibitions on mandatory arbitration, waivers of Federal claims, and single premium credit insurance. *See* TILA sections 129B(b)(1) and (2), (c)(1) and (2) and 129C(d) and (e), as added by sections 1402, 1403, and 1414(a) of the Dodd-Frank Act. In the proposal, the Bureau noted that the statutory definitions largely parallel analogous definitions in the 2010 Loan Originator Final Rule and other portions of Regulation Z for "loan originator" and "consumer credit transaction secured by a dwelling," respectively.

The proposal explained the Bureau's intent to retain the existing regulatory terms to maximize continuity, while adjusting the regulation and commentary to reflect differences between the existing Regulation Z definition of "loan originator" and the new TILA definition of "mortgage originator" and to provide additional interpretation and clarification. In the case of "residential mortgage loan" and "consumer credit transaction secured by a dwelling," the Bureau did not propose to make any changes to the regulation or commentary.

Finally, the proposal would have added three new definitions germane to the scope of the compensation restrictions and other aspects of the proposal: (1) "loan originator organization" in new § 1026.36(a)(1)(ii); (2) "individual loan originator" in new § 1026.36(a)(1)(iii); and (3) "compensation" in new § 1026.36(a)(3).

As noted in part III.F above, the Bureau separately is adopting several other final rules and issuing one proposal, all relating to mortgage credit, to implement requirements of title XIV of the Dodd-Frank Act. Two of those final rules, the 2013 ATR Final Rule and 2013 HOEPA Final Rule, require creditors to calculate the points and fees charged in connection with a transaction to determine whether certain coverage tests under those rules have been met. Both of these rules generally require that creditors include in the points and fees calculation all "compensation" paid directly or indirectly by a consumer or creditor to a "loan originator,"[57] terms that are defined broadly in this final rule. While the Bureau believes that such broad definitions are well-suited to achieving the Dodd-Frank Act's goals for this rulemaking, the Bureau believes that it may be appropriate to interpret the terms more narrowly in the 2013 ATR and HOEPA Final Rules. The present rule, for example, contains a prohibition against paying compensation to a loan originator based upon loan terms. It would entirely defeat the purpose of this rule if a creditor were free to pay discretionary bonuses after a transaction was consummated based upon the terms of that transaction and thus for purposes of this rule the term compensation

[57] Specifically, as adopted in the 2013 ATR Final Rule, § 1026.32(b)(1)(ii) provides that points and fees for a closed-end credit transaction include "[a]ll compensation paid directly or indirectly by a consumer or creditor to a loan originator, as defined in § 1026.36(a)(1), that can be attributed to that transaction at the time the interest rate is set."

cannot be limited to payments made, or determined, at particular moments in time. In contrast, in the ATR and HOEPA contexts, the terms loan originator and compensation are used to define a discrete input into the points and fees calculation that needs to be made at a specific moment in time in order to determine whether the coverage tests are met. Thus, § 1026.32(b)(1)(ii) and associated commentary, as adopted in the 2013 ATR Final Rule, provide that compensation must be included in points and fees for a particular transaction only if such compensation can be attributed to that particular transaction at the time the interest rate is set. The commentary also provides examples of compensation types (*e.g.*, base salary) that, in the Bureau's view, are not attributable to a particular transaction and therefore are excluded from the points and fees calculation.

At the same time the Bureau issued the 2013 ATR and HOEPA Final Rules, the Bureau also issued the 2013 ATR Concurrent Proposal, which seeks public comment on other aspects of the definitions of "compensation" and "loan originator" for purposes of the points and fees calculation. Among other things, the proposal solicits comment on whether additional guidance would be useful in the ATR and HOEPA contexts for the treatment of compensation paid to persons who are "loan originators" but who are not employed by a creditor or mortgage broker (*e.g.*, certain employees of manufactured home retailers, servicers, and other parties that do not meet exclusions specified in this rule). Because of the overlapping issues addressed in these rules, the Bureau is carefully considering how these rules interact and requests comment in the concurrent proposal on whether there are additional factors that the Bureau should consider to harmonize the various provisions.

36(a)(1) Loan Originator

36(a)(1)(i)

Existing § 1026.36(a)(1) defines the term “loan originator” for purposes of § 1026.36. Section 1401 of the Dodd-Frank Act defines the term “mortgage originator” in TILA section 103(cc)(2). As discussed further below, both definitions are similar to but not identical with the SAFE Act definition of “loan originator” for purposes of national registration and licensing requirements.

The proposal would have retained the term “loan originator” in § 1026.36, but would have made some changes to the definition and associated commentary to reflect certain distinctions in the Dodd-Frank Act’s definition of mortgage originator. In the proposed rule, the Bureau stated that the regulatory definition of “loan originator” was generally consistent with the statutory definition of “mortgage originator.” The Bureau also noted “loan originator” has been in wide use since first adopted by the Board in 2010. The Bureau posited that changes to the terminology would likely require stakeholders to make corresponding revisions in many aspects of their operations, including policies and procedures, compliance materials, and software and training.

A few credit union commenters urged the Bureau to use “mortgage originator” instead of “loan originator” to distinguish the terminology and its scope of coverage from those of the SAFE Act and its implementing regulations, Regulations G and H, which refer to a covered employee at a non-depository institution as a “loan originator” and a covered employee at a depository institution as a “mortgage loan originator.” The Bureau has considered the comment, but continues to believe that the burdens outlined in the proposal would outweigh any of the potential benefits garnered by signaling differences in meaning. Thus, the final rule retains the terminology “loan originator.”

Although the Bureau proposed to retain the term “loan originator,” it did propose changes to the definition of the term in § 1026.36(a)(1) to reflect the scope of the term “mortgage originator” under section 103(cc)(2) of TILA. Specifically, the statute states “mortgage originator”:

> (A) means any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain—(i) takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan;
>
> (B) includes any person who represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such person can or will provide any of the services or perform any of the activities described in subparagraph A.

TILA section 103(cc)(4) further defines “assists a consumer in obtaining or applying to obtain a residential mortgage loan” to include, among other things, advising on terms, preparing loan packages, or collecting information on behalf of the consumer. TILA section 103(cc)(2)(C) through (G) provides certain exclusions from the general definition of mortgage originator, including an exclusion for certain administrative and clerical staff. These various elements are discussed further below.

Existing § 1026.36(a)(1) defines “loan originator” as: “with respect to a particular transaction, a person who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person." The Bureau proposed to redesignate § 1026.36(a)(1) as § 1026.36(a)(1)(i) and explained that the phrase "arranges, negotiates, or otherwise obtains an extension of consumer credit for another person" in the definition of "loan originator" encompassed a broad variety of activities[58] including those described in new TILA section 103(cc)(2) with respect to the definition of "mortgage originator."

Nevertheless, the Bureau proposed to revise the general definition of loan originator and associated commentary to include a person who "takes an application, arranges, offers, negotiates, or otherwise obtains an extension of credit for another person" as well as to make certain other revisions to the existing definition of "loan originator" to reflect new TILA section 103(cc)(2). The proposal explained that the Bureau interpreted "arranges" broadly to include any task that is part of the process of originating a credit transaction, including advertising or communicating to the public that one can perform loan origination services and referring a consumer to any other person who participates in the origination process.[59] Participating in the origination process, in turn, includes any task involved in the loan origination process, from commencing the process of originating a transaction through arranging consummation of the credit transaction (subject to certain exclusions). That is, the definition includes both persons who participate in arranging a credit transaction with others and persons who arrange the transaction entirely, including initially contacting and orienting the consumer to a particular loan originator's or creditor's origination process, assisting the consumer to apply for a loan, taking

[58] This view is consistent with the Board's related rulemakings on this issue. *See* 75 FR 58509, 58518 (Sept. 24, 2010); 74 FR 43232, 43279 (Aug. 26, 2009); 73 FR 44522, 44565 (July 30, 2008); 73 FR 1672, 1726 (Jan. 9, 2008); 76 FR 27390, 27402 (May 11, 2011).

[59] Arrange is defined by the Merriam-Webster Online Dictionary to include: (1) "to put into a proper order or into a correct or suitable sequence, relationship, or adjustment"; (2) "to make preparations for"; and (3) "to bring about an agreement or understanding concerning." *Arrange Definition*, Merriam-Webster.com, *available at*: http://www.merriam-webster.com/dictionary/arrange.

the application, offering and negotiating transaction terms, and making arrangements for consummation of the credit transaction.

The Bureau also stated that “arranges, negotiates, or otherwise obtains an extension of consumer credit for another person” in the existing definition of “loan originator” already included the following activities specified in TILA section 103(cc)(2)(A): (1) taking a loan application; (2) assisting a consumer in obtaining or applying to obtain a loan; and (3) offering or negotiating terms of a loan. Nevertheless, to remove any uncertainty and facilitate compliance, the Bureau proposed to add “takes an application” and “offers,” as used in TILA section 103(cc)(2)(A), to the definition of “loan originator” in § 1026.36(a) to state expressly that these core elements were included in the definition of “loan originator.” Similarly, proposed comment 36(a)-1.i.A would have stated that “loan originator” includes persons who assist a consumer in obtaining or applying to obtain a loan, including each specific activity identified in the statute as included in the meaning of “assist.”

Most commenters did not focus on the proposed revised definition as a whole, but rather on specific activities that they believed should or should not be included in the general definition of loan originator. Manufactured housing financers generally commented that the proposed definition should include a more expansive list of specific activities that conform to those detailed by HUD’s SAFE Act rulemakings for inclusion or exclusion from the definition of loan originator in Regulation H and its appendix A, with some modifications to exclude more employee activities. Some non-depository institution commenters stated that the proposed definition of “loan originator” should be more closely aligned with the SAFE Act definition. Many depository institution commenters stated that the proposed definition was overly broad because it included persons who normally would not be considered loan originators and should instead be narrowed to be similar to the definition of "mortgage loan originator" specified by the Federal banking agencies in their regulations implementing the SAFE Act. *See* 75 FR 44656 (July 28, 2010).

As discussed in the proposal and in more detail below, the Dodd-Frank Act gives broad meaning to the term "mortgage originator," and the Bureau therefore believes it appropriate to give the regulatory term "loan originator" equally broad meaning. In light of commenters' concerns regarding particular activities covered by the definition, the Bureau also believes more clarity should be provided regarding the specific activities that are included or excluded by the definition of loan originator. In the following discussion, the Bureau first addresses why it is adopting a broad definition of "loan originator" and then explains specific elements of the definition and related comments.

Congress defined "mortgage originator" for the purposes of TILA, as amended by the Dodd-Frank Act, to be broader than its definition of "loan originator" in the SAFE Act, which it enacted just two years previously. Moreover, although Congress adopted legislation that effectively codified major provisions of the Board's 2009 Loan Originator Proposal, Congress used broader language than the Board had proposed.[60] Under the Dodd-Frank Act amendments to TILA section 103(cc)(2)(A), a person is a "mortgage originator" for TILA purposes if the person engages in *any one* of the following activities for, or in expectation of, direct or indirect compensation or gain: (1) takes a loan application; (2) assists a consumer in obtaining or applying to obtain a loan; or (3) offers or negotiates terms of a loan. Under the SAFE Act a person is a "loan originator" *only* if the person engages in both of the following activities: (1)

[60] The Board's proposal defined a loan originator as one who for gain "arranges, negotiates or otherwise obtains an extension of consumer credit." The Board finalized this definition in its 2010 Loan Originator Final Rule.

takes a residential mortgage loan application; and (2) offers or negotiates terms of a residential mortgage loan for compensation or gain. 12 U.S.C. 5102(4).

Thus, there are three main differences between the two definitions, in terms of the activities involved.[61] First, any individual element under TILA, as amended by the Dodd-Frank Act, qualifies the person as a mortgage originator, while the SAFE Act requires that an individual must participate in both taking an application and offering or negotiating terms to trigger the statute's requirements. Second, the TILA definition of "mortgage originator" is separately triggered by assisting a consumer in obtaining or applying to obtain a loan, which is further defined under TILA to include, among other things, advising on terms, preparing loan packages, or collecting information on behalf of the consumer, while the SAFE Act does not specifically reference this activity. Third, "mortgage originator" under TILA section 103(cc)(2)(B) further includes "any person who represents to the public through advertising or other means of communicating or providing information . . . that such person can or will provide any of the services or perform any of the activities" described in TILA section 103(cc)(2)(A).

The Bureau believes that these differences between definitions evidence a congressional intention when enacting the Dodd-Frank Act to cast a wide net to ensure consistent regulation of a broad range of persons that may have financial incentives and opportunities to steer consumers to credit transactions with particular terms early in the origination process. The statutory definition even includes persons who simply inform consumers that they can provide mortgage origination services, prior to and independent of actually providing such services. The Bureau also believes that both TILA and the SAFE Act evidence a congressional concern specifically about the risk that trusted advisers or first-in-time service providers could steer consumers to

[61] Another difference, not pertinent here, is that the SAFE Act's "loan originator" includes only natural persons, whereas TILA's "mortgage originator" can include organizations.

particular credit providers, products, and terms. Thus, for instance, the Bureau notes that in both laws Congress specifically included real estate brokers that are compensated by a creditor or mortgage broker in the definitions of “mortgage originator” and “loan originator” respectively. 15 U.S.C. 1602(cc)(2)(D), 12 U.S.C. 5103(3)(A)(iii).

For the reasons stated above and as discussed more extensively below, the Bureau is redesignating § 1026.36(a)(1) as § 1026.36(a)(1)(i) and revising the general definition of loan originator in § 1026.36(a)(1)(i). The Bureau also is adopting additional provisions in, and commentary to, § 1026.36(a)(1) to provide further clarification and analysis for specific activities included or excluded from the definition of “loan originator.” As described further below, the Bureau is defining “loan originator” in § 1026.36(a)(1)(i) to include a person who 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. The Bureau is also providing clarifications that address a variety of specific actions such as taking an application, management, underwriting, and administrative or clerical tasks, as well as the treatment of particular types of persons such as real estate brokers, seller financers, housing counselors, financial advisors, accountants, servicers and employees of manufactured home retailers. The revisions to § 1026.36(a)(1)(i) further clarify that, to be a loan originator, a person needs only to receive or expect to receive direct or indirect compensation in connection with performing loan origination activities. The revisions additionally remove the phrase “with respect to a particular transaction” from the existing definition to clarify that the definition applies to persons engaged in the activities it describes regardless of whether any specific consumer credit transaction is consummated. Moreover, comment 36(a)-1.i.B clarifies that the definition of loan originator includes not only employees but also agents and contractors of a creditor or mortgage broker that satisfy the definition.

Takes an Application, Offers, Arranges, Assists a Consumer, Negotiates, or Otherwise Obtains or Makes

As described above, TILA section 103(cc)(2) defines "mortgage originator" to include a person who "takes a residential mortgage loan application," "assists a consumer in obtaining or applying to obtain a residential mortgage loan," or "offers or negotiates terms of a residential mortgage loan." TILA section 103(cc)(4) provides that a person "assists a consumer in obtaining or applying to obtain a residential mortgage loan" by taking actions such as "advising on residential mortgage loan terms (including rates, fees, and other costs), preparing residential mortgage loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan."

The Bureau proposed comment 36(a)-1.i.A to provide further interpretation of the proposed phrase, "takes an application, offers, arranges, negotiates, or otherwise obtains," to clarify the phrase's applicability in light of these statutory provisions. Specifically, the Bureau proposed to clarify in comment 36(a)-1.i.A that the definition of "loan originator" and, more specifically, "arranges" also includes all of the activities listed in TILA 103(cc)(4) that define the term "assists a consumer in obtaining or applying for consumer credit," including advising on credit terms, preparing application packages (such as a loan or pre-approval application or supporting documentation), and collecting information on behalf of the consumer to submit to a loan originator or creditor. The comment also would have included any person that advertises or communicates to the public that such person can or will provide any of the listed services or activities. The Bureau addresses each of these and additional activities in the "takes an application," "offers, "arranges," "assists," and "negotiates or otherwise obtains or makes" analyses below.

Takes an application. The Bureau proposed to add "takes an application," as used in the definition of "mortgage originator" in TILA section 103(cc)(2)(A), to the definition of "loan originator" in § 1026.36(a). A few industry groups and several manufactured housing financers raised concerns that the proposal did not define or provide any interpretation of the phrase. One manufactured housing financer commented that the mere physical act of writing (or typing) information onto an application form on behalf of a consumer was a purely administrative and clerical act that should not be considered taking an application. This commenter indicated that such activity serves the interest of low-income consumers who may be uncomfortable with the home buying and credit application processes. The commenter further noted that completing the application in this manner ensures that the credit information is accurately conveyed and clearly written to avoid unnecessary delays in the application process. Another industry group commenter suggested that, under the proposal, merely delivering a completed application to a loan officer, without more, would qualify as "takes an application."

In the proposal, the Bureau noted that, in connection with the application process, certain minor actions alone would not be included in the definition of loan originator. For instance, the proposal stated that physically handling a completed application form to deliver it to a loan officer would not constitute acting as a loan originator where the person performing the delivery does not assist the consumer in completing the application, process or analyze the information reflected in the application, or discuss specific transaction terms or products with the consumer. Instead, these activities would be considered administrative and clerical and thus within TILA section 103(cc)(2)(C)'s express exclusion from the definition of "mortgage originator" of persons who perform “purely administrative and clerical tasks on behalf of mortgage originators.” In light of the comments received, the Bureau is revising comment 36(a)-4.i in the final rule to state explicitly that such activities are not included in the definition of loan originator.

The Bureau believes, however, that filling out a consumer’s application, inputting the information into an online application or other automated system, and taking information from the consumer over the phone to complete the application should be considered “tak[ing] an application” for the purposes of the rule. The Bureau believes that individuals performing these functions play an important enough role in the origination process that they should be subject to the requirements the Dodd-Frank Act establishes with respect to loan originators, including the prohibition on compensation that creates steering incentives. Consumers providing information for an application during the initial stages of the origination process are susceptible to steering influences that could be harmful. For example, the application taker could submit or characterize the application in a way that is more favorable to the application taker while limiting the consumer’s options or qualifying the consumer for a transaction the consumer cannot repay. Or, when taking in the information provided by the consumer the application taker could encourage a consumer to seek certain credit terms or products. The Bureau is revising comment 36(a)-1.i.A and comment 36(a)-4.i to clarify which activities do or do not constitute “tak[ing] an application” by discussing how persons merely aiding a consumer to understand how to complete an application would not be engaged in taking an application, while persons who actually fill out the application are taking an application.

Offers. The Bureau proposed to revise the general definition of loan originator and associated commentary to include a person who “offers” an extension of credit. This revision would reflect new TILA section 103(cc)(2) that includes in the definition of "mortgage originator" persons who "offer" terms of a residential mortgage loan.

In proposed comment 36(a)-1 and the supplementary information of the proposal, the Bureau explained that "arranges" would also include any task that is part of the process of originating a credit transaction, including advertising or communicating to the public by a person that the person can perform loan origination services, as well as referring a consumer to any other person who participates in the origination process. Several industry associations, banks, and manufactured housing finance commenters urged the Bureau not to include in the definition of "loan originator" bank tellers, receptionists, customer service representatives, or others who periodically refer consumers to loan originators. A large bank commenter indicated that the TILA definition of mortgage originator does not expressly include employees who perform referral activities.

Prior to the transfer of TILA rulemaking authority to the Bureau, the Board interpreted the definition of loan originator to include referrals when such activity was performed for compensation or other monetary gain or in the expectation of compensation or other monetary gain. The Bureau further notes that HUD also interpreted the SAFE Act "offers and negotiates" to include referrals. Specifically, Regulation H, as restated by the Bureau, provides in 12 CFR 1008.103(c)(2)(i)(C):

> An individual "offers or negotiates terms of a residential mortgage loan for compensation or gain" if the individual: . . . (C) Recommends, refers, or steers a borrower or prospective borrower to a particular lender or set of residential mortgage loan terms, in accordance with a duty to or incentive from any person

other than the borrower or prospective borrower . . . . 76 FR 78483, 78493 (Dec. 19, 2011). *See also* 76 FR 38464, 38495 (June 30, 2011).

The Federal banking agencies, when implementing the SAFE Act, did not specifically address whether referral activities are included in "offers or negotiates" terms of a loan. However, the agencies noted that activities considered to be offering or negotiating loan terms do not require a showing that an employee received a referral fee. *See* 75 FR 44656 (July 28, 2010). Thus, the agencies appear to have contemplated that referral activity is included in the meaning of "offers or negotiates" terms of a loan.

To maintain consistency with Regulation H and to facilitate compliance, the Bureau interprets "offers" for purposes of the definition of loan originator in § 1026.36(a)(1) to include persons who: (1) present for consideration by a consumer particular credit terms; or (2) recommend, refer, or steer a consumer to a particular loan originator, creditor, credit terms, or credit product. The Bureau believes that, even at initial stages of the mortgage origination process, persons who recommend, refer, or steer consumers to a particular loan originator, creditor, set of credit terms, or credit product could have influence over the particular credit products or credit terms that a consumer seeks or ultimately obtains. Moreover, because to be a loan originator someone who offers credit must do so for, or in the expectation of, direct or indirect compensation or gain, there not only is an incentive to steer the consumer to benefit the referrer but the referrer is also effectively participating in the extending of an offer of consumer credit on behalf of the person who pays the referrer's compensation. The Bureau believes that the statute was intended to reach such situations and that it appropriately regulates these activities without imposing significant burdens.[62]

For instance, most persons engaged in compensated referral activities (*e.g.*, employees being paid by their employers for referral activities) receive a flat fee for each referral. A flat fee is permissible under the existing and final rule, which in § 1026.36(d)(1) generally prohibits loan originators from receiving compensation that is based on a term of a transaction but permits compensation based on the amount of the transaction or on a flat per-transaction basis. Accordingly, application of the regulation will not require a change in compensation practices where referrers are compensated on a flat fee basis. However, if referrers were to receive compensation based on transaction terms, the Bureau believes such persons would also likely be incentivized to steer consumers to particular transaction terms that may be harmful to the consumers. Moreover, most consumers are likely unaware that the person referring or recommending a particular creditor or a particular credit product may have a financial incentive to do so. There is even less consumer sensitivity to these potential harms when a trusted advisor is engaged in such referral activity. As also discussed in the proposal, the Bureau believes that one of the primary focuses of the Dodd-Frank Act and this rulemaking is to prevent such incentives.

[62] The Bureau also believes that referral activities are encompassed within the language "assists a consumer in obtaining or applying to obtain a residential mortgage loan" in TILA section 103(cc)(2). TILA section 103(cc)(4) provides that "'a person assists a consumer in obtaining or applying to obtain a residential mortgage loan' by, among other things, advising on residential mortgage loan terms.…" The Bureau believes that "among other things" encompasses referral, which is a form of advising a consumer on where to obtain consumer credit. To the extent there is any uncertainty with respect to whether a person engaging in referral activity for or in expectation of direct or indirect compensation is a loan originator, the Bureau is also exercising its authority under TILA section 105(a) to prescribe rules that contain additional requirements, differentiations, or other provisions. The Bureau believes that this adjustment is necessary or proper to effectuate the purposes of TILA and to prevent circumvention or evasion thereof.

Similarly, the Bureau believes that provisions of the final rule requiring loan originators to be appropriately "qualified" under § 1026.36(f), with regard to background checks, character screening, and training of loan originators, also will not be significantly burdensome. The Bureau believes that many referrers employed by non-depository institutions likely already meet the rule's qualification requirements. States that follow the interpretation of the SAFE Act in Regulation H already require certain persons who refer consumers, according to a duty or incentive, to obtain a loan originator license. Furthermore, in contrast with Regulation H, as described above, many States have enacted a broader definition of loan originator than is required under the SAFE Act by using the disjunctive, *i.e.*, takes an application "or" offers or negotiates, with the result that persons who refer are already subject to State loan originator licensing requirements in those States even if they do not also "take an application."[63] Individuals who are licensed under the SAFE Act are not subject to additional substantive requirements to be "qualified" under this final rule, as discussed further in the section-by-section analysis of § 1026.36(f) and (g) concerning loan originator qualification requirements.

The Bureau additionally believes that employees of depository institutions likely also already meet many of the final rule's criminal background and fitness qualification requirements in new § 1026.36(f) because they are subject to background-check requirements under the Federal Deposit Insurance Act or Federal Credit Union Act. Moreover, the qualification training requirements of this final rule for depository institution loan originators specify that the training be commensurate with the individual's loan origination activities. Accordingly, training that fulfills the final rule's qualification requirements for persons whose only loan origination

[63] See the section-by-section analysis of § 1026.36(f) and (g) below for additional background on the SAFE Act.

activities are referrals is relatively modest as also further discussed in the section-by-section analysis of § 1026.36(f) and related commentary.

As discussed further below, the Bureau is providing greater clarification in comment 36(a)-4 to explain that administrative staff who provide contact or general information about available credit in response to requests from consumers generally are not for that reason alone loan originators. For example, an employee who provides a loan originator's or creditor's contact information to a consumer in response to the consumer's request does not become a loan originator, provided that the teller or receptionist does not discuss particular credit terms and does not refer the consumer, based on the teller's or receptionist's assessment of the consumer's financial characteristics, to a certain loan originator or creditor seeking to originate particular transactions to consumers with those financial characteristics. In contrast, a referral occurs (and an employee is a loan originator) when, for example, a bank teller asks a consumer if the consumer is interested in refinance loans with low introductory rates and provides contact information for a loan originator based on the teller's assessment of information provided by the consumer or available to the teller regarding the consumer's financial characteristics.[64]

The Bureau is revising comment 36(a)-1.i.A.*1* to clarify that the definition of loan originator includes a person who refers a consumer (when the referral activities are engaged in for compensation or other monetary gain) to a loan originator or creditor or an employee, agent, or contractor of a loan originator or creditor. The Bureau is further clarifying the definition of "referral" as generally including any oral or written action directed to a consumer that can affirmatively influence the consumer to select a particular loan originator or creditor to obtain an

[64] The Bureau believes that a referral based on the employee's assessment of the financial characteristics of the consumer occurs only if an individual in fact has the discretion to choose to direct a consumer to a particular loan originator.

extension of credit when the consumer will pay for such credit. In comment 36(a)-1.i.A.*2* the Bureau is clarifying that arranging a credit transaction is one of the activities that can make a person a "loan originator." The Bureau is also clarifying in comment 36(a)-1.i.A.*4* that the definition of "loan originator" includes a person who presents for consideration by a consumer particular credit terms or communicates with a consumer for the purpose of reaching a mutual understanding about prospective credit terms.

The Bureau is revising comment 36(a)-4 to clarify that the loan originator definition, nevertheless, does not include persons who (whether or not for or in the expectation of compensation or gain): (1) provide general explanations, information, or descriptions in response to consumer queries, such as explaining terminology or lending policies; (2) as employees of a creditor or loan originator, provide loan originator or creditor contact information in response to the consumer's request, provided that the employee does not discuss particular transaction terms and does not refer the consumer, based on the employee's assessment of the consumer's financial characteristics, to a particular loan originator or creditor seeking to originate particular transactions to consumers with those financial characteristics; (3) describe product-related services; or (4) explain or describe the steps that a consumer would need to take to obtain a credit offer, including providing general clarification on qualifications or criteria that would need to be met that is not specific to that consumer's circumstances.

Arranges. The Board's 2010 Loan Originator Final Rule defined "loan originator" in § 1026.36(a)(1) as: "with respect to a particular transaction, a person who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person." The proposal would have broadly clarified "arranges" to include, for example, any part of the process of originating a credit transaction, including advertising or communicating to the public that one can perform origination services and referring a consumer to another person who participates in the process of originating a transaction. The clarification in proposed comment 36(a)-1.i.A would have included both persons who participate in arranging a credit transaction with others and persons who arrange the transaction entirely, including through initial contact with the consumer, assisting the consumer to apply for mortgage credit, taking the application, offering and negotiating transaction terms, and making arrangements for consummation of the credit transaction.

The term “arranges” is not part of the definition of mortgage originator in TILA section 103(cc)(2)(A) as enacted by the Dodd-Frank Act. Nevertheless, the Bureau proposed to preserve the existing regulation’s use of the term and, as noted, indicated its belief that the term subsumes many of the activities described in the statutory definition. The Bureau did not propose to include the statutory “assists a consumer” element, for example, for this reason. As discussed below, however, the Bureau is including that element in the final definition. The Bureau therefore considered removing “arranges” from the definition in this final rule. To prevent any inference that the final rule narrows the definition of loan originator, however, the Bureau has kept the term in the final rule.

Several industry groups and a manufactured housing finance commenter stated that the Bureau’s proposed interpretation of “arranges” was overbroad. Several commenters questioned whether “arranges” would include activities typically performed by or unique to certain commonly recognized categories of industry personnel. Specifically, these commenters sought clarification on whether the term’s scope would include activities typically performed by underwriters, senior managers who work on underwriting and propose counter-offers to be offered to consumers, loan approval committees that approve or deny transactions (with or without conditions or counter-offers) and communicate this information to loan officers, processors who assemble files for submission to underwriters, loan closers, and individuals involved with secondary market pricing who establish rates that the creditor's loan officers quote to the public.

The Bureau believes the meaning of "arranges" does include activities performed by these persons when those activities amount to offering or negotiating credit terms available from a creditor with consumers or assisting a consumer in applying for or obtaining an extension of credit, and thus also amount to other activities specified in the definition of loan originator. However, most of the activities these persons typically engage in would likely not amount to offering or negotiating and thus would likely not be included in the definition of "loan originator." Comment 36(a)-4 and the corresponding analysis below on management, administrative, and clerical tasks provide additional clarifications on which of these and similar activities are not included in the definition of loan originator.

In proposed comment 36(a)-1 and the supplementary information of the proposal, the Bureau explained that "arranges" would also include any task that is part of the process of originating a credit transaction, including advertising or communicating to the public by a person that the person can perform loan origination services, as well as referring a consumer to any other person who participates in the origination process. The Bureau is finalizing the definition of "loan originator" in § 1026.36(a)(1)(i) and in related comment 36(a)-1.i.A to include certain advertising activities and also to include referrals as discussed in more detail above in the analysis of "offers." Nevertheless, comment 36(a)-1, as adopted, does not state that "arranges" includes any task that is part of the process of originating a credit transaction because some loan origination activities under this final rule are included under elements other than "arranges."

Assists a consumer. TILA section 103(cc)(2)(A)(ii) provides that a mortgage originator includes a person who "assists a consumer in obtaining or applying to obtain a residential mortgage loan." TILA section 103(cc)(4) provides that a person "assists a consumer in obtaining or applying to obtain a residential mortgage loan" by taking actions such as "advising on residential mortgage loan terms (including rates, fees, and other costs), preparing residential mortgage loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan." The Bureau proposed to clarify in comment 36(a)-1.i.A that the term "loan originator" includes a person who assists a consumer in obtaining or applying for consumer credit by: (1) advising on specific credit terms (including rates, fees, and other costs); (2) filling out an application; (3) preparing application packages (such as a credit application or pre-approval application or supporting documentation); or (4) collecting application and supporting information on behalf of the consumer to submit to a loan originator or creditor. Each component of this statutory provision (*i.e.*, advising on residential mortgage loan terms, preparing residential mortgage loan packages, and collecting information on behalf of the consumer) is addressed below.

TILA section 103(cc)(4) provides that a person "assists a consumer in obtaining or applying to obtain a residential mortgage loan" by, among other things, "advising on residential mortgage loan terms (including rates, fees, and other costs)." The Bureau proposed to clarify in comment 36(a)-1.i.A that "takes an application, arranges, offers, negotiates, or otherwise obtains an extension of consumer credit for another person" includes "assists a consumer in obtaining or applying for consumer credit by advising on credit terms (including rates, fees, and other costs)."

In the proposal, the Bureau also stated that the definition of "mortgage originator" in TILA generally does not include bona fide third-party advisors such as accountants, attorneys, registered financial advisors, certain housing counselors, or others who advise a consumer on credit terms offered by another person and do not receive compensation directly or indirectly from that person. The Bureau indicated that the definition of "mortgage originator" would apply to persons who advise consumers regarding the credit terms being advertised or offered by that person or by the loan originator or creditor to whom the person brokered or referred the transaction in expectation of compensation, rather than objectively advising consumers on transaction terms already offered by an unrelated party to the consumer (*i.e.*, in the latter scenario the advisor did not refer or broker the transaction to a mortgage broker or a creditor and is not receiving compensation from a loan originator or creditor originating the transaction or an affiliate of that loan originator or creditor). If the advisor receives payments or compensation from a loan originator, creditor, or an affiliate of the loan originator or creditor offering, arranging, or extending the consumer credit in connection with advising a consumer on credit terms, however, the advisor could be considered a loan originator.

The Bureau is defining "loan originator" in § 1026.36(a)(1)(i) to include persons who "assist a consumer in obtaining or applying to obtain" an extension of credit. The Bureau is providing additional clarification in revised comments 36(a)-1 and 36(a)-4 on the meaning of "assists a consumer in obtaining or applying to obtain" an extension of credit.

Several industry groups and housing counselor commenters requested additional clarification on the meaning of "assists a consumer in obtaining or applying for consumer credit *by advising on credit terms* (including rates, fees, and other costs)." The Bureau interprets the phrase, "advising on credit terms (including rates, fees, and other costs)" to include advising a consumer on whether to seek or accept specific credit terms from a creditor. However, the phrase does not include persons who merely provide general explanations or descriptions in response to consumer queries, such as by explaining general credit terminology or the interactions of various credit terms not specific to a transaction. The Bureau also is adopting additional clarifications in comment 36(a)-1.v to reflect its interpretation that "advising on credit terms" does not include the activities performed by bona fide third-party advisors such as accountants, attorneys, registered financial advisors, certain housing counselors, or others who advise consumers on particular credit terms but do not receive compensation or other monetary gain, directly or indirectly, from the loan originator or creditor offering or extending the particular credit terms.

The Bureau believes that payment from the loan originator or creditor offering or extending the credit usually evidences that the advisor is incentivized to depart from the advisor's core, objective consumer advisory activity to further the credit origination goals of the loan originator or creditor instead. Thus, this interpretation applies only to advisory activity that is part of the advisor's activities. Although not a requirement for the exclusion, the Bureau believes that advisers acting under authorization or the regulatory oversight of a governing body, such as licensed accountants advising clients on the implications of credit terms, registered financial advisors advising clients on potential effects of credit terms on client finances, HUD-approved housing counselors assisting applicants with understanding the origination process and various credit terms offered by a loan originator or a creditor, or a licensed attorney assisting clients to consummate the purchase of a home or with divorce, trust, or estate planning matters are generally already subject to substantial consumer protection requirements. Such third-party advisors would be loan originators, however, if they advise consumers on particular credit terms and receive compensation or other monetary gain, directly or indirectly, from the loan originator or creditor offering or extending the particular credit terms. Therefore, these persons may no longer be viewed as acting within the scope of their bona fide third-party activities, which typically do not involve any part of the loan origination process (*i.e.*, no longer acting solely as an accountant, financial advisor, housing counselor, or an attorney instead of a loan originator).

The Bureau understands that some nonprofit housing counselors or housing counselor organizations may receive fixed sums from creditors or loan originators as a result of agreements between creditors and local, State, or Federal agencies or where such compensation is expressly permitted by applicable local, State or Federal law that requires counseling. The Bureau believes that housing counselors acting pursuant to such permission or authority for a particular transaction should not be considered loan originators for that transaction. Thus, funding or compensation received by a housing counselor organization or person from a loan originator or a creditor or the affiliate of a loan originator or creditor that is not contingent on referrals or on engaging in loan origination activities other than assisting a consumer in obtaining or applying to obtain a residential mortgage transaction, where such compensation is expressly permitted by applicable local, State, or Federal law that requires counseling and the counseling performed complies with such law (for example, § 1026.34(a)(5) and § 1026.36(k)) or where the compensation is paid pursuant to an agreement between the creditor or loan originator (or either's affiliate) and a local, State, or Federal agency, would not cause these persons to be considered to be "advising on credit terms" within the meaning of the loan originator definition. The Bureau has added comment 36(a)-1.v to clarify further that such third-party advisors are not loan originators.

The Bureau has adopted further clarification in comment 36(a)-1.i.A.*3* to note that the phrase "assists a consumer in obtaining or applying for consumer credit by advising on credit terms (including rates, fees, and other costs)" applies to "specific credit terms" rather than "credit terms" generally. The Bureau has also clarified the exclusion for advising consumers on non-specific credit terms and the loan process generally from the definition of "loan originator" for persons performing management, administrative and clerical tasks in comment 36(a)-4 as discussed further below.

TILA section 103(cc)(4) provides that a person "assists a consumer in obtaining or applying to obtain a residential mortgage loan" by, among other things, "preparing residential mortgage loan packages." The proposal would have clarified "preparing residential mortgage loan packages" in comment 36(a)-1.i.A.*3* by stating "preparing application packages (such as credit or pre-approval application or supporting documentation)."

Many industry group, bank, and manufactured housing finance commenters stated that individuals primarily engaged in "back-office" processing such as persons supervised by a loan originator who compile and assemble application materials and supporting documentation to submit to the creditor should not be considered loan originators. A housing assistance group and a State housing finance agency indicated that HUD-approved housing counselors often assist consumers with collecting and organizing documents for submitting application materials to loan originators or creditors. These commenters further requested clarification regarding whether housing counselors engaged in these activities would be considered loan originators.

The Bureau agrees that persons generally engaged in loan processing or who compile and process application materials and supporting documentation and do not take an application, collect information on behalf of the consumer, or communicate or interact with consumers regarding specific transaction terms or products are not loan originators (see the separate discussion above on taking an application and collecting information on behalf of the consumer). Accordingly, while the Bureau is adopting the phrase "preparing application packages (such as credit or pre-approval application or supporting documentation)" as proposed, it also is providing additional interpretation in comment 36(a)-4 with respect to persons who engage in certain management, administrative, and clerical tasks and are not included in the definition of loan originator. The Bureau believes this commentary should clarify that persons providing general application instruction to consumers so consumers can complete an application or persons engaged in certain processing functions without interacting or communicating with the consumer regarding specific transaction terms or products (other than confirming terms that have already been transmitted to the consumer in a written offer) are not included in the definition of loan originator.

As discussed above regarding advising on residential mortgage loan terms and below in the discussion of collecting information on behalf of the consumer, the Bureau does not believe the definition of loan originator includes bona fide third-party advisors, including certain housing counselors that aid consumers in collecting and organizing documents, or others who do not receive compensation from a loan originator, a creditor, or the affiliates of a loan originator or a creditor in connection with a consumer credit transaction (or those who only receive compensation paid to housing counselors where counseling is required by applicable local, State, or Federal law and the housing counselors' activities are compliant with such law). This interpretation is included in comment 36(a)-1.v.

TILA section 103(cc)(4) provides that a person "assists a consumer in obtaining or applying to obtain a residential mortgage loan" by, among other things, "collecting information *on behalf of the consumer* with regard to a residential mortgage loan." (Emphasis added.) The Bureau proposed to clarify in comment 36(a)-1.i.A that the definition of "loan originator" includes assisting a consumer in obtaining or applying for consumer credit by "collecting information on behalf of the consumer to submit to a loan originator or creditor."

Several industry associations, banks, and manufactured housing finance commenters sought clarification on whether "collecting information on behalf of the consumer to submit to a loan originator or creditor" includes persons engaged in clerical activities with respect to such information. A bank, a manufactured housing financer, and an industry group commenter argued that persons who contact the consumer to collect application and supporting information on behalf of a loan originator or creditor should not be subject to the rule. Many of these commenters also suggested that activities such as collecting information would qualify for the exclusion from the SAFE Act definition of loan originator for "administrative or clerical tasks."

As discussed above, the Bureau believes the Dodd-Frank Act definition of loan originator is broader in most ways than that in the SAFE Act. The Bureau also believes, however, that persons who, *acting on behalf of a loan originator or creditor*, verify information provided by the consumer in the credit application, such as by asking the consumer for documentation to support the information the consumer provided in the application, or for the consumer's authorization to obtain supporting documentation from third parties, are not collecting information *on behalf of the consumer*. Persons engaged in these activities are collecting information *on behalf of the loan originator or creditor*. Furthermore, this activity is administrative or clerical in nature as discussed further in the managers, administrative and clerical tasks analysis below. However, collecting information "on behalf of the consumer" would include gathering information or supporting documentation from third parties *on behalf of* *the consumer* to provide to the consumer, for the consumer then to provide in the application or for the consumer to submit to the loan originator or creditor, for compensation or in expectation of compensation from a loan originator, creditor, or an affiliate of the loan originator or creditor. Comment 36(a)-1.i.A.*3* clarifies this point.

The Bureau is finalizing comment 36(a)-1.i.A.*3* to clarify that the definition of "loan originator" includes assisting a consumer in obtaining or applying for consumer credit by "collecting information on behalf of the consumer to submit to a loan originator or creditor." Thus, a person performing these activities is a loan originator. The Bureau is also providing additional interpretation in comment 36(a)-4 with respect to persons who engage only in certain management, administrative, and clerical tasks (*i.e.*, typically loan processors for the purposes of this discussion) and are therefore not included in the definition of loan originator.

TILA section 103(cc)(2)(B) provides that a mortgage originator "includes any person who represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such person can or will provide any of the services or perform any of the activities described in subparagraph (A)." The Bureau proposed to revise comment 36(a)-1.i.A to clarify that a loan originator "includes a person who in expectation of compensation or other monetary gain advertises or communicates to the public that such person can or will provide any of these (loan origination) services or activities."

The Bureau stated in the section-by-section analysis of proposed § 1026.36(a) that the Bureau believes the existing definition of "loan originator" in § 1026.36(a) includes persons who, in expectation of compensation or other monetary gain, communicate or advertise loan origination activities or services to the public. The Bureau noted in the analysis that the phrase “advertises or communicates to the public” is very broad and includes, but is not limited to, the use of business cards, stationery, brochures, signs, rate lists, or other promotional items listed in TILA section 103(cc)(2)(B), if these items advertise or communicate to the public that a person can or will provide loan origination services or activities. The Bureau also stated in the analysis that the Bureau believed this clarification furthers TILA’s goal in section 129B(a)(2) of ensuring that responsible, affordable credit remains available to consumers.

A commenter questioned whether paid advertisers would be considered loan originators under the proposal. The Bureau believes a person performs the activity described in the “advertises or communicates” provision only if the person, or an employee or affiliate of the person, advertises that *that* person can or will provide loan origination services or activities. Thus, a person simply publishing or broadcasting an advertisement that indicates that a third party can or will perform loan origination services is not a loan originator. The Bureau notes that the more an advertisement is specifically directed at and communicated to a particular consumer or small number of consumers only, the more the advertisement could constitute a referral and not an advertisement (see the definition of referral in comment 36(a)-1.i.A.*1*). The Bureau is finalizing comment 36(a)-1.i.A.*5* to accommodate changes to surrounding proposed text as follows: “the scope of activities covered by the term loan originator includes: . . . advertising or communicating to the public that one can or will perform any loan origination services. Advertising the services of a third party who engages or intends to engage in loan origination activities does not make the advertiser a loan originator.”

TILA section 103(cc)(2)(B) does not contain an express requirement that a person must advertise for or in expectation of compensation or gain to be considered a “mortgage originator.” To the extent there is any uncertainty, the Bureau relies on its exception authority under TILA section 105(a) to clarify that such a person must advertise for or in expectation of compensation or gain in return for the services advertised to be a "loan originator." Under TILA section 103(cc)(2)(A), persons that engage in one or more of the core "mortgage originator" activities of the statute and that do not receive or expect to receive compensation or gain are not "mortgage originators." The Bureau believes that also applying the compensation requirement to persons who advertise that they can or will perform "mortgage originator" activities maintains consistency throughout the definition of "mortgage originator." This result effectuates the purposes of TILA in ensuring that responsible, affordable mortgage credit remains available to consumers and facilitates compliance by reducing uncertainty.

Negotiates or otherwise obtains or makes. TILA section 103(cc)(2) defines "mortgage originator" to include a person who "negotiates" terms of a residential mortgage loan. Existing § 1026.36(a)(1) contains "negotiates" and "otherwise obtains" in the definition of "loan originator," and the Bureau proposed to retain the terms in the definition. The Bureau did not define "negotiates" or "otherwise obtains" in the proposal except to state that "arranges, negotiates, or otherwise obtains" in the existing definition of "loan originator" already includes the core elements of the term "mortgage originator" in TILA section 103(cc)(2)(A).

The Bureau did not receive any comments specific to the definition of "negotiates" or "otherwise obtains." Consistent with the definition of "negotiates" in Regulation H and to facilitate compliance, in comment 36(a)-1.i.A.*4*, the Bureau interprets "negotiates" as encompassing the following activities: (1) presenting for consideration by a consumer particular credit terms; or (2) communicating with a consumer for the purpose of reaching a mutual understanding about prospective credit terms. The Bureau also is including in the definition of a loan originator the additional phrase "or makes" to ensure that creditors that extend credit without the use of table funding, including those that do none of the other activities described in the definition in § 1026.36(a)(1)(i) but solely provide the funds to consummate transactions, are loan originators for purposes of § 1026.36(f) and (g). As discussed in more detail below, those requirements are applicable to all creditors engaged in loan origination activities, unlike the other provisions of § 1026.36.

Manufactured Home Retailers

The definition of "mortgage originator" in TILA section 103(cc)(2)(C)(ii) expressly excludes certain employees of manufactured home retailers if they assist a consumer in obtaining or applying to obtain a residential mortgage loan by preparing residential mortgage loan packages or collecting information on behalf of the consumer with regard to a residential mortgage loan but do not take a residential mortgage loan application, do not offer or negotiate terms of a residential mortgage application, and do not advise a consumer on loan terms (including rates, fees, and other costs). The definition of "loan originator" in existing § 1026.36(a)(1) does not address such employees. The Bureau proposed to implement the new statutory exclusion by revising the definition of "loan originator" in § 1026.36(a)(1) to exclude employees of a manufactured home retailer who assist a consumer in obtaining or applying to obtain consumer credit, provided such employees do not take a consumer credit application, offer or negotiate terms of a consumer credit transaction, or advise a consumer on credit terms (including rates, fees, and other costs).

Many manufactured housing finance commenters sought clarification on whether retailers and their employees would be considered loan originators. The commenters stated that some employees perform both sales activities and loan origination activities, but receive compensation characterized as a commission for the sales activities only. The Bureau notes that, under the statute and proposed rule, a person who for direct or indirect compensation engages in loan origination activities is a loan originator and that all forms of compensation count for this purpose, even if they are not structured as a commission or other transaction-specific form of compensation (*i.e.*, compensation includes salaries, commissions, bonus, or any financial or similar incentive regardless of the label or name of the compensation as stated in existing comment 36(d)(1)-1, which this rulemaking recodifies as comment 36(a)-5). Thus, if a manufactured housing retailer employee receives compensation "in connection with" the employee's loan origination activities, the employee is a loan originator, regardless of the stated purpose or name of the compensation. To clarify this point further, the Bureau has revised § 1026.36(a)(1)(i) and comment 36(a)-1.i.A to provide that, if a person receives direct or indirect compensation for taking an application, assisting a consumer in obtaining or applying to obtain, arranging, offering, negotiating, or otherwise obtaining or making an extension of consumer credit for another person, the person is a loan originator.

A large number of manufactured housing industry commenters stated that the Bureau should further clarify what activities would be considered "assisting the consumer in obtaining or applying to obtain" credit, "taking an application," "offering or negotiating terms," or "advising" on credit terms. The Bureau has included several clarifications of these elements of the definition of "loan originator" in this final rule in § 1026.36(a)(1)(i) and comments 36(a)-1.i.A and 36(a)-4, as discussed above.

One manufactured housing finance commenter stated that, under the proposed exclusion for employees of a manufactured home retailer, employees could be compensated, in effect, for referring a consumer to a creditor without becoming a loan originator. The Bureau disagrees. The proposed exclusion was for "employees of a manufactured home retailer who assist a consumer in obtaining or applying to obtain consumer credit, provided such employees do not take a consumer credit application, offer or negotiate terms of a consumer credit transaction, or advise a consumer on credit terms (including rates, fees, and other costs)." As discussed above and clarified in comment 36(a)-1.i.A, the definition of "loan originator" includes referrals of a consumer to another person who participates in the process of originating a credit transaction because referrals constitute a form of "offering . . . credit terms." The one core activity that the exclusion permits manufactured housing retail employees to perform without becoming loan originators, "[a]ssisting a consumer in obtaining or applying to obtain" credit, has a statutorily defined meaning that does not include referring consumers to a creditor. Thus, employees of manufactured home retailers who refer consumers to particular credit providers would be considered loan originators if they are compensated for such activity.

Many manufactured housing financer commenters stated they were concerned that all compensation paid to a manufactured home retailer and its employees could be considered loan originator compensation and therefore counted as "points and fees" in the Board's 2011 ATR Proposal and the Bureau's 2012 HOEPA Proposal. As noted above, in the 2013 ATR Concurrent Proposal, the Bureau is seeking public comment on whether additional clarification is necessary for determining when compensation paid to such loan originators must be included in points and fees.

Creditors

Section 1401 of the Dodd-Frank Act amended TILA to add section 103(cc)(2)(F), which provides that the definition of "mortgage originator" expressly excludes creditors (other than creditors in table-funded transactions) for purposes of TILA section 129B(c)(1), (2), and (4), which include restrictions on compensation paid to loan originators and are implemented in

§ 1026.36(d). As noted, however, the TILA section 103(cc)(2)(F) exclusion from these compensation provisions for creditors does not apply to a table-funded creditor. Accordingly, a table-funded creditor that meets the definition of a loan originator in a transaction is subject to the compensation restrictions. The proposal noted this limited exclusion from the compensation provisions and also noted that TILA section 129B(b), added by section 1402 of the Dodd-Frank Act, imposes new qualification and loan document unique identifier requirements that apply to all creditors that otherwise meet the definition of a loan originator whether or not they make use of table-funding. These new requirements are implemented in § 1026.36(f) and (g), respectively.

Existing § 1026.36(a) includes a creditor extending table-funded credit transactions in the definition of a loan originator. That is, a creditor who originates the transaction but does not finance the transaction at consummation out of the creditor's own resources, including, for example, by drawing on a bona fide warehouse line of credit or out of deposits held by that creditor, is a loan originator. The Bureau proposed to amend the definition of loan originator in § 1026.36(a)(1)(i) to include all creditors, whether or not they engage in table-funded transactions, for purposes of § 1026.36(f) and (g) only. The Bureau also proposed to make technical amendments to comment 36(a)-1.ii on table funding to reflect the applicability of TILA section 129B(b)'s new requirements to such creditors.

The Bureau received comments from a manufactured housing industry group and a manufactured housing financer seeking clarification regarding whether manufactured home retailers are table-funded creditors, general TILA creditors, or neither. These commenters stated that the Bureau should specifically clarify that manufactured home retailers are not table-funded creditors. These commenters noted that manufactured home purchases are often financed using retail installment sales contracts. The commenters further explained that the credit-sale form of financing is the creditor's choice and not the retailer's.

Under the existing rule, manufactured housing retailers that assign the retail installment sales contract at consummation to another person that provides the funding directly are already considered tabled-funded creditors included in the definition of loan originator for such transactions. These table-funded creditors are subject to the restrictions on compensation paid to loan originators if the table-funded creditor otherwise meets the definition of a loan originator. The Dodd-Frank Act did not provide a definition or treatment of table-funded creditors that differs from the existing rule, and the Bureau believes it would be inconsistent to exempt manufactured housing retailers that act as table-funded creditors from the restrictions on compensation that apply to all table-funded creditors that also meet the definition of a loan originator.

To accommodate the applicability of the new qualification and unique identifier requirements to creditors, the Bureau is defining "loan originator" in § 1026.36(a)(1)(i) and associated comment 36(a)-1.i.A.*2* to clarify that the term includes persons who "make" an extension of credit. The Bureau is also revising § 1026.36(a)(1)(i) to clarify further that all creditors engaging in loan origination activities are loan originators for purposes of § 1026.36(f) and (g). The Bureau is adopting the proposed clarification on the applicability of the loan originator compensation rules to creditors in table-funded transactions and the technical revisions as proposed.

Servicers

TILA section 103(cc)(2)(G) defines "mortgage originator" to exclude a servicer or its employees, agents, or contractors, "including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing or subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind." The term "servicer" is defined by TILA section 103(cc)(7) as having the same meaning as "servicer" "in section 6(i)(2) of the Real Estate Settlement Procedures Act of 1974 [RESPA] (12 U.S.C. 2605(i)(2))."

This provision in RESPA defines the term "servicer" as "the person responsible for servicing of a loan (including the person who makes or holds a loan if such person also services the loan)."[65] The term "servicing" is defined to mean "receiving any scheduled periodic payments from a borrower pursuant to the terms of any loan, including amounts for escrow accounts described in section 2609 of [title 12], and making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan." 12 U.S.C. 2605(i)(3).

Existing comment 36(a)-1.iii provides that the definition of "loan originator" does not apply to a servicer when modifying existing credit on behalf of the current owner. The loan originator definition only includes persons involved in extending consumer credit. Thus, modifications of existing credit, which are not refinancings that involve extinguishing existing obligations and replacing them with a new credit extension as described under § 1026.20(a), are not subject to the rule. The Bureau's proposal would have amended comment 36(a)-1.iii to

[65] RESPA defines "servicer" to exclude: (A) the FDIC in connection with changes in rights to assets pursuant to section 1823(c) of title 12 or as receiver or conservator of an insured depository institution; and (B) Ginnie Mae, Fannie Mae, Freddie Mac, or the FDIC, in any case in which changes in the servicing of the mortgage loan is preceded by (i) termination of the servicing contract for cause; (ii) commencement of bankruptcy proceedings of the servicer; or (iii) commencement of proceedings by the FDIC for conservatorship or receivership of the servicer (or an entity by which the servicer is owned or controlled). 12 U.S.C. 2605(i)(2).

clarify and reaffirm this distinction in implementing the Dodd-Frank Act's definition of mortgage originator.

As stated in the supplementary information of the proposal, the Bureau believes the exception in TILA section 103(cc)(2)(G) applies to servicers and servicer employees, agents, and contractors only when engaging in specified servicing activities with respect to a particular transaction after consummation, including loan modifications that do not constitute refinancings. The Bureau stated that it does not believe that the statutory exclusion was intended to shield from coverage companies that intend to act as servicers on transactions that they originate when they engage in loan origination activities prior to consummation of such transactions or to apply to servicers of existing mortgage debts that engage in the refinancing of such debts. The Bureau believes that exempting such companies merely because of the general status of "servicer" with respect to some credit would be inconsistent with the general purposes of the statute and create a large potential loophole.

The Bureau's rationale for the proposed amendment to the comment rested on analyzing the two distinct parts of the statute. Under TILA section 103(cc)(2)(G), the definition of "mortgage originator" does not include: (1) "a servicer" or (2) "servicer employees, agents and contractors, including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind." Considering the text of this provision in combination with the definition of "servicer" under RESPA in 12 U.S.C. 2605(i)(2), a servicer that is responsible for servicing a mortgage debt or that extends mortgage credit *and* services it is excluded from the definition of "mortgage originator" for that particular transaction after it is consummated and the servicer becomes responsible for servicing it. "Servicing" is defined under RESPA as "receiving and making payments according to the terms of the loan." Thus, a servicer cannot be responsible for servicing a transaction that does not yet exist. An extension of credit that may be serviced exists only after consummation. Therefore, for purposes of TILA section 103(cc)(2)(G), a person is a servicer with respect to a particular transaction only after it is consummated and that person retains or obtains its servicing rights.

In the section-by-section analysis of the proposal, the Bureau further stated this interpretation of the statute is the most consistent with the definition of "mortgage originator" in TILA section 103(cc)(2). A person cannot be a servicer of a credit extension until after consummation of the transaction. A person taking an application, assisting a consumer in obtaining or applying to obtain a mortgage transaction, offering or negotiating terms of a transaction, or funding the transaction prior to or at consummation is a mortgage originator or creditor (depending upon the person's role). Thus, a person that funds a transaction from the person's own resources or a creditor engaged in a table-funded transaction is subject to the appropriate provisions in TILA section 103(cc)(2)(F) for creditors until the person becomes responsible for servicing the resulting debt obligation after consummation. The Bureau explained that this interpretation is also consistent with the definition of "loan originator" in existing § 1026.36(a) and comment 36(a)-1.iii. If a loan modification by the servicer constitutes a refinancing under § 1026.20(a), the servicer is considered a loan originator or creditor until after consummation of the refinancing when responsibility for servicing the refinanced debt arises.

The proposal's supplementary information stated the Bureau's belief that the second part of the statutory servicer provision applies to individuals (*i.e.*, natural persons) who are employees, agents, or contractors of the servicer "who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind." The Bureau further noted that, to be considered employees, agents, or contractors of the servicer for the purposes of TILA section 103(cc)(2)(G), the person for whom the employees, agent, or contractors are working first must be a servicer. Thus, as discussed above, the particular transaction must have already been consummated before such employees, agents, or contractors can be excluded from the statutory term, "mortgage originator" under TILA section 103(cc)(2)(G).

In the supplementary information of the proposal, the Bureau interpreted the phrase "offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind" to be examples of the types of activities the individuals are permitted to engage in that satisfy the purposes of TILA section 103(cc)(2)(G). The Bureau explained, however, that "renegotiating, modifying, replacing and subordinating principal of existing mortgages" or any other related activities does not extend to refinancings, such that persons that engage in a refinancing, as defined in § 1026.20(a), do qualify as loan originators for the purposes of TILA section 103(cc)(2)(G). Under the Bureau's view as stated in the proposal, a servicer may modify an existing debt obligation in several ways without being considered a loan originator. A formal satisfaction of the existing obligation and replacement by a new obligation, however, is a refinancing that involves a new extension of credit.

The Bureau further interpreted the term "replacing" in TILA section 103(cc)(2)(G) not to include refinancings of consumer credit. The term "replacing" is not defined in TILA or Regulation Z, but the Bureau indicated its belief in the proposal that the term "replacing" in this context means replacing existing debt without also satisfying the original obligation. For example, two separate debt obligations secured by a first- and second-lien, respectively, may be "replaced" by a single, new transaction with a reduced interest rate and principal amount, the proceeds of which do not satisfy the full obligation of the prior debts. In such a situation, the agreement for the new transaction may stipulate that the consumer remains responsible for the outstanding balances that have not been refinanced, if the consumer refinances or defaults on the new transaction within a stated period of time. This is conceptually distinct from a refinancing as described in § 1026.20(a), which refers to situations where an existing "obligation *is satisfied and replaced* by a new obligation."[66] (Emphasis added.)

The Bureau reasoned in the supplementary information of the proposal that the ability to repay provisions of TILA section 129C, which were added by section 1411 of the Dodd-Frank Act, make numerous references to certain "refinancings" for exemptions from the income verification requirement of section 129C. TILA section 128A, as added by section 1418 of the Dodd-Frank Act, contains a required disclosure that includes a "refinancing" as an alternative for consumers of hybrid adjustable rate mortgages to pursue before the interest rate adjustment or reset after the fixed introductory period ends. Moreover, prior to the Dodd-Frank Act amendments, TILA contained the term "refinancing" in numerous provisions. For example, TILA section 106(f)(2)(B) provides finance charge tolerance requirements specific to a

[66] Comment 20(a)-1 clarifies: "The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer's behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation *must completely replace* the prior one." (Emphasis added).

"refinancing," TILA section 125(e)(2) exempts certain "refinancings" from right of rescission disclosure requirements, and TILA section 128(a)(11) requires disclosure of whether the consumer is entitled to a rebate upon "refinancing" an obligation in full that involves a precomputed finance charge. The Bureau stated for these reasons its belief that, if Congress intended "replacing" to include or mean a "refinancing" of consumer credit, Congress would have used the existing term, "refinancing." Instead, without any additional guidance from Congress, for the purposes of proposed comment 36(a)-1.iii, the Bureau deferred to the existing definition of "refinancing" in § 1026.20(a), where the definition of "refinancing" requires both replacement *and* satisfaction of the original obligation as separate and distinct elements of the defined term.

Furthermore, as the Bureau explained in the proposal's supplementary information, the above interpretation of "replacing" better accords with the surrounding statutory text in TILA section 103(cc)(2)(G), which provides that servicers include persons offering or negotiating a residential mortgage loan for the purposes of "renegotiating, modifying, replacing or subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind." Taken as a whole, this text applies to distressed consumers for whom replacing and fully satisfying the existing obligation(s) likely is not an option. The situation covered by the text is distinct from a refinancing in which a consumer would simply use the proceeds from the refinancing to satisfy an existing loan or existing loans.

The Bureau stated in the proposal's supplementary information that this interpretation gives full effect to the exclusionary language as Congress intended, to avoid undesirable impacts on servicers' willingness to modify existing loans to benefit distressed consumers, without undermining the new protections generally afforded by TILA section 129B. The Bureau further stated that a broader interpretation that excludes servicers and their employees, agents, and contractors from those protections solely by virtue of their coincidental status as servicers would not be the best reading of the statute as a whole and likely would frustrate rather than further congressional intent.

Indeed, as the Bureau also noted in the supplementary information of the proposal, if persons were not included in the definition of mortgage originator when making but prior to servicing a transaction or based purely on a person's status as a servicer under the definition of "servicer," at least two-thirds of mortgage creditors (and their originator employees) nationwide could be excluded from the definition of "mortgage originator" in TILA section 103(cc)(2)(G). Many, if not all, of the top ten mortgage creditors by volume either hold or service loans they originated in portfolio or retain servicing rights for the loans they originate and sell into the secondary market.[67] Under an interpretation that would categorically exclude a person who makes and also services a transaction or whose general "status" is a "servicer," these creditors would be excluded as "servicers" from the definition of "mortgage originator." Further, their employees, agents, and contractors would also be excluded from the definition under this interpretation.

The Bureau explained in the proposal's supplementary information that this result would be not only contrary to the statutory text but also contrary to Congress's stated intent in section 1402 of the Dodd-Frank Act, to ensure that responsible, affordable mortgage credit remains

[67] For example, the top ten U.S. creditors by mortgage origination volume in 2011 held 72.7 percent of the market share. 1 Inside Mortg. Fin., *The 2012 Mortgage Market Statistical Annual* 52-53 (2012) (these percentages are based on dollar amounts). These same ten creditors held 60.8 percent of the market share for mortgage servicing. 1 Inside Mortg. Fin., *The 2012 Mortgage Market Statistical Annual* 185-186 (2012) (these percentages are based on dollar amounts). Most of the largest creditors do not ordinarily sell their originations into the secondary market with servicing released.

available to consumers by regulating practices related to residential mortgage loan origination. For example, based on the discussion above the top ten mortgage creditors by origination and servicing volume alone, as much as approximately 61 percent of the nation's loan originators, could not only be excluded from prohibitions on dual compensation and compensation based on transaction terms but also from the new qualification requirements added by the Dodd-Frank Act.

The Bureau's proposed rule would have amended comment 36(a)-1.iii, to reflect the Bureau's interpretation of the statutory text as stated in the supplementary information of the proposal and again above, to facilitate compliance, and to prevent circumvention. In the supplementary information, the Bureau also interpreted the statement in existing comment 36(a)-1.iii that the "definition of 'loan originator' does not apply to a loan servicer when the servicer modifies an existing loan on behalf of the current owner of the loan" as consistent with the definition of mortgage originator as it relates to servicers in TILA section 103(cc)(2)(G). Proposed comment 36(a)-1.iii would have clarified that the definition of "loan originator" excludes a servicer or a servicer's employees, agents, and contractors when offering or negotiating terms of a particular existing debt obligation on behalf of the current owner for purposes of renegotiating, modifying, replacing, or subordinating principal of such a debt where the consumer is not current, is in default, or has a reasonable likelihood of becoming in default or not current. The Bureau also proposed to amend comment 36(a)-1.iii to clarify that § 1026.36 "only applies to extensions of consumer credit that constitute a refinancing under § 1026.20(a). Thus, the rule does not apply if a renegotiation, modification, replacement, or subordination of an existing obligation's terms occurs, unless it is a refinancing under § 1026.20(a)."

Several industry groups and creditors supported the Bureau's approach to not including servicers in the definition of loan originator. Industry groups and several large banks stated that the final rule should make clear that the definition of loan originator does not include individuals facilitating loan modifications, short sales, or assumptions. An industry group commenter indicated that the final rule should clarify that persons who "offer" to modify an existing obligation should also not be included in the definition of loan originator. Other large banks and industry groups stated that the final rule should clarify that servicers include persons who permit a new consumer to assume an existing obligation. Furthermore, they argued, the exclusion for servicers should apply to companies that, for example, pay off a lien on the security property and allow the consumer to repay the amount required over time. A large secondary market commenter also stated that comment 36(a)-1.iii should be further clarified to include circumstances where the servicer is modifying a mortgage obligation on behalf of an assignee.

The Bureau is adopting § 1026.36(a)(1)(i)(E) to implement TILA section 103(cc)(2)(G) consistent with the analysis above, as well as comment 36(a)-1.iii as proposed with a few minor clarifications to address issues raised by several of the commenters. The final rule amends comment 36(a)-1.iii to clarify that the exclusion from the definition of loan originator for a "servicer" also excludes the servicer's employees, agents, and contractors. The final rule also revises the comment to exclude persons who "offer" to modify existing obligations from the definition of loan originator. The Bureau is also clarifying comment 36(a)-1.iii to exclude servicers that modify the obligations on behalf of an assignee or that modify obligations the servicer itself holds.

The Bureau continues to believe, as noted in the supplementary information of the proposal, that a formal satisfaction of the consumer's existing obligation *and* replacement by a new obligation is a refinancing and not a modification. But, short of refinancing, a servicer may modify a mortgage obligation without being considered a loan originator. In both a short sale and an assumption, there is no new obligation for the consumer currently obligated to repay the debt. The existing obligation is effectively terminated from that consumer's perspective.

In a short sale the security property is sold and the existing obligation is extinguished. Thus, the Bureau believes that a short sale constitutes a modification of the existing obligation assuming it is not being replaced by a new obligation on the seller. If the property buyer in the short sale receives financing from the person who was servicing the seller's obligation, this financing is a new extension of credit that is subject to § 1026.36.

In an assumption, however, a different consumer agrees to take on the existing obligation. From this consumer's perspective the existing obligation is a new extension of credit. The Bureau believes such consumers should be no less protected than the original consumer who first became obligated on the transaction. Therefore, assumptions are subject to § 1026.36. The Bureau is clarifying comment 36(a)-1.iii to provide that persons that agree with a different consumer to accept the existing debt obligation are not servicers.

Regarding the comment that servicers should include persons that pay off a lien on the security property and allow the consumer to repay the amount required over time, the Bureau generally does not interpret the "servicer" exclusion from the definition of loan originator to apply to such persons. The Bureau believes that, although paying off the lien and permitting the consumer to repay it over time is related to the existing obligation, such a transaction creates a new debt obligation of the consumer to repay the outstanding balance and is not a modification of the existing obligation. But whether such a person is a servicer also depends on the terms of the note and security instrument for the existing obligation. In some instances, under the terms of the existing agreement, an advance made by the debt holder to protect or maintain the holder's security interest may become part of the existing debt obligation in which case such an advance could effectively operate to modify the existing obligation by adding to the existing debt but not to create a new debt obligation. The Bureau would consider persons making advances under these circumstances, in accordance with the existing agreement to be servicers.

Real Estate Brokers

TILA section 103(cc)(2)(D) states that the definition of "mortgage originator" does not "include a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with applicable State law, unless such person or entity is compensated by a lender, a mortgage broker, or other mortgage originator or by any agent of such lender, mortgage broker, or other mortgage originator." As the Bureau stated in the proposal, a real estate broker that performs loan origination activities or services as described in § 1026.36(a) is a loan originator for the purposes of § 1026.36.[68] The Bureau proposed to add comment 36(a)-1.iv to clarify that the term loan originator does not include real estate brokers that meet the statutory exclusion in TILA section 103(cc)(2)(D).

The Bureau stated in the proposal that the text of TILA section 103(cc)(2)(D) related to payments to a real estate broker "by a lender, a mortgage broker, or other mortgage originator or by any agent of such lender, mortgage broker, or other mortgage originator" is directed at payments by such persons in connection with the origination of a particular consumer credit transaction secured by a dwelling to finance the acquisition or sale of that dwelling (*e.g.*, to purchase the dwelling or to finance repairs to the property prior to selling it). If real estate

[68] The Bureau understands that a real estate broker license in some States also permits the licensee to broker mortgage loans and in certain cases make mortgage loans. The Bureau does not consider brokering mortgage loans and making mortgage loans to be real estate brokerage activities.

brokers are deemed mortgage originators simply by receiving compensation from a creditor, then a real estate broker would be considered a mortgage originator if the real estate broker received compensation from a creditor for reasons wholly unrelated to loan origination (*e.g.*, if the real estate broker found new office space for the creditor).

The Bureau also stated in the proposal that it does not believe that either the definition of "mortgage originator" in TILA section 103(cc)(2) or the statutory purpose of TILA section 129B(a)(2) to "assure consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deception or abusive," demonstrate that Congress intended the provisions of TILA section 129B applicable to mortgage originators to cover real estate brokerage activity that is wholly unrelated to a particular real estate transaction involving a residential mortgage loan. The Bureau concluded that, for a real estate broker to be included in the definition of "mortgage originator," the real estate broker must receive compensation in connection with performing one or more of the three core "mortgage originator" activities for a particular consumer credit transaction secured by a dwelling such as referring a consumer to a mortgage originator or creditor as discussed above (*i.e.*, a referral is a component of "offering" a residential mortgage loan).

The Bureau included the following example in the supplementary information: Assume XYZ Bank pays a real estate broker for a broker price opinion in connection with a pending modification or default of a mortgage obligation for consumer A. In an unrelated transaction, consumer B compensates the same real estate broker for assisting consumer B with finding and negotiating the purchase of a home. Consumer B also obtains credit from XYZ Bank to purchase the home. The Bureau stated its belief that this real estate broker is not a loan originator under these facts. Proposed comment 36(a)-1.iv would have clarified this point. The proposed comment would also clarify that a payment is not from a creditor, a mortgage broker, other mortgage originator, or an agent of such persons if the payment is made on behalf of the consumer to pay the real estate broker for real estate brokerage activities performed for the consumer.

The Bureau further noted in the proposal's supplementary information that the definition of "mortgage originator" in TILA section 103(cc)(2)(D) does not include a person or entity that *only performs real estate brokerage activities* and is licensed or registered in accordance with applicable State law. The Bureau stated its belief that, if applicable State law defines real estate brokerage activities to include activities that fall within the definition of loan originator in § 1026.36(a), the real estate broker is a loan originator when engaged in such activities subject to § 1026.36 and is not a real estate broker under TILA section 103(cc)(2)(D). In this situation, even though State law defines real estate brokerage activities to include loan origination activities, TILA section 103(cc)(2)(d) excludes only persons who perform real estate brokerage activities. A person performing loan origination activities does not become a person performing real estate brokerage activities for the purposes of TILA section 103(cc)(2)(d) because State law declares such loan origination activities to be real estate brokerage activities. The Bureau invited comment on this proposed clarification of the meaning of "loan originator" for real estate brokers.

The Bureau received one comment from a real estate broker trade association generally agreeing with the Bureau's interpretation of the real estate broker exclusion from the definition of loan originator. The association also commented, however, that the Bureau should clarify that where a brokerage earns a real estate commission for selling a foreclosed property owned by a creditor such compensation does not turn real estate brokerage into loan originator activity.

The Bureau is adopting § 1026.36(a)(1)(i)(C) to implement TILA section 103(cc)(2)(D) in accordance with the foregoing principles, as well as comment 36(a)-1.iv as proposed with additional clarification regarding payments from the proceeds of a credit transaction to a real estate agent on behalf of the creditor or seller and with respect to sales of properties owned by a loan originator, creditor, or an affiliate of a loan originator or creditor. The Bureau agrees that where a real estate broker earns a real estate commission only for selling a foreclosed property owned by a creditor such compensation does not turn real estate brokerage into a loan originator activity. But if, for example, a real estate agent was paid compensation by the real estate broker, an affiliate of the creditor (*e.g.*, the affiliate is a real estate brokerage that pays its real estate agents), for taking the consumer's credit application and performing other functions related to loan origination, the real estate agent would be considered a loan originator when engaging in such activity as set forth in § 1026.36(a)(1) and comment 36(a)-1.i.A. Accordingly, different parts of the commentary may apply depending on the circumstances.

Seller Financers

As noted above, TILA section 103(cc)(2)(F) and § 1026.36(a)(1) generally exclude creditors (other than table-funded creditors) from the definition of "loan originator" for most purposes under § 1026.36. Under existing Regulation Z, a person that sells property and permits the buyer to pay for the home in more than four installments, subject to a finance charge, generally is a creditor under § 1026.2(a)(17)(i). However, § 1026.2(a)(17)(v) provides that the definition of creditor: (1) does not include a person that extended credit secured by a dwelling (other than high-cost mortgages) five or fewer times in the preceding calendar year; and (2) does not include a person who extends no more than one high-cost mortgage (subject to § 1026.32) in any 12-month period. Accordingly, absent special provision, certain "seller financers" that conduct a relatively small number of transactions per year are not "creditors" under Regulation Z and therefore could be subject to the loan originator compensation and other restrictions provided in § 1026.36 when engaging in loan origination activities.

The Dodd-Frank Act specifically addressed this issue in section 1401, which amended TILA section 103(cc)(2)(E) to provide that the term "mortgage originator" does not include a person, estate, or trust that provides mortgage financing in connection with the sale of up to three properties in any twelve-month period, each of which is owned by the person, estate, or trust and serves as security for the financing, but only if the financing meets a set of detailed prescriptions. Specifically, such seller-financed credit must:

> (i) not [be] made by a person, estate, or trust that has constructed, or acted as a contractor for the construction of, a residence on the property in the ordinary course of business of such person, estate, or trust; (ii) [be] fully amortizing; (iii) [be] with respect to a sale for which the seller determines in good faith and documents that the buyer has a reasonable ability to repay the loan; (iv) [have] a fixed rate or an adjustable rate that is adjustable after 5 or more years, subject to reasonable annual and lifetime limitations on interest rate increases; and (v) meet any other criteria the Bureau may prescribe.

The Bureau proposed comment 36(a)-1.v to implement these criteria. The proposed comment provided that the definition of "loan originator" does not include a natural person, estate, or trust that finances in any 12-month period the sale of three or fewer properties owned by such natural person, estate, or trust where each property serves as security for the credit transaction. It further stated that the natural person, estate, or trust also must not have constructed or acted as a contractor for the construction of the dwelling in its ordinary course of business. The proposed comment also stated that the natural person, estate, or trust must determine in good faith and document that the buyer has a reasonable ability to repay the credit transaction. Finally, the proposed comment stated that the credit transaction must be fully amortizing, have a fixed rate or an adjustable rate that adjusts only after five or more years, and be subject to reasonable annual and lifetime limitations on interest rate increases.

The Bureau also proposed to include further interpretation in the comment as to how a person may satisfy the criterion to determine in good faith that the buyer has a reasonable ability to repay the credit transaction. The comment would have provided that the natural person, estate, or trust makes such a good faith determination by complying with separate regulations to implement a general requirement under section 1411 of the Dodd-Frank Act for all creditors to make a reasonable and good faith determination of consumers' ability to repay before extending them closed-end mortgage credit. Those regulations, which were proposed by the Board in its 2011 ATR Proposal and which the Bureau intended to finalize in § 1026.43, contain detailed requirements concerning the verification of income, debts, and other information; payment calculation rules; and other underwriting practices. The Bureau noted that the language of the general obligation on creditors to consider consumers' ability to repay in TILA section 129C(a)(1), largely parallels the ability to repay criterion in the seller financer language of TILA section 103(cc)(2)(E), except that the general requirement mandates that the evaluation be made on "verified and documented" information.

While the Bureau proposed to implement the statutory exclusion, however, the Bureau also posited an interpretation in the preamble to the proposal that would have excluded many seller financers from the definition of "loan originator" without having to satisfy the statutory criteria. Specifically, the interpretation would have treated persons who extend credit as defined under Regulation Z from their own resources (*i.e.*, are not engaged in table-funded transactions in which they assign the seller financing agreement at consummation) as creditors for purposes of the loan originator compensation rules even if they were excluded from the first branch of the Regulation Z definition of "creditor" under Regulation Z's de minimis thresholds (*i.e.*, no more than five mortgages generally). 77 FR at 55288. Under this interpretation, such persons would not have been subject to the requirements for "loan originators" under § 1026.36, and still would not have been subject to other provisions of Regulation Z governing "creditors." Instead, the only seller financers that would have been required to show that they satisfied the statutory and regulatory criteria were parties that engaged in up to three transactions and did not satisfy the second branch of the Regulation Z definition of creditor (i.e. made more than one high-cost mortgages per year.

The Bureau received a large number of comments strongly opposing the proposed treatment of the seller financer exclusion. These comments noted that seller financers are typically natural persons who would be unable to satisfy the ability to repay criteria of the proposed exclusion given what the commenters viewed as the complexities involved in the ability to repay analysis and the fact that consumers obtaining seller financing typically do not meet traditional underwriting standards. In addition, several commenters stated that the criterion to investigate ability to repay may place the seller financer in an unfair bargaining position with respect to the real estate transaction because the seller financer would have access to the buyer's financial information while also negotiating the property sale. Moreover, commenters asserted, an average private seller cannot always provide financing in compliance with the specific balloon, interest-only, introductory period, and amortization restrictions required by the proposed exclusion. Some commenters urged that seller financers should not be prohibited from financing agreements with these features.

Many commenters addressed the merits of seller financing in general. For example, some commenters noted that seller financing creates an opportunity for investors to buy foreclosed properties and resell them to buyers who cannot obtain traditional financing, thus helping to reduce the inventory of foreclosed properties via options unavailable to most creditors and buyers. Commenters additionally indicated that seller financing is one of only a few options in some cases, especially for first-time buyers, persons newly entering the workforce, persons with bad credit due to past medical issues, or where traditional creditors are unwilling to take a security interest in the property for various reasons. Many of these commenters asserted that this exclusion would curtail seller financing. Thus, certain buyers would be forced to seek financing from banks unlikely to lend to them, and many rural sales would not occur. Others argued that to qualify for this exclusion seller financers would need to meet onerous TILA and Regulation Z requirements.

One escrow trade association suggested that the Bureau increase the de minimis exemption (regularly extending credit threshold) for the definition of creditor to 25 or fewer credit transactions. Other trade associations suggested that the Bureau create an exemption for occasional seller financing similar to the SAFE Act's de minimis exemption for depository institutions or the loan originator business threshold for non-depository institutions. Furthermore, these trade associations suggested that the Bureau amend Regulation Z to exempt anyone from the definition of loan originator who is exempt from the licensing and registration requirements of the SAFE Act.

Many commenters who submitted a comment on the seller financer exclusion mistakenly believed that the proposal would amend Regulation Z to eliminate exclusions from the definition of creditor for persons who do not regularly extend credit and replace such exclusions with the exclusion in comment 36(a)-1.v. Many of these commenters also mistakenly stated that the exclusion would require all seller financers to finance sales of their homes according to the criteria in proposed comment 36(a)-1.v.

In response to comments, the Bureau is adopting the seller financer exclusion set forth in the statute in § 1026.36(a)(1)(i)(D), with additional clarifications, adjustments, and criteria in § 1026.36(a)(4) and (a)(5) and associated commentary discussed below.

In the final rule, persons (including estates or trusts) that finance the sale of three or fewer properties in any 12-month period would be seller financers excluded from the definition of "loan originator" if they meet one set of criteria that largely tracks the criteria for the mortgage financing exclusion in TILA section 103(cc)(2)(E). This exclusion is referred to as the "three-property exclusion." Upon further consideration the Bureau believes it is also appropriate to exclude natural persons, estates, or trusts that finance the sale of only one property they own in any 12-month period under a more streamlined set of criteria provided in § 1026.36(a)(5). This exclusion is referred to as the "one-property exclusion." The Bureau is not, however, adopting the interpretation discussed in the proposal that would have treated only seller financers that engage in two or three high-cost mortgage transactions as being required to demonstrate compliance with the requirements of the rule to qualify for the exclusion from the definition of loan originator. The criteria for satisfying the three- and one-property exclusions are discussed in detail in the section-by-section analyses of § 1026.36(a)(4) and (5), below.

As discussed in the proposal, the seller financer exclusion from the definition of “loan originator” in the statute is in addition to exclusions already available under TILA and Regulation Z, specifically the exclusion of creditors including seller financers that engage in five or fewer such transactions in a calendar year. Moreover, the exclusion is only for the purposes of provisions in § 1026.36 that apply to loan originators. Any person relying on the seller financer exclusion is thereby excluded only from the loan originator requirements of § 1026.36 and not the remaining requirements of § 1026.36 or other provisions of Regulation Z. For example, such a person would still be subject to the restrictions in § 1026.36(d) if the person pays compensation to a loan originator. Such a person would also have to comply with the § 1026.36(h) provision on mandatory arbitration.

In deciding to adopt two exclusions from the definition of loan originator for seller financers, the Bureau looked in part to the purposes of the seller financer exclusion in the statute, which the Bureau believes was designed primarily to accommodate persons or smaller-sized estates or family trusts with no, or less sophisticated, compliance infrastructures. Such persons and entities may engage in seller financer transactions on just a single or handful of properties, making it impracticable for them to develop and apply the types of underwriting practices and standards that are used routinely by traditional creditors. The Bureau has accordingly attempted to consider compliance burden and to calibrate the criteria appropriately to avoid unwarranted restrictions on access to responsible, affordable mortgage credit from such sources.

At the same time, the Bureau is also aware of concerns that persons or entities have been exploiting the existing exclusion in § 1026.2(a)(17)(v) of Regulation Z for persons that extend credit secured by a dwelling (other than high-cost mortgages) five or fewer times in the preceding calendar year, and might do the same with regard to this exclusion from the definition of loan originator under § 1026.36. In particular, the Bureau has received reports that persons may be recruiting multiple individuals or creating multiple entities to extend credit for five or fewer such transactions each and then acquiring the mortgages shortly after they have been consummated. Such conduct may be designed to evade the requirements of Regulation Z. In these circumstances, however, the person may in fact be extending credit for multiple transactions secured by a dwelling through an intermediary, and thus be subject to applicable requirements for creditors and/or loan originators under Regulation Z.

Managers, Administrative, or Clerical Staff

TILA section 103(cc)(2)(C) defines "mortgage originator" to exclude persons who do not otherwise engage in the core activities listed in the originator definition and perform purely administrative or clerical tasks on behalf of mortgage originators. Existing comment 36(a)-4 clarifies that managers, administrative staff, and similar individuals who are employed by a creditor or loan originator but do not arrange, negotiate, or otherwise obtain an extension of credit for a consumer, or whose compensation is not based on whether any particular loan is originated, are not loan originators. In the proposal, the Bureau stated that it believes the existing comment is largely consistent with TILA section 103(cc)(2)(C)'s treatment of administrative and clerical tasks.

The Bureau proposed minor technical revisions to existing comment 36(a)-4, however, to conform the language more closely to TILA section 103(cc)(2)C) by including references to "clerical" staff and to taking applications and offering loan terms. The proposed revisions would also clarify that "producing managers" who meet the definition of a loan originator would be considered loan originators. The Bureau further stated in the proposal that producing managers generally are managers of an organization (including branch managers and senior executives) that, in addition to their management duties, also originate transactions subject to § 1026.36. Thus, compensation such as salaries, commissions, bonuses, or other financial or similar incentives received by producing managers in connection with loan origination activities would be subject to the restrictions of § 1026.36. Non-producing managers (*i.e.*, managers, senior executives, etc., who have a management role in an organization including, but not limited to, managing loan originators, but who do not otherwise meet the definition of loan originator) would not be considered loan originators if their compensation is not otherwise based on whether any particular loan is originated (*i.e.*, this exclusion from the definition of loan originator does not apply to non-producing managers who receive compensation based on particular transactions originated by other loan originators).

The Bureau also noted in the proposal that the statutory definition of the phrase, "assists a consumer in obtaining or applying to obtain a residential mortgage loan," suggests that minor actions – *e.g.*, accepting a completed application form and delivering it to a loan officer, without assisting the consumer in completing it, processing or analyzing the information, or discussing transaction terms – constitute administrative and clerical tasks. In such situations, the person is not actively aiding or further achieving a completed credit application or collecting information on behalf of the consumer specific to a mortgage transaction. In the proposal, the Bureau stated its belief that this interpretation was also consistent with the exclusion in TILA section 103(cc)(2)(C)(i) for certain administrative and clerical persons.

Industry group and creditor commenters addressing proposed comment 36(a)-4 generally supported the Bureau's proposed revision. However, many industry groups and banks sought further clarification regarding "producing managers." One bank commenter suggested that a manager who arranges, negotiates, or otherwise obtains an extension of consumer credit for another person but does not receive compensation specific to any particular transaction should not be considered a loan originator. Another industry association commenter was concerned that the proposal did not contain a clear definition of "producing manager." The commenter noted that officers and managers need to be involved in loan originations from time to time and that their compensation is not directly based on such involvement in an individual transaction. Another industry association commenter described the issue as defining the boundary between a manager engaged in customary credit approval functions or setting terms in counter-offer situations, which are more akin to underwriting, and a manager actively arranging transactions for consumers.

The Bureau generally agrees that a person who approves credit transactions or sets terms of the transaction in counter-offer situations is not a loan originator (and also not a "producing manager") – provided any communication to or with the consumer regarding specific transaction terms, an offer, negotiation, a counter-offer, or approval conditions is made by a qualified loan originator. Moreover, persons who make underwriting decisions by receiving and evaluating the consumer's information to determine whether the consumer qualifies for a particular credit transaction or credit offer are considered to be engaged in management, administrative, or clerical tasks for the purposes of the rule if the persons only advise the loan originator or creditor on whether the credit may be extended or purchased and all communications to or with the consumer regarding specific transaction terms, an offer, negotiation, a counter-offer, or approval conditions with the consumer are made by a loan originator. Also, the Bureau considers persons who establish pricing that the creditor offers generally to the public, via advertisements or other marketing or via other persons who are qualified loan originators, to be engaged in management, administrative, or clerical tasks rather than loan origination activities. The Bureau is providing further clarifications on these points accordingly, in comment 36(a)-4.

The Bureau disagrees with the commenter suggesting that a manager who arranges, negotiates, or otherwise obtains an extension of consumer credit for another person but does not receive compensation specific to any particular transaction should not be considered a loan originator. Persons who receive compensation in connection with engaging in such loan origination activities, regardless of whether the compensation is specific to any particular transaction, are loan originators. For this reason, for other reasons discussed with respect to profits-based compensation plans and the new qualification and unique document identifier requirements in § 1026.36(f) and (g), and for reasons related to persons who perform other activities in addition to loan origination activities, the Bureau is revising comments 36(a)-1.i, 36(a)-4, 36(a)-4.v, and 36(a)-5 to clarify further that a person, including a manager, who is employed by a loan originator or creditor (and thus receives compensation from the employer) and who engages in the foregoing loan origination activities is a loan originator. The Bureau is therefore removing language referring to performance of loan origination activities not in the expectation of compensation because it believes that such language created circularity and could cause uncertainty in applying the broader definition of "loan originator."

Industry trade associations, large and small banks, and a credit union requested in their comment letters further clarification on whether certain "back-office" loan processing activities would be considered assisting a consumer in obtaining or applying to obtain an extension of credit and thus included in "arranging" or "otherwise obtaining an extension of credit" for the purposes of the "loan originator" definition. The Bureau believes that after a loan application has been submitted by the consumer to the loan originator or creditor, persons who: (1) provide general explanations or descriptions in response to consumer queries, such as explaining credit terminology or policies, or describing product-related services; (2) verify information provided by the consumer in the credit application, such as by asking the consumer for supporting documentation or the consumer's authorization to obtain supporting documentation from other persons; or (3) compile and assemble credit application packages and supporting documentation to submit to the creditor while acting on behalf of a loan originator or creditor are not "arranging" or "otherwise obtaining an extension of credit" for the purposes of the definition of "loan originator" as described in more detail above. The Bureau is adding specific discussions of these activities to comment 36(a)-4.

Several industry group and bank commenters stated that the final rule should not apply to senior employees who assist consumers only under limited or occasional circumstances. Similarly, these and other industry trade association and bank commenters asserted that the definition of loan originator should not include any employees who are not primarily and regularly engaged in taking the consumer's application and offering or negotiating transaction terms with consumers. A large industry trade association commenter and a bank commenter indicated that the definition of loan originator should not include persons such as managers who originate fewer than a de minimis number of transactions per year, *i.e.*, five and twelve mortgages per year, respectively.

The Bureau believes that creating a complete de minimis exclusion from the mortgage originator restrictions of the Dodd-Frank Act for any person otherwise subject to them and involved in the credit business would be inconsistent with the statutory scheme. TILA section 103(cc)(2) contains a specific, conditional exclusion for seller financers who engage in three transactions or less in a 12-month period. It seems doubtful that Congress would have made that exclusion so limited if it intended other persons who are in the consumer credit business to benefit from a general exclusion where they participate in a perhaps even greater number of transactions. Unlike the licensing and registration provisions of the SAFE Act (12 U.S.C. 5103) for depositories and nondepositories respectively, Congress did not provide an explicit de minimis exclusion (see 12 U.S.C. 5106(c)) or reference individuals engaged in the "business" of loan origination in the Dodd-Frank Act for the new residential mortgage loan origination qualification and compensation requirements in section 129B(b) and (c) of TILA. In the Dodd-Frank Act, Congress merely referred to persons engaging in mortgage originator activities for compensation or gain with one narrow exclusion for seller financers not constructing or acting as a contractor for the construction of a residence on the property being financed in the ordinary course of business. Given the above, the Bureau believes that a narrow exemption for pooled compensation, for example, is more appropriate than a wholesale exclusion from the definition of loan originator for persons otherwise involved with the credit business.

The Bureau believes that the absence of such an exclusion or exemption further demonstrates that Congress intended the definition of "mortgage originator" in TILA, and thus the scope of coverage of TILA's compensation, qualification, and loan document unique identifier provisions, to be broader than the somewhat similar definition of "loan originator" in the SAFE Act, which sets the scope of coverage of the SAFE Act's licensing and registration requirements. The Bureau therefore is not including in the final rule an exemption from its provisions for persons other than seller financers engaged in a limited number of credit transactions per year. The Bureau further believes that declining to create such a de minimis exemption for other persons provides protections for consumers that outweigh any other public benefit that an exemption might provide. However, as discussed in more detail in the section-by-section analysis of § 1026.36(d)(1)(iv), the Bureau believes that a limited de minimis exemption from the prohibition on compensation based on a term of a transaction for participation in profits-based compensation plans is appropriate for loan originators who originate ten or fewer loans in a twelve-month period.

36(a)(1)(ii); 36(a)(1)(iii)

Certain provisions of TILA section 129B, such as the qualification and loan document unique identifier requirements, as well as certain new clarifications in the regulation that the Bureau proposed (and now is adopting), necessitate a distinction between loan originators who are natural persons and those that are organizations. The Bureau therefore proposed to establish the distinction by creating new definitions for “individual loan originator” and “loan originator organization” in new § 1026.36(a)(1)(ii) and (iii). Proposed § 1026.36(a)(1)(ii) would have defined an individual loan originator as a natural person that meets the definition of loan originator in § 1026.36(a)(1)(i). Proposed § 1026.36(a)(1)(iii), in turn, would have defined a loan originator organization as any loan originator that is not an individual loan originator.

The Bureau proposed to revise comment 36(a)-1.i.B to clarify that the term “loan originator organization” is a loan originator other than a natural person, including but not limited to a trust, sole proprietorship, partnership, limited liability partnership, limited partnership, limited liability company, corporation, bank, thrift, finance company, or a credit union. As discussed in the supplementary information of the proposed rule, the Bureau understands that States have recognized many new business forms over the past 10 to 15 years. The Bureau believed that the additional examples provided in the proposal should help to facilitate compliance with § 1026.36 by clarifying the types of persons that fall within the definition of “loan originator organization.” The Bureau invited comment on whether other examples would be helpful for these purposes.

The Bureau received very few comments on the proposed definitions for individual loan originator and loan originator organization. One creditor commenter thought that the additional definitions would add further complexity to describe the various persons acting in the mortgage market. This commenter thought the proposal should return to the definitions that existed in the TILA and Regulation Z framework prior to issuance by the Board of its 2010 Loan Originator Final Rule. That is, this commenter argued, the Bureau should use the terms “individual loan originator” or “individual loan officer” and either “mortgage broker” or “creditor” as appropriate.

The Bureau is adopting § 1026.36(a)(1)(ii) and (iii) as proposed. The Bureau is also adopting comment 36(a)-1.i.B largely as proposed but with the further clarification that “loan originator organization” includes any legal existence other than a natural person. The comment is also adopted in comment 36(a)-1.i.D instead of comment 36(a)-1.i.B as proposed. The Bureau is using the terms “individual loan originator” and “loan originator organization” to facilitate use of the Bureau’s authority to permit loan originator organizations to share compensation on a particular transaction with individual loan originators. Moreover, creditors occasionally act as mortgage brokers and are considered loan originators in their own right for purposes of the qualification and unique identifier provisions in § 1026.36(f) and (g). Accordingly, the Bureau believes use of the terms is appropriate and necessary to allow greater precision and to facilitate compliance with the statutory and regulatory requirements.

36(a)(2) Mortgage Broker

TILA section 129B(b)(1) imposes new substantive requirements on all mortgage originators, including creditors involving qualification requirements and the requirement to include a unique identifier on loan documents, which the Bureau is proposing to implement in § 1026.36(f) and (g). The compensation restrictions applicable to loan originators in existing § 1026.36 also applied to creditors engaged in table-funded transactions. Existing § 1026.36(a)(2) defines "mortgage broker" as "any loan originator that is not an employee of the creditor." This definition would include creditors engaged in table-funded transactions. The Bureau therefore proposed a conforming amendment to exclude creditors for table-funded transactions from the definition of "mortgage broker" even though for certain purposes such creditors are loan originators to accommodate the new qualification and unique identifier requirements. Proposed § 1026.36(a)(2) provided that a mortgage broker is "any loan originator that is not a creditor or the creditor's employee."

The Bureau did not receive any comment on this proposal. The Bureau, however, is not revising the definition of "mortgage broker" as proposed. The revisions made by this final rule to the definition of "loan originator" in § 1026.36(a)(1)(i) accommodate creditors engaged in table-funded transactions and other creditors for the purposes of applying the new substantive requirements in § 1026.36(f) and (g) and the remaining requirements of § 1026.36 generally. Conforming amendments to existing § 1026.36(a)(2) are no longer necessary.

36(a)(3) Compensation

Sections 1401 and 1403 of the Dodd-Frank Act contain multiple references to the term "compensation" but do not define the term. The existing rule does not define the term in regulatory text. Existing comment 36(d)(1)-1, however, provides interpretation on the meaning of compensation.

Definition of Compensation and Comment 36(a)-5.i and ii.

Existing comment 36(d)(1)-1.i provides that the term "compensation" includes salaries, commissions, and any financial or similar incentive provided to a loan originator that is based on any of the terms or conditions of the loan originator's transactions. The Bureau proposed to define the term "compensation" in new § 1026.36(a)(3) to include "salaries, commissions, and any financial or similar incentive provided to a loan originator for originating loans," intending this definition to be consistent with the interpretation in the existing commentary in 36(d)(1)-1.i, as explained in the proposal. Consistent with this proposed definition, proposed comment 36(a)-5.i stated that compensation is defined in § 1026.36(a)(3) as salaries, commissions, and any financial or similar incentive provided to a person for engaging in loan origination activities. Existing comment 36(d)(1)-1.i also provides examples of compensation, and those provisions would have been transferred to proposed comment 36(a)-5.i without revision.

Existing comment 36(d)(1)-1.ii clarifies that compensation includes amounts the loan originator retains and is not dependent on the label or name of any fee imposed in connection with the transaction. The Bureau proposed to transfer these provisions to new proposed comment 36(a)-5.ii without revision.

To clarify the intent of the definition of compensation, the final rule revises the definition in § 1026.36(a)(3) to include "salaries, commissions, and any financial or similar incentive" without specifying "provided to a loan originator for originating loans." The Bureau believes that the definition of "compensation" adopted in the final rule is more consistent with the intent and wording of the existing interpretation on the meaning of compensation set forth in existing comment 36(d)(1)-1.i, and is less circular when viewed in conjunction with the definition of "loan originator." Consistent with the definition of "compensation" as adopted in

§ 1026.36(a)(3), the final rule revises comment 36(a)-5.i to reflect that compensation is defined in § 1026.36(a)(3) as salaries, commissions, and any financial or similar incentive. The final rule also revises comment 36(a)-5.ii to reflect that the definition of compensation in § 1036(a)(3) applies to § 1026.36 generally, including § 1026.36(d) and (e).

Third-Party Charges and Charges for Services That Are Not Loan Origination Activities

Existing comment 36(d)(1)-1.iii provides that compensation includes amounts the loan originator retains, but does not include amounts the originator receives as payments for bona fide and reasonable third-party charges, such as title insurance or appraisals. The Bureau proposed to revise existing comment 36(d)(1)-1.iii (redesignated as proposed comment 36(a)-5.iii) to make more clear that the term "third party" does not include the creditor, its affiliates, or the affiliates of the loan originator. Specifically, proposed comment 36(a)-5.iii would have clarified that the term "compensation" as used in § 1026.36 does not include amounts a loan originator receives as payment for bona fide and reasonable charges, such as credit reports, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator.

The proposed revisions would have been consistent with provisions set forth in TILA section 129B(c)(2) concerning exceptions to the general prohibition on dual compensation for payments made to bona fide third-party service providers, as added by section 1403 of the Dodd-Frank Act. Specifically, TILA section 129B(c)(2)(A) provides that, for any mortgage loan,[69] a

[69] TILA section 129B(c)(2) uses the term "mortgage loan" rather than the "residential mortgage loan" used in TILA section 129B(c)(1), which generally prohibits compensation from being paid to loan originators based on loan terms. Nonetheless, the Bureau believes that the restrictions in TILA section 129B(c)(2) are limited to "residential mortgage loans" because TILA section 129B(c)(2) applies to mortgage originators. The definition of "mortgage originator" in TILA section 103(cc)(2) generally means a person who for compensation takes a residential mortgage loan application; assists a consumer in obtaining or applying to obtain a residential mortgage loan, or offers or negotiates terms of a residential mortgage loan.

mortgage originator generally may not receive from any person other than the consumer any origination fee or charge except bona fide third-party charges not retained by the creditor, the mortgage originator, or an affiliate of either. Likewise, no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third-party charges as described above. In addition, TILA section 129B(c)(2)(B) provides that a mortgage originator may receive an origination fee or charge from a person other than the consumer if, among other things, the mortgage originator does not receive any compensation directly from the consumer. As discussed in more detail in the section-by-section analysis of § 1026.36(d)(2), the proposal interpreted "origination fee or charge" to mean compensation that is paid in connection with the transaction, such as commissions that are specific to, and paid solely in connection with, the transaction.

Nonetheless, TILA section 129B(c)(2) does not prevent a mortgage originator from receiving payments from a person other than the consumer for bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of either, even if the mortgage originator also receives loan originator compensation directly from the consumer. For example, assume that a mortgage originator receives compensation directly from a consumer in a transaction. TILA section 129B(c)(2) does not restrict the mortgage originator from receiving payment from a person other than the consumer (*e.g.*, a creditor) for bona fide charges, such as title insurance or appraisals, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator.

Consistent with TILA section 129B(c)(2), under proposed § 1026.36(d)(2)(i) and proposed comment 36(a)-5.iii, a loan originator that receives compensation directly from a consumer would not have been restricted under proposed § 1026.36(d)(2)(i) from receiving a payment from a person other than the consumer for bona fide and reasonable charges where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. In addition, a loan originator would not be deemed to be receiving compensation directly from a consumer for purposes of proposed § 1026.36(d)(2)(i) where the originator imposes such a bona fide and reasonable third-party charge on the consumer.

Like existing comment 36(d)(1)-1, proposed comment 36(a)-5.iii also would have recognized that, in some cases, amounts received for payment for such third-party charges may exceed the actual charge because, for example, the loan originator cannot determine with accuracy what the actual charge will be before consummation. In such a case, under proposed comment 36(a)-5.iii, the difference retained by the originator would not have been deemed compensation if the third-party charge collected from a person other than the consumer was bona fide and reasonable, and also complies with State and other applicable law. On the other hand, if the loan originator marks up a third-party charge and retains the difference between the actual charge and the marked-up charge, the amount retained would have been compensation for purposes of § 1026.36(d) and (e).

Proposed comment 36(a)-5.iii, like existing comment 36(d)(1)-1.iii, would have contained two illustrations. The illustrations in proposed comment 36(a)-5.iii.A and B would have been similar to the ones contained in existing comment 36(d)(1)-1.iii.A and B except that the illustrations would have been amended to clarify that the charges described in those illustrations are not paid to the creditor, its affiliates, or the affiliate of the loan originator. The proposed illustrations also would have simplified the existing illustrations.

The Bureau solicited comment on proposed comment 36(a)-5.iii. Specifically, the Bureau requested comment on whether the term “compensation” should exclude payment from the consumer or from a person other than the consumer to the loan originator, as opposed to a third party, for certain unambiguously ancillary services rather than core loan origination services, such as title insurance or appraisal, if the loan originator, creditor or the affiliates of either performs those services, so long as the amount paid for those services is bona fide and reasonable. The Bureau further solicited comment on how such ancillary services might be described clearly enough to distinguish them from the core origination charges that would not be excluded under such a provision.

Several industry commenters suggested that the definition of “compensation” in § 1026.36(a)(3) should exclude payments to loan originators for services other than core loan origination services, such as title insurance or appraisal, regardless of whether the loan originator, creditor, or affiliates of either are providing these services, so long as the amount charged for those services are bona fide and reasonable. Other industry commenters suggested that the Bureau specifically exclude bona fide and reasonable affiliate fees from the definition of “compensation” in § 1026.36(a)(3). These commenters argued that there is no basis for a distinction between affiliate and non-affiliate charges. These commenters also argued that a requirement that both affiliate and non-affiliate charges be bona fide and reasonable would be sufficient to protect consumers. In addition, several commenters stated that affiliated business arrangements are expressly permitted and regulated by RESPA. One commenter further argued that the Bureau’s proposal discourages the use of affiliates, which undercuts a goal of the Bureau’s 2012 TILA-RESPA Proposal to increase certainty around the costs imposed by affiliated providers by providing for a zero tolerance for settlement charges of affiliated entities.

Another commenter stated that fees paid to affiliated parties for services such as property insurance, home warranties (both service contract and insurance products), and similar services should be excluded from the definition of "compensation" in the same manner as third-party charges. The commenter stated that all of these types of services relate to the purchase of a home, and are traditionally purchased or maintained regardless of whether the home purchase is financed. Therefore, the commenter suggested that these types of services are clearly not related to core loan origination services, *i.e.*, taking an application, assisting in obtaining a loan, or offering/negotiating loan terms.

Certain industry commenters also expressed particular concern that affiliated title charges were not explicitly excluded from the definition of "compensation." These commenters stated that there is no rational basis for not explicitly excluding affiliated title charges from the definition of "compensation" because, for example, title insurance fees are regulated at the State level either through statutorily prescribed rates or through a requirement that title insurance premiums be publicly filed. These commenters noted that, as a result of State regulation, there is little variation in title insurance charges from provider to provider and such charges are not subject to manipulation. In a variation of the argument that the Bureau generally should exclude affiliate charges from the definition of "compensation," some industry commenters suggested that the Bureau should adopt a specific exclusion for affiliates' title fees to the extent such fees are otherwise regulated at the State level, or to the extent that such charges are reasonable and do not exceed the cost for an unaffiliated issuers title insurance.

With respect to third-party charges, the final rule adopts comment 36(a)-5.iii substantially as proposed, except that the interpretation discussing situations where the amounts received for payment for third-party charges exceeds the actual charge has been moved to comment 36(a)-

5.v, as discussed in more detail below. The Bureau notes that comment 36(a)-5.iii uses the term "bona fide and reasonable" to describe third-party charges. As in the 2013 ATR Final Rule and 2013 HOEPA Final Rule, in response to commenters' concerns that the "reasonableness" of third-party charges may be second-guessed, the Bureau notes its belief that the fact that a transaction for such third-party services is conducted arms-length ordinarily should be sufficient to make the charge reasonable.

In addition, based on comments received and the Bureau's own analysis, the final rule revises comment 36(a)-5.iv to clarify whether payments for services that are not loan origination activities are compensation under § 1026.36(a)(3). As adopted in the final rule, comment 36(a)-5.iv.A clarifies that the term "compensation" for purposes of § 1026.36(a)(3) does not include: (1) a payment received by a loan originator organization for bona fide and reasonable charges for services it performs that are not loan origination activities; (2) a payment received by an affiliate of a loan originator organization for bona fide and reasonable charges for services it performs that are not loan origination activities; or (3) a payment received by a loan originator organization for bona fide and reasonable charges for services that are not loan origination activities where those amounts are not retained by the loan originator organization but are paid to the creditor, its affiliate, or the affiliate of the loan originator organization. Comment 36(a)-5.iv.C as adopted clarifies that loan origination activities for purposes of that comment means activities described in § 1026.36(a)(1)(i) (*e.g.*, taking an application, offering, arranging, negotiating, or otherwise obtaining an extension of consumer credit for another person) that would make a person performing those activities for compensation a loan originator as defined in § 1026.36(a)(1)(i).

The Bureau recognizes that loan originator organizations or their affiliates may provide services to consumers that are not loan origination activities, such as title insurance, if permitted by State and other applicable law. If the term "compensation" for purposes of § 1026.36(a)(3) were applied to include amounts paid by the consumer or a person other than the consumer for services that are not loan origination activities, the loan originator organization or its affiliates could be restricted under § 1026.36(d)(1) and (d)(2) from being paid for those services. For example, assume a loan originator organization provides title insurance services to consumers and that title insurance is required on a transaction and thus is a term of the transaction under § 1026.36(d)(1)(ii). In addition, assume the loan originator organization receives compensation from the creditor in a transaction. If compensation for purposes of § 1026.36(a)(3) included amounts paid for these services by consumers to the loan originator organization, the payment of the charge to the loan originator organization for title insurance services would be prohibited by § 1026.36(d)(1) because the amount of the loan originator organization's compensation would increase based on a term of the transaction, namely the fact that the consumer received the title insurance services from the loan originator instead of a third party. In addition, the loan originator organization would be prohibited by the dual compensation provisions in § 1026.36(d)(2) (redesignated as § 1026.36(d)(2)(i)) from both collecting the title insurance fee from the consumer, and also receiving compensation from the creditor for this transaction.

Likewise, assume the same facts, except that the loan originator organization's affiliate provided the title insurance services to the consumer. The amount of any payment to the affiliate directly or through the loan originator organization for the title insurance would be considered compensation to the loan originator organization because under § 1026.36(d)(3) the loan originator organization and its affiliates are treated as a single person. Thus, if compensation for purposes of § 1026.36(a)(3) included amounts paid for the title insurance services to the affiliate, the affiliate could not receive payment for the title insurance services without the loan originator organization violating § 1026.36(d)(1) and (d)(2).

The Bureau also recognizes that loan originator organizations may receive payment for services that are not loan origination activities where those amounts are not retained by the loan originator but are paid to the creditor, its affiliate, or the affiliate of the loan originator organization. For example, assume a loan originator organization receives compensation from the creditor in a transaction. Further assume the loan originator organization collects from the consumer $25 for a credit report provided by an affiliate of the creditor, and this fee is bona fide and reasonable. Assume also that the $25 for the credit report is paid by the consumer to the loan originator organization but the loan originator organization does not retain this $25. Instead, the loan originator organization pays the $25 to the creditor's affiliate for the credit report. If the term "compensation" for purposes of § 1026.36(a)(3) included amounts paid by the consumer or a person other than the consumer for such services that are not loan origination activities, the loan originator organization would be prohibited by § 1026.36(d)(2) (redesignated as § 1026.36(d)(2)(i)) from both collecting this $25 fee from the consumer, and also receiving compensation from the creditor for this transaction.

The Bureau believes that it is appropriate for loan originator organizations and their affiliates to receive payments for services that are not loan origination activities, as described above, so long as the charge imposed on the consumer or collected from a person other than the consumer for these services is bona fide and reasonable. The Bureau believes that the bona fide and reasonable standards will provide sufficient protection to prevent loan originator organizations from circumventing the restrictions in § 1026.36(d)(1) and (2) by disguising compensation for loan origination activities within ancillary service charges.

The Bureau notes, however, that the final rule does not allow individual loan originators to distinguish between payments they receive for performing loan origination activities and payments purportedly being received for performing other activities. Comment 36(a)-5.iv.B as adopted in the final rule makes clear that compensation includes any salaries, commissions, and any financial or similar incentive provided to an individual loan originator, regardless of whether it is labeled as payment for services that are not loan origination activities. The Bureau believes that allowing individual loan originators to distinguish between these two types of payments would promote circumvention of the restrictions on compensation in § 1026.36(d)(1) and (2). For example, if an individual loan originator were allowed to exclude from the definition of "compensation" payments to it by the loan originator organization by asserting that this payment was received for performing activities that are not loan origination activities, a loan originator organization and/or the individual loan originator could disguise compensation for loan origination activities by simply labeling those payments as received for activities that are not loan origination activities. The Bureau believes that it would be difficult for compliance and enforcement purposes to determine whether the payments that were labeled as received for activities that are not loan origination activities were legitimate payment for those activities or whether these payments were labeled as payments for activities that are not loan origination activities merely to evade the restrictions in § 1026.36(d)(1) and (2).

The Bureau further notes that the additional interpretation in comment 36(a)-5.iv as adopted in the final rule does not permit a loan originator organization or an individual loan originator to receive compensation based on whether the consumer obtains an ancillary service from the loan originator organization or its affiliate if that service is a term of the transaction under § 1026.36(d)(1). For example, assume that title insurance is required for a transaction and thus is a term of the transaction under § 1026.36(d)(1)(ii). In this case, a loan originator organization would be prohibited under § 1026.36(d)(1) from charging the consumer compensation of 1.0 percent of the loan amount if the consumer obtains title insurance from the loan originator organization, but charging the consumer 2.0 percent of the loan amount if the consumer does not obtain title insurance from the loan originator organization. Likewise, in that transaction, an individual loan originator would be prohibited under § 1026.36(d)(1) from receiving a larger amount of compensation from the loan originator organization if the consumer obtained title insurance from the loan originator organization as opposed to obtaining title insurance from a third party.

As discussed above, the final rule moves the interpretation in proposed comment 36(a)-5.iii discussing situations where the amounts received for payment for third-party charges exceeds the actual charge to comment 36(a)-5.v, and revises it. The final rule also extends this interpretation to amounts received by the loan originator organization for payment for services that are not loan origination activities where those amounts are not retained by the loan originator but are paid to the creditor, its affiliate, or the affiliate of the loan originator organization.

Specifically, as discussed above, comment 36(a)-5.iii as adopted in the final rule clarifies that the term "compensation" as used in § 1026.36 does not include amounts a loan originator receives as payment for bona fide and reasonable charges, such as credit reports, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. In addition, comment 36(a)-5.iv.A.*3* clarifies that compensation does not include the amount the loan originator organization receives as payment for bona fide and reasonable charges for services that are not loan origination activities where those amounts are not retained by the loan originator but are paid to the creditor, its affiliate, or the affiliate of the loan originator organization. Comment 36(a)-5.v notes that, in some cases, amounts received by the loan originator organization for payment for third-party charges described in comment 36(a)-5.iii or payment for services to the creditor, its affiliates, or the affiliates of the loan originator organization described in comment 36(a)-5.iv.A.*3* may exceed the actual charge because, for example, the loan originator organization cannot determine with accuracy what the actual charge will be when it is imposed and instead uses average charge pricing (in accordance with RESPA). In such a case, comment 36(a)-5.v provides that the difference retained by the loan originator organization is not compensation if the charge imposed on the consumer or collected from a person other than the consumer was bona fide and reasonable, and also complies with State and other applicable law. On the other hand, if the loan originator organization marks up the charge (a practice known as “upcharging”), and the loan originator organization retains the difference between the actual charge and the marked-up charge, the amount retained is compensation for purposes of § 1026.36, including § 1026.36(d) and (e). Comment 36(a)-5.v as adopted in the final rule contains two examples illustrating this interpretation.

Returns on Equity Interests and Dividends on Equity Holdings

In the proposal, the Bureau proposed new comment 36(a)-5.iv to clarify that the definition of compensation for purposes of § 1026.36(d) and (e) includes stock, stock options, and equity interests that are provided to individual loan originators and that, as a result, the provision of stock, stock options, or equity interests to individual loan originators is subject to the restrictions in § 1026.36(d) and (e). The proposed comment would have further clarified that bona fide returns or dividends paid on stock or other equity holdings, including those paid to loan originators who own such stock or equity interests, are not considered compensation for purposes of § 1026.36(d) and (e). The comment would have explained that: (1) bona fide returns or dividends are those returns and dividends that are paid pursuant to documented ownership or equity interests allocated according to capital contributions and where the payments are not mere subterfuges for the payment of compensation based on transaction terms; and (2) bona fide ownership or equity interests are ownership or equity interests not allocated based on the terms of a loan originator's transactions. The comment would have given an example of a limited liability company (LLC) loan originator organization that allocates its members' respective equity interests based on the member's transaction terms; in that instance, the distributions are not bona fide and, thus, are considered compensation for purposes of § 1026.36(d) and (e). The Bureau stated that it believed the clarification provided by proposed comment 36(a)-5.iv was necessary to distinguish legitimate returns on ownership from returns on ownership in companies that manipulate business ownership structures as a means to circumvent the restrictions on compensation in § 1026.36(d) and (e).

The Bureau invited comment on proposed comment 36(a)-5.iv and on whether other forms of corporate structure or returns on ownership interest should have been specifically addressed in the definition of "compensation." The Bureau also sought comment generally on other methods of providing incentives to loan originators that the Bureau should have considered specifically addressing in the proposed interpretation of the term "compensation." The Bureau received only one comment substantively addressing the issues raised in the proposed comment. A State credit union trade association commented that the proposed redefinition of compensation to include stock, stock options, and equity interests that are provided to individual loan originators would "exponentially" increase the cost of record retention because, the commenter argued, the records must be retained for each individual loan originator. The association believed the proposed three-year retention requirement in § 1026.25(c)(2) would not otherwise be problematic but for the revised definition of compensation.

The Bureau has not made any changes in response to this commenter. The Bureau disagrees with the commenter that the proposed redefinition of compensation to include stock, stock options, and equity interests that are provided to individual loan originators would increase the costs of record retention at all, let alone an "exponential" amount. The Bureau believes that records evidencing the award of stock and stock options are no more difficult and expensive to retain than records evidencing payment of cash compensation, particularly if such awards are made pursuant to a stock options plan or similar company-wide plan. Moreover, the awarding of equity interests to an individual loan originator by a creditor or loan originator organization presumably would be documented by an LLC agreement or similar legal document, which can be easily and inexpensively retained (as can the records of any distributions made under the LLC or like agreement).

Accordingly, the Bureau is adopting the substance of proposed comment 36(a)-5.iv (but codified as comment 36(a)-5.vi because of additional new comments being adopted) as proposed, with two changes. First, comment 36(a)-5.vi references "loan originators" rather than "individual loan originators" whereas the proposal language used such terms inconsistently. Reference to "loan originators" is appropriate to account for the possibility that the comment could, depending on the circumstances, apply to a loan originator organization or an individual loan originator. Second, comment 36(a)-5.vi now includes an additional clarification about what constitutes "bona fide" ownership and equity interests. The proposed comment would have clarified that the term "compensation" for purposes of § 1026.36(d) and (e) does not include bona fide returns or dividends paid on stock or other equity holdings. The proposed comment would have clarified further that returns or dividends are "bona fide" if they are paid pursuant to documented ownership or equity interests, if they are not functionally equivalent to compensation, and if the allocation of bona fide ownership and equity interests according to capital contributions is not a mere subterfuge for the payment of compensation based on transaction terms. In addition to these clarifications which the Bureau is adopting as proposed, the final comment clarifies that ownership and equity interests are not "bona fide" if the formation or maintenance of the business organization from which returns or dividends are paid is a mere subterfuge for the payment of compensation based on the terms of transactions. The Bureau believes this additional language is necessary to prevent evasion of the rule through the use of corporations, LLCs, or other business organizations as vehicles to pass through payments to loan originators that otherwise would be subject to the restrictions of § 1026.36(d) and (e).

36(a)(4) Seller Financers; Three Properties

In support of the exclusion for seller financers in § 1026.36(a)(1)(i)(D) discussed above, under the statute's exclusion incorporated with clarifications, adjustments, and additional criteria into the rule as the three-property exclusion in § 1026.36(a)(4), a person (as defined in § 1026.2(a)(22), to include an estate or trust) that meets the criteria in § 1026.36(a)(4) is not a loan originator under § 1026.36(a)(1).[70] In § 1026.36(a)(4) the Bureau has largely preserved the

[70] The Bureau's proposal would have implemented the seller financer exclusion in TILA section 103(cc)(2)(E) to be available only to "natural persons," estates, and trusts. *See* 77 FR at 55288, 55357. As discussed below, the three-property exclusion in the final rule is available to "persons," estates, and trusts, consistent with the language in TILA section 103(cc)(2)(E). "Person" is defined in § 1026.2(a)(22) to mean "a natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit." *See*

statutory criteria for the seller financer exclusion but with some alternatives to reduce complexity and facilitate compliance, while balancing the needs of consumers, including by adding three additional criteria.

The first criterion is that the person provides seller financing for the sale of three or fewer properties in any 12-month period to purchasers of such properties, each of which is owned by the person and serves as security for the financing. This criterion tracks the introductory language of TILA section 103(cc)(2)(E).

The second criterion is that the person has not constructed, or acted as a contractor for the construction of, a residence on the property in the ordinary course of business of the person. This criterion tracks TILA section 103(cc)(2)(E)(i).

The third criterion is that the person provides seller financing that meets three requirements: First, the financing must be fully amortizing. This requirement tracks TILA section 103(cc)(2)(E)(ii). Second, the person must determine in good faith that the consumer has a reasonable ability to repay. The language of this requirement largely tracks TILA section 103(cc)(2)(E)(iii). It departs from the statute, however, in that it does not require documentation of the good faith determination. Where seller financers retain such documentation, they will be able to respond to questions that could arise as to their compliance with TILA and Regulation Z. However, pursuant to its authority under TILA section 105(a), the Bureau is not adopting a requirement that the seller document the good faith determination. The Bureau believes that the statute's exclusion is designed primarily to accommodate persons or smaller-sized estates or family trusts with no, or less sophisticated, compliance infrastructures. If technical

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also 15 U.S.C. 1602(d) and (e). The Bureau is not including the words "estate" and "trust" in the three-property exclusion, as the term "person" includes estates and trusts. In contrast, the one-property exclusion in the final rule is available only to "natural persons," estates, and trusts.

recordkeeping violations were sufficient to jeopardize a person's status as a seller financer, this could limit the value of the exclusion. Accordingly, the Bureau believes that alleviating such burdens for seller financers will effectuate the purposes of TILA by ensuring that responsible, affordable mortgage credit remains available to consumers and will facilitate compliance by seller financers.

The third requirement of this third criterion is that the financing have a fixed rate or an adjustable rate that is adjustable after five or more years, subject to reasonable annual and lifetime limitations on interest rate increases. This requirement largely tracks TILA section 103(cc)(2)(E)(iv). However, the Bureau believes that, for the financing to have reasonable annual and lifetime limitations on interest rate increases, the foundation upon which those limitations is based must itself be reasonable. This requirement can be met if the index is widely published. Accordingly, the final rule also provides: (1) if the financing agreement has an adjustable rate, the rate must be determined by the addition of a margin to an index and be subject to reasonable rate adjustment limitations; and (2) the index on which the adjustable rate is based must be a widely available index such as indices for U.S. Treasury securities or LIBOR. The Bureau is interpreting and adjusting the criterion in TILA section 103(cc)(2)(E)(iv) using its authority under TILA section 105(a). The Bureau believes its approach effectuates the purposes of TILA in ensuring consumers are offered and receive consumer credit that is understandable and not unfair, deceptive or abusive. To the extent the additional provisions could be considered additional criteria, the Bureau is also exercising its authority under TILA section 103(cc)(2)(E)(v) to add additional criteria.

The Bureau is adding a new comment 36(a)(4)-1 to explain how a person can meet the criterion on a good faith determination of ability to repay under the three-property exclusion. It provides that the person determines in good faith that the consumer has a reasonable ability to repay the obligation if the person either complies with general ability-to-repay standards in § 1026.43(c) or complies with alternative criteria described in the comment.

The Bureau is providing the option of making the good faith determination of ability to repay based on alternative criteria using its interpretive authority under TILA section 105(a) and section 1022 of the Dodd-Frank Act. The Bureau believes that many seller financers who may occasionally finance the sales of properties they own may not be in a position feasibly to comply with all of the requirements of § 1026.43(c) in meeting the criterion in TILA section 103(cc)(2)(E)(iii). As discussed above, the Bureau believes that the statute's exclusion is designed primarily to accommodate persons or smaller-sized estates or family trusts with no, or less sophisticated, compliance infrastructures. Furthermore, providing alternative standards to meet this criterion will help ensure that responsible, affordable seller financing remains available to consumers consistent with TILA section 129B(a)(1).

New comment 36(a)(4)-1 explains how a person could consider the consumer's income to make the good faith determination of ability to repay. If the consumer intends to make payments from income, the person considers evidence of the consumer's current or reasonably expected income. If the consumer intends to make payments with income from employment, the person considers the consumer's earnings, which may be reflected in payroll statements or earnings statements, IRS Form W-2s or similar IRS forms used for reporting wages or tax withholding, or military Leave and Earnings Statements. If the consumer intends to make payments from other income, the person considers the consumer's income from sources such as from a Federal, State, or local government agency providing benefits and entitlements. If the consumer intends to make payments from income earned from assets, the person considers income from the relevant assets, such as funds held in accounts with financial institutions, equity ownership interests, or rental property. However, the value of the dwelling that secures the financing does not constitute evidence of the consumer's ability to repay. In considering these and other potential sources of income to determine in good faith that the consumer has a reasonable ability to repay the obligation, the person making that determination may rely on copies of tax returns the consumer filed with the IRS or a State taxing authority.

New comment 36(a)(4)-2 provides safe harbors for the criterion that a seller financed adjustable rate financing be subject to reasonable annual and lifetime limitations on interest rate increases. New comment 36(a)(4)-2.i. provides that an annual rate increase of two percentage points or less is reasonable. New comment 36(a)(4)-2.ii. provides that a lifetime limitation of an increase of six percentage points or less, subject to a minimum floor of the person's choosing and maximum ceiling that does not exceed the usury limit applicable to the transaction, is reasonable.

36(a)(5) Seller Financers; One Property

In support of the exclusion for seller financers in § 1026.36(a)(1)(i)(D) discussed above, the Bureau is further establishing criteria for the one-property exclusion in § 1026.36(a)(5). The Bureau has attempted to implement the statutory exclusion in a way that effectuates congressional intent, but remains concerned that the exclusion is fairly complex. The Bureau understands that natural persons, estates, and trusts that rarely engage in seller financing may engage in such transactions a few times during their lives in the case of natural persons or perhaps not more than once for estates or family trusts. For this reason, and given the complexities commenters highlighted of the seller financer exclusion in the statute, the Bureau is establishing an additional exclusion where only one property is financed in a given 12-month period.

Under the exclusion incorporated into the final rule as the one-property exclusion in § 1026.36(a)(5), a natural person, an estate, or a trust (but not other persons) that meets the criteria in that paragraph is not a loan originator under § 1026.36(a)(1). The first criterion is that the natural person, estate, or trust provides seller financing for the sale of only one property in any 12-month period to purchasers of such property, which is owned by the natural person, estate, or trust and serves as security for the financing. This criterion is similar to the introductory language of TILA section 103(cc)(2)(E), except that rather than a three-property maximum per 12-month period, the one-property exclusion uses a one-property maximum per 12-month period.

The second criterion is that the natural person, estate, or trust has not constructed, or acted as a contractor for the construction of, a residence on the property in the ordinary course of business of the person, estate or trust. Again, this criterion tracks TILA section 103(cc)(2)(E)(i).

The third criterion is that the financing meet two requirements: First, the financing must have a repayment schedule that does not result in negative amortization. This requirement is narrower than the criterion in TILA section 103(cc)(2)(E)(ii), which requires that the financing be fully amortizing, not just that it does not result in negative amortization. The second requirement parallels the third criterion's third requirement for the three-property exclusion, described above, with regard to credit terms. Specifically, consistent with TILA section 103(cc)(2)(E)(iv), the financing must have a fixed rate or an adjustable rate that is adjustable after five or more years, subject to reasonable annual and lifetime limitations on interest rate increases. Further, if the financing agreement has an adjustable rate, the rate must be determined by the addition of a margin to an index and be subject to reasonable rate adjustment limitations. In addition, the index on which the adjustable rate is based must be a widely available index such as indices for U.S. Treasury securities or LIBOR. The Bureau has also adopted comment 36(a)(5)-1 to provide the same safe harbors regarding adjustable rate financing as apply under the three-property exclusion as discussed above with respect to the one-property exclusion.

The Bureau believes that the one-property exclusion is appropriate because natural persons, estates, or trusts that may finance the sales of properties not more than once in a 12-month period (and perhaps only a few times in a lifetime) are not in a position to comply with all of the requirements of § 1026.43(c) or even the alternative criteria under the three-property exclusion discussed above in meeting the criterion in TILA section 103(cc)(2)(E)(iii). Accordingly, the Bureau believes this exclusion will help ensure that responsible, affordable seller financing remains available to consumers consistent with TILA section 129B(a)(1). Natural persons, trusts, and estates using this exclusion do not need to comply with the criteria in TILA section 103(cc)(2)(E) to be excluded from the definition of loan originator under § 1026.36(a)(1) as seller financers.

In creating the exclusion, the Bureau is relying on its authority under TILA section 105(a) to prescribe rules providing adjustments and exceptions necessary or proper to facilitate compliance with and effectuate the purposes of TILA. At the same time, to the extent the Bureau is imposing other criteria that are not in TILA section 103(cc)(2)(E) on natural persons, trusts, and estates using this exclusion, the Bureau is exercising its authority under TILA section 105(a) to impose additional requirements the Bureau determines are necessary or proper to effectuate the purposes of TILA or to facilitate compliance therewith. The Bureau also has authority to impose additional criteria under TILA section 103(cc)(2)(E)(v). The Bureau believes that any risk of consumer harm under the one-property exclusion is not appreciably greater than the risk under the three-property exclusion.

36(b) Scope

Scope of Transactions Covered by § 1026.36

This rulemaking implements new TILA sections 129B(b)(1) and (2) and (c)(1) and (2) and 129C(d) and (e), as added by sections 1402, 1403, and 1414(a) of the Dodd-Frank Act. TILA section 129B(b)(1) and (2) and (c)(1) and (2) requires that loan originators be "qualified;" that depository institutions maintain policies and procedures to ensure compliance with various requirements; restrictions on loan originator compensation; and restrictions on the payment of upfront discount points and origination points or fees with respect to "residential mortgage loans." TILA section 129B(c)(2) applies to mortgage originators engaging in certain activities with respect to "any mortgage loan" but for reasons discussed above, the Bureau interprets TILA section 129B(c)(2) to only apply to residential mortgage loans. TILA section 103(cc)(5) defines a "residential mortgage loan" as "any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling, other than a consumer credit transaction under an open end credit plan" or a time share plan under 11 U.S.C. 101(53D). TILA section 129C(d) and (e) impose prohibitions on mandatory arbitration and single-premium credit insurance for residential mortgage loans or any extension of credit under an open-end consumer credit plan secured by the principal dwelling of the consumer.

The Bureau proposed to recodify § 1026.36(f) as § 1026.36(j) to accommodate new § 1026.36(f), (g), (h), and (i). The Bureau also proposed to amend § 1026.36(j) to reflect the scope of coverage for the proposals implementing TILA sections 129B (except for 129B(c)(3)) and 129C(d) and (e), as added by sections 1402, 1403, and 1414(a) of the Dodd-Frank Act, as discussed further below.

The proposal would have applied, in § 1026.36(h), the new prohibition on mandatory arbitration clauses, waivers of Federal claims, and related issues mandated by TILA section 129C(e) and, in § 1026.36(i), the new prohibition on financing single-premium credit insurance mandated by TILA section 129C(e) both to home equity lines of credit (HELOCs), as defined by § 1026.40, and closed-end credit transactions secured by the consumer's principal dwelling. In contrast, the proposal would have amended § 1026.36(j) to apply the new loan originator qualification and loan document identification requirements in TILA section 129B(b), as implemented in new § 1026.36(f) and (g), to closed-end consumer credit transactions secured by a dwelling (which is broader than the consumer's principal dwelling), but not to HELOCs. This scope of coverage would have been the same as the scope of transactions covered by § 1026.36(d) and (e) (governing loan originator compensation and the prohibition on steering), which coverage the proposal would not have amended. The proposal also would have made technical revisions to comment 36-1 to reflect these scope-of-coverage changes.

A mortgage broker association and several mortgage brokers and mortgage bankers submitted similar comments specifically stating that the Bureau should exempt all prime, traditional, and government credit products from the compensation regulations while retaining restrictions for high-cost and subprime mortgages. These commenters suggested that the exemption would eliminate any incentive for placing a prime qualified consumer in a high-cost mortgage for the purpose of greater financial gain.

A State housing finance authority submitted a comment requesting that the Bureau exempt products developed by and offered through housing finance agencies. The commenter stated that it developed credit products for at-or-below median income households and poorly served rural communities and assisted repairing and remediating code violations in urban centers. The commenter further stated that its products addressed unmet needs in the marketplace, including energy efficiency and repair credit, partnership credit programs with Habitat for Humanity, rehabilitation credit programs for manufactured housing, down-payment and closing cost assistance programs for first-time homebuyers, and employee assistance programs for affordable homes near work.[71]

The Bureau believes that in most cases exempting certain credit products would be contrary to the Dodd-Frank Act compensation restrictions that apply to all mortgage loans regardless of the product type or the social or economic goals advanced by the creditor or loan originator organization. Section 1026.36(d) applies to all closed-end consumer credit secured by a dwelling except for certain time share-secured transactions and does not make a distinction between whether a credit transaction is prime or subprime. The specific mortgage originator compensation restrictions and qualification requirements in TILA section 129B added by the Dodd-Frank Act do not specify different treatment on the basis of credit transaction type.[72] The Bureau believes that, regardless of the type of mortgage product being sold or its value to consumers, the policy of ensuring that the loan originator is qualified and trained is still relevant. The Bureau likewise believes that, regardless of the product type, consumers are entitled to

[71] The same commenter noted that HUD expressly exempted housing finance agencies from the SAFE Act based on HUD's finding that these agencies "carry out housing finance programs … without the purpose of obtaining profit." The SAFE Act applies only to individuals who engage "in the business of a loan originator." *See* 12 U.S.C. 1504(a). The Dodd-Frank Act does not similarly require a nexus to business activity.

[72] Moreover, the statement of Congressional findings in the Dodd-Frank Act accompanying the amendments to TILA that are the subject of this rulemaking supports the application of the rulemaking provisions to the prime mortgage market. Congress explained that it found "that economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers." Section 1402 of the Dodd-Frank Act (TILA section 129B(a)(1). This statement does not distinguish different types of credit products.

protection from loan originators with conflicting interests and thus that the restrictions on compensating the loan originator based on transaction terms and on dual compensation are relevant across-the board. Accordingly, the Bureau declines to create distinctions between credit products in setting forth this rulemaking's scope of coverage.

The Bureau received a comment noting discrepancies among the supplementary information, regulation text, and commentary regarding § 1026.36(h) and (i). The Bureau is finalizing the scope provisions as proposed but adopting proposed § 1026.36(j) as § 1026.36(b) with the heading, "Scope" and providing in § 1026.36(b) and comment 36-1 (now redesignated comment 36(b)-1) that § 1026.36(h) and (i) also applies to closed-end consumer credit transactions secured by a dwelling. The Bureau believes that organizing the scope section after the definitions section in § 1026.36(a) and providing a heading will facilitate compliance by making the scope and coverage of the rule easier to discern. The Bureau notes that, to determine the scope of coverage for any particular substantive provision in § 1026.36, the applicable scope of coverage provision in § 1026.36(b), the scope of coverage in comment 36(b)-1, and the substantive regulatory provision itself must be read together. The Bureau's redesignation of comment 36-1 to comment 36(b)-1 should additionally facilitate compliance by making the scope and coverage of the rule easier to discern.

To the extent there is any uncertainty in TILA sections 129B (except for (c)(3)) and 129C(d) and (e) regarding which provisions apply to different types of transactions, the Bureau relies on its interpretive authority under TILA section 105(a).

Consumer Credit Transaction Secured by a Dwelling

Existing § 1026.36 applies the section's coverage to "a consumer credit transaction secured by a dwelling." TILA section 129B uses the term "residential mortgage loan" for the purpose of determining the applicability of the provisions of this rulemaking. TILA section 103(cc)(5) defines a "residential mortgage loan" as "any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling, other than a consumer credit transaction under an open end credit plan." The proposal would have continued to use "consumer credit transaction secured by a dwelling" and would not have adopted "residential mortgage loan" in § 1026.36.

Existing § 1026.2(a)(19) defines "dwelling" to mean "a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence." In the proposal, the Bureau explained that the definition of "dwelling" in § 1026.2(a)(19) was consistent with the meaning of dwelling in the definition of "residential mortgage loan" in TILA section 103(cc)(5). The Bureau proposed to interpret "dwelling" also to include dwellings in various stages of construction. Consumer credit to finance construction is often secured by dwellings in this fashion. The Bureau proposed to maintain this definition of dwelling.

The Bureau did not receive comment on its intention to continue to use consumer credit transaction secured by a dwelling or its interpretation of a dwelling. The Bureau continues to believe that changing the terminology of "consumer credit transaction secured by a dwelling" to "residential mortgage loan" is unnecessary because the same meaning would be preserved. Accordingly, the Bureau is adopting § 1026.36(b) as proposed.

36(d) Prohibited Payments to Loan Originators

Section 1026.36(d) contains the core restrictions on loan originator compensation in this final rule. Section 1026.36(d)(1) generally prohibits compensation based on the terms of the transaction, other than credit amount. This section is designed to address incentives that could cause a loan originator to steer consumers into particular credit products or features to increase the loan originator's own compensation. Section 1026.36(d)(2) generally prohibits loan originators from receiving compensation in connection with a transaction from both the consumer and other persons (dual compensation), and is designed to address potential consumer confusion about loan originator loyalty where a consumer pays an upfront fee but does not realize that the loan originator may also be compensated by the creditor. Each of these prohibitions is similar to one first enacted in the Board's 2010 Loan Originator Final Rule. Congress largely codified similar prohibitions in the Dodd-Frank Act, with some adjustments; this final rule reconciles certain differences between the statutory and regulatory provisions.

36(d)(1) Payments Based on a Term of A Transaction

As discussed earlier, section 1403 of the Dodd-Frank Act added new TILA section 129B(c). This new statutory provision builds on, but in some cases imposes new or different requirements than, the existing Regulation Z provisions restricting compensation based on credit terms established by the 2010 Loan Originator Final Rule.[73] Currently, § 1026.36(d)(1)(i), which was added to Regulation Z by the 2010 Loan Originator Final Rule, provides that, in connection with a consumer credit transaction secured by a dwelling, "no loan originator shall receive and no person shall pay to a loan originator, directly or indirectly, compensation in an

[73] The Board issued that final rule after passage of the Dodd-Frank Act, but acknowledged that a subsequent rulemaking would be necessary to implement TILA section 129B(c). *See* 75 FR 58509 (Sept. 24, 2010).

amount that is based on any of the transaction's terms or conditions."[74] Section 1026.36(d)(1)(ii) states that the amount of credit extended is not deemed to be a transaction term or condition, provided that compensation received by or paid to a loan originator, directly or indirectly, is based on a fixed percentage of the amount of credit extended; the provision also states that such compensation may be subject to a minimum or maximum dollar amount. With certain adjustments, discussed below, the Dodd-Frank Act generally codifies these provisions in new TILA section 129B(c)(1). Specifically, new TILA section 129B(c)(1) provides that, "[f]or any residential mortgage loan, no mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal)." 12 U.S.C. 1639b(c)(1).

In addition, Congress set forth "rules of construction" in new TILA section 129B(c)(4). This provision states, among other things, that nothing in section 129B(c) of TILA shall be construed as "permitting yield spread premium or other similar compensation that would, for any residential mortgage loan, permit the total amount of direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of the loan (other than the amount of the principal)." 12 U.S.C. 1639b(c)(4)(A).[75] This provision also states that nothing in

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[74] In adopting this restriction, the Board noted that "compensation payments based on a loan's terms or conditions create incentives for loan originators to provide consumers loans with higher interest rates or other less favorable terms, such as prepayment penalties." 75 FR 58509, 58520 (Sept. 24, 2010). The Board cited "substantial evidence that compensation based on loan rate or other terms is commonplace throughout the mortgage industry, as reflected in Federal agency settlement orders, congressional hearings, studies, and public proceedings." *Id.* Among the Board's stated concerns was that "creditor payments to brokers based on the interest rate give brokers an incentive to provide consumers loans with higher interest rates. Large numbers of consumers are simply not aware this incentive exists." 75 FR 58509, 58511 (Sept. 24, 2010). The Board adopted this prohibition based on its finding that compensating loan originators based on a loan's terms or conditions, other than the amount of credit extended, is an unfair practice that causes substantial injury to consumers. 75 FR 58509, 58520 (September 24, 2010). The Board stated that it was relying on authority under TILA section 129(l)(2) (since redesignated as section 129(p)(2)) to prohibit acts or practices in connection with mortgage loans that it finds to be unfair or deceptive. *Id.*

[75] Congress did not define "yield spread premium." However, as discussed elsewhere in this notice, the Bureau is interpreting this term to mean compensation for loan originators that is calculated and paid as a premium above every $100 in principal.

TILA section 129B(c) prohibits incentive payments to a mortgage originator based on the number of residential mortgage loans originated within a specified period of time, which is generally consistent with the interpretation provided in existing comment 36(d)(1)-3.[76] 12 U.S.C. 1639b(c)(4)(D).

These provisions of new TILA section 129B(c) differ from the existing regulations in a key respect: they expand the scope of the restrictions on loan originator compensation from transactions in which any person other than the consumer pays the loan originator to *all* residential mortgage loans. Under the 2010 Loan Originator Final Rule, transactions in which the consumer pays compensation directly to a loan originator organization are not subject to the restrictions, so the amount of the compensation may be based on the terms and conditions of the transaction.

The proposal sought to implement new TILA section 129B by amending § 1026.36(d) to reflect the fact that the Dodd-Frank Act applies the ban on compensation based on terms to all residential mortgage loans and to further harmonize the existing regulation's language with the statute's language. The Bureau also took the opportunity to address a number of interpretive questions about the 2010 Loan Originator Final Rule that have been frequently raised by industry with both the Board and the Bureau.

36(d)(1)(i)

As noted above, section 1403 of the Dodd-Frank Act generally codifies the baseline rule in existing § 1026.36(d). As the Bureau described in the proposal, however, the new statutory provisions differ from the existing regulatory provisions in three primary respects. First, unlike existing § 1026.36(d)(1)(iii), the statute does not contain an exception to the general prohibition

[76] Existing comment 36(d)(1)-3 clarifies that the loan originator's overall loan volume delivered to the creditor is an example of permissible compensation for purposes of the regulation.

on varying compensation based on terms for transactions where the mortgage originator receives compensation directly from the consumer. Second, while existing § 1026.36(d)(1) prohibits compensation that is based on a transaction's "terms or conditions," TILA section 129B(c)(1) refers only to compensation that varies based on "terms." Third, existing § 1026.36(d)(1)(i) provides that the loan originator may not receive and no person shall pay compensation in an amount "that is based on" any of the transaction's terms or conditions, whereas TILA section 129B(c)(1) prohibits compensation that "varies based on" the terms of the loan.

Prohibition Against Payments Based on a Term of a Transaction

Existing § 1026.36(d)(1) provides that no loan originator shall receive and no person shall pay to a loan originator, directly or indirectly, compensation in an amount that is based on any of the transaction's terms or conditions. Similarly, new TILA section 129B(c)(1) prohibits mortgage originators from receiving or being paid, directly or indirectly, compensation that varies based on the terms of the transaction. However, neither TILA nor existing Regulation Z defines a transaction's terms.

The Board realized that the compensation prohibition in § 1026.36(d)(1) could be circumvented by compensating a loan originator based on a substitute factor that is not a transaction term or condition but effectively mimics a transaction term or condition. Existing comment 36(d)(1)-2 further clarifies that compensation based on a proxy for a term or condition of a transaction is also prohibited. The comment explains that compensation based on the consumer's credit score or similar representation of credit risk, such as the consumer's debt-to-income ratio is not one of the transaction's terms or conditions. However, if compensation varies in whole or in part with a factor that serves as a proxy for transaction terms or conditions, the compensation is deemed to be based on a transaction's terms or conditions.

The Board and the Bureau have each received numerous inquiries on whether compensation based on various specified factors would be compensation based on a proxy for a term or condition of a transaction and thus prohibited. Based on the volume of questions received about the existing compensation prohibition and the commentary concerning proxies, the Bureau recognized in the proposal that this issue had become a significant source of confusion and uncertainty. The Bureau responded by proposing to revise § 1026.36(d)(1)(i), comment 36(d)(1)-2, and related commentary to remove the term "conditions" and to clarify the meaning of proxy. Specifically, the proposal outlined a multi-stage analysis, starting first with a determination of whether a loan originator's compensation is "based on" a transaction's terms. If so, such compensation would generally violate § 1026.36(d)(1)(i). If not, the second inquiry is whether compensation is based on a proxy for a transaction's terms. The proposal would have subjected a factor to a two-part test to determine if it is a prohibited proxy for a loan term. First, whether the factor substantially correlates with a term or terms of the transaction is analyzed. Second, whether the loan originator can, directly or indirectly, add, drop, or change the factor when originating the transaction. The Bureau also specifically solicited comment on the issue of transaction terms and proxies, alternatives to the Bureau's proposal, and whether any action to revise the proxy concept and analysis would be helpful and appropriate. 77 FR at 55293.

As discussed further below, the Bureau is retaining this multi-stage analysis in the final rule, with additional clarifications, examples, and commentary based on the comments and additional analysis. In response to the comments received, however, the Bureau has recognized that two additions would provide useful clarification and facilitate compliance. Accordingly, the Bureau is not only finalizing the multi-stage proxy analysis, but amending the regulation to define what is a "term of a transaction" in the first instance and providing additional commentary listing several compensation methods that are expressly permitted under the statute and regulation without need for application of a proxy analysis. The Bureau believes that this additional clarification will significantly reduce uncertainty regarding permissible and impermissible compensation methods, while maintaining critical safeguards against evasion of the Dodd-Frank Act mandate.

Specifically, the final rule amends § 1026.36(d)(1)(i) to prohibit compensation based on "a term of a transaction," amends § 1026.36(d)(1)(ii) to define that term to mean "any right or obligation of the parties to a credit transaction," and makes conforming amendments to remove the term "conditions" from related regulatory text and commentary.

The Bureau is also amending comment 36(d)(1)-1.iii to provide further clarification of this definition. Under comment 36(d)(1)-1.iii, the Bureau interprets "credit transaction" as the operative acts (*e.g.*, the consumer's purchase of certain goods or services essential to the transaction) and written and oral agreements that, together, create the consumer's right to defer payment of debt or to incur debt and defer its payment. For the purposes of § 1026.36(d)(1)(ii), this means: (1) the rights and obligations, or part of any rights or obligations, memorialized in a promissory note or other credit contract, as well as the security interest created by a mortgage, deed of trust, or other security instrument, and in any document incorporated by reference in the note, contract, or security instrument; (2) the payment of any loan originator or creditor fees or charges imposed on the consumer, including any fees or charges financed through the interest rate; and (3) the payment of any fees or charges imposed on the consumer, including any fees or charges financed through the interest rate, for any product or service required to be obtained or performed as a condition of the extension of credit. The potential universe of fees and charges as described above that could be included in the definition of a term of a transaction is limited to any of those required to be disclosed in either or both the Good Faith Estimate and the HUD-1 (or HUD-1A) and subsequently in any TILA and RESPA integrated disclosures promulgated by the Bureau as required by the Dodd-Frank Act.

The Bureau believes the statutory text of TILA evidences a Congressional intent to define "credit transaction" within the definition of "residential mortgage loan" to include not only the note, security instrument and any document incorporated by reference into the note or security instrument but also any product or service required as a condition of the extension of credit. TILA section 129B(c)(1) prohibits compensation "that varies based on the terms of the [residential mortgage] loan." TILA section 103(cc)(5) defines "residential mortgage loan" to mean "any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling" other than certain specified forms of credit. TILA section 103(f) defines "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." In other words, any product or service the creditor requires the acquisition or performance of prior to granting the *right* to the consumer to defer payment of debt or to incur debt and defer its payment (*i.e.*, required as a condition of the extension of credit) is also included in the definition.

Moreover, express Congressional support for including any product or service required as a condition of the extension credit in the definition of a term of a transaction can be found in TILA section 103(cc)(2)(C) and (cc)(4). Both provisions contain this phrase: ". . . loan terms (including rates, *fees, and other costs*)" (emphasis added). The Bureau believes that fees and costs charged by the loan originator or creditor for the credit, or for a product or service provided by the loan originator or creditor related to the extension of that credit, impose additional costs on the consumer and thus are "loan terms." The Bureau is not including other costs paid by the consumer as part of the overall transaction (*i.e.*, the Bureau is not including costs other than those required as a condition of the extension of credit in the definition), because such costs are not part of the "credit transaction" and thus are not a term of a "residential mortgage loan." For example, costs not included in a term of a transaction for the purposes of the final rule could include charges for owner's title insurance or fees paid by a consumer to an attorney representing the consumer's interests.

Attempts to evade the prohibition on compensation based on a term of the transaction could be made by paying the loan originator based on whether a product or service has been purchased and not based on the amount of the fee or charge for it. The Bureau believes that payment based on whether the underlying product or service was purchased is equivalent to paying based on the existence of a fee or the charge. That is, payment based on either the amount of the fee or charge or the existence of a fee or charge would be payment based on a term of the transaction.

To reduce uncertainty and facilitate compliance, the Bureau is limiting the universe of potential fees or charges that could be included in the definition of a term of the transaction to any fees or charges required to be disclosed in either or both the Good Faith Estimate and the HUD-1 (or HUD-1A) (and subsequently in any TILA-RESPA integrated disclosure promulgated by the Bureau). Moreover, to facilitate compliance, the Bureau believes the fees or charges that meet the definition of a term of a transaction should be readily identifiable under an existing regulatory regime or a regime that loan originators and creditors will be complying with in the future (*i.e.*, the upcoming TILA-RESPA integrated disclosure regime). To the extent there is any uncertainty regarding the definition of "loan terms" or "consumer credit transaction" in TILA section 103(cc)(2)(C), (cc)(4), and (cc)(5), the Bureau relies on its interpretive authority and authority to prevent circumvention or evasion and facilitate compliance under TILA section 105(a).

Thus, any provision or part of a provision included in the note or the security instrument or any document incorporated by reference that creates any right or obligation of the consumer or the creditor effectively is a term of the transaction. For example, the consumer's promise to pay interest at a yearly rate of X percent is a term of the transaction. The rate itself is also a term of the transaction. The existence of a prepayment penalty or the specific provision or part of the provision describing the prepayment penalty in the note additionally is a term of the transaction.

Any provision set forth in riders to the note or security instrument such as covenants creating rights or obligations in an adjustable rate rider, planned unit development, second home, manufactured home, or condominium rider are also included. For example, a provision in a condominium rider requiring the consumer to perform all of the consumer's obligations under the condominium project's constituent documents is a term of a transaction. The name of the planned unit development is also a term of the transaction if it is part of the creditor's right described in the planned unit development rider to secure performance of the consumer's promise to pay.

Any loan originator or creditor fee or charge imposed on the consumer for the credit or for a product or service provided by the loan originator or creditor that is related to the extension of that credit, including any fee or charge financed through the interest rate, is a term of a transaction. Thus, points, discount points, document fees, origination fees, and mortgage broker fees imposed on consumers are terms of a transaction. Also, if a creditor performs the appraisal or a second appraisal, and charges an appraisal fee, the appraisal fee is a term of the transaction regardless of whether it is required as a condition of the extension of credit if the appraisal is related to the credit transaction (*i.e.*, the appraisal is for the dwelling that secures the credit). Fees and charges for goods obtained or services performed by the loan originator or creditor in a "no cost" loan where the fees and charges are financed through the interest rate instead of paid directly by the consumer at closing are also terms of the transaction.

Moreover, any fees or charges for any product or service required to be obtained or performed as a condition of the extension of credit are also terms of a transaction. For example, creditors often require consumers to purchase hazard insurance or a creditor's title insurance policy. The amount charged for the insurance or the purchase of the underlying insurance policy itself is a term of the transaction if the policy is required as a condition of the extension of credit.

Comment 36(d)(1)-2 explains that, among other things, the interest rate, annual percentage rate, collateral type (*e.g.*, condominium, cooperative, detached home, or manufactured housing), and the existence of a prepayment penalty are terms of a transaction for purposes of § 1026.26(d)(1). As discussed below, this comment also provides interpretations about permissible compensation factors that are neither terms of a transaction nor proxies for such terms under § 1026.36(d)(1).

The Bureau recognizes that, under § 1026.36(d)(1), a term of a transaction could also include, for example, creditor requirements that a consumer pay a recording fee for the county recording certain credit transaction documents, maintain an escrow account, or pay any upfront fee or charge as a condition of the extension of credit. Thus, the requirement for a consumer to pay recording fees or taxes to the county for the recording service as a condition of the extension of credit would be considered a term of a transaction. But, as with many other terms of the transaction, the requirement to pay recording taxes under this scenario would not likely present a risk of violating the prohibition against compensation based on a term of a transaction because a person typically would not compensate a loan originator based on whether the consumer paid recording taxes to the county.

As noted above, compensation paid to a loan originator organization directly by a consumer *(i.e.*, mortgage broker fees imposed on the consumer) is a term of a transaction under § 1026.36(d)(1)(ii). As a result, the Bureau is concerned that § 1026.36(d)(1) could be read to prohibit a loan originator organization from receiving compensation directly from a consumer in all cases because that compensation would necessarily be based on itself, and thus, based on a transaction term. The Bureau believes that Congress did not intend that the prohibition in TILA section 129B(c)(1) on compensation being paid based on the terms of the loan to prevent loan originator organizations from receiving compensation directly from a consumer in all cases. In fact, TILA section 129B(c)(2) specifically contemplates transactions where loan originators would receive compensation directly from the consumer.[77] Thus, the final rule amends comment 36(d)(1)-2 to clarify that compensation paid to a loan originator organization directly by a consumer in a transaction is not prohibited by § 1026.36(d)(1) simply because that compensation itself is a term of the transaction. Nonetheless, that compensation may not be based on any other term of the transaction or a proxy for any other term of the transaction. In addition, in a transaction where a loan originator organization is paid compensation directly by a consumer,

[77] Specifically, TILA section 129B(c)(2)(A) states that, for any mortgage loan, a mortgage originator generally may not receive from any person other than the consumer any origination fee or charge except bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of either. Likewise, no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third-party charges as described above. Notwithstanding this general prohibition on payments of any origination fee or charge to a mortgage originator by a person other than the consumer, however, TILA section 129B(c)(2)(B) provides that a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if, among other things, the mortgage originator does not receive any compensation directly from the consumer.

compensation paid by the loan originator organization to individual loan originators is not prohibited by 1026.36(d)(1) simply because it is based on the amount of compensation paid directly by the consumer to the loan originator organization but the compensation to the individual loan originator may not be based on any other term of the transaction or proxy for any other term of the transaction.

Prohibition Against Payment Based on a Factor That Is a Proxy for a Term of a Transaction

In the 2010 Loan Originator Final Rule, the Board adopted comment 36(d)(1)-2, which explains how the prohibition on compensation based on a transaction's terms is also violated when compensation is based on a factor that is a proxy for a term of a transaction. As an example, the comment notes that a consumer's credit score or similar representation of credit risk, such as the consumer's debt-to-income ratio, is not one of the transaction's terms or conditions. The comment goes on to clarify, however, that if a loan originator's compensation varies in whole or in part with a factor that serves as a proxy for loan terms or conditions, then the originator's compensation is based on a transaction's terms or conditions. The comment also provides an example of payments based on credit score that would violate existing § 1026.36(d)(1). As previously discussed, the Board realized the compensation prohibition in § 1026.36(d)(1) could be circumvented by compensating a loan originator based on a substitute factor that is not a transaction term or condition but effectively mimics a transaction term or condition.

Since the Board's 2010 Loan Originator Final Rule was promulgated, the Board and the Bureau have received numerous inquiries on the commentary regarding proxies and whether particular loan originator compensation practices would be prohibited because they set compensation based on factors that are proxies for transaction terms. Small entity representatives providing input during the Small Business Review Panel process also urged the Bureau to use this rulemaking to clarify this issue. While some industry stakeholders sought guidance or approval of particular compensation practices, the Bureau also learned through its outreach that a number of creditors felt that the existing proxy commentary was appropriate and should not in any event be made more permissive. Some of these institutions explained that they had always paid their loan originators the same commission – *i.e.*, percentage of the amount of credit extended – regardless of type or terms of the transactions originated. In their opinion, changes in the Bureau's approach to proxies would allow unscrupulous loan originators to employ compensation practices that would violate the principles of the prohibition against compensation based on a transaction's terms.

Based on this feedback and its own analysis, the Bureau proposed revisions to § 1026.36(d)(1)(i) and comment 36(d)(1)-2.i to clarify how to determine whether a factor is a proxy for a transaction's term to facilitate compliance and prevent circumvention. The proposal's amendments to § 1026.36(d)(1)(i) would have clarified in regulatory text that compensation based on a proxy for a transaction's terms would be prohibited. In addition, the proposed clarification in § 1026.36(d)(1)(i) and comment 36(d)(1)-2.i would have provided that a factor (that is not itself a term of a transaction originated by the loan originator) is a proxy for the transaction's terms if two conditions were satisfied: (1) the factor substantially correlates with a term or terms of the transaction; and (2) the loan originator can, directly or indirectly, add, drop, or change the factor when originating the transaction.[78]

[78] As discussed in the proposal, the Bureau specifically sought input during the Small Business Review Panel process on clarifying the rule's application to proxies. The proxy proposal under consideration presented to the small entity representatives during the Small Business Review Panel process stated that "a factor is a proxy if: (1) it substantially correlates with a term of a transaction; and (2) the MLO has discretion to use the factor to present credit to the consumer with more costly or less advantageous term(s) than term(s) of other credit available through

As proposed, both prongs of the proxy analysis would have to be met for a factor to be a proxy. If the factor substantially correlates with a term of a transaction originated by the loan originator, then the factor would be a proxy only if the loan originator could, directly or indirectly, add, drop, or change the factor when originating the transaction. In the supplementary information to the proposal, the Bureau noted that where a loan originator had no or minimal ability directly or indirectly to add, drop, or change a factor, that factor would not be a proxy for the transaction's terms because the loan originator would not be able to steer consumers based on that factor.

The Bureau also proposed to delete the example of credit score as a proxy for a transaction's terms or conditions in existing comment 36(d)(1)–2. The proposal explained that this example created uncertainty for creditors and loan originators and did not adequately reflect the Bureau's proposed treatment of proxies. Under the proposal, a credit score may or may not be a proxy for a term of a transaction depending on the facts and circumstances. Similarly, the proposal would have removed the example stating that loan-to-value ratio would not be a term of a transaction to conform to other aspects of the proposal.

Instead, proposed comment 36(d)(1)-2.i, provided three new examples to illustrate use of the proposed proxy standard and to facilitate compliance with the rule.

The Bureau proposed to add comment 36(d)(1)-2.i.A to provide an example of the application of the proposed proxy definition to address whether compensation based on a loan originator's employment tenure would be considered a proxy for a transaction term under the proposed definition. The proposal explained that this factor would likely not meet the first prong

the MLO for which the consumer likely qualifies." Upon further consideration, the Bureau believed the proxy proposal contained in the proposed rule would be easier to apply uniformly and would better addresses cases where the loan originator does not "use" the factor than the specific proposal presented to the Small Business Review Panel.

of the proposed proxy definition because employment tenure would likely have little correlation with a transaction's term and thus not be "substantially correlated" to a term of a transaction.

The Bureau proposed to add comment 36(d)(1)-2.i.B to provide an example of the application of the proposed proxy definition to address whether compensation to a loan originator based on whether an extension of credit would be held in portfolio or sold into the secondary market would be considered a factor that is a proxy for a transaction term under the proposed definition. The example assumed an extension of credit would be held in portfolio or sold into the secondary market depending in large part on whether it had a five-year balloon feature or a 30-year term. Thus, the factor would meet the first prong of the proxy definition because whether an extension of credit would be held in portfolio or would be sold into the secondary market would substantially correlate with one or more transaction terms (*i.e.*, interest rate, term). The loan originator in the example may be able to change the factor indirectly by steering the consumer to choose the five-year balloon or the 30-year term. Thus, whether an extension of credit is held in portfolio or sold into the secondary market would be a proxy for a transaction's terms under these particular facts and circumstances.

The Bureau proposed to add comment 36(d)(1)-2.i.C to provide an example of the application of the proposed proxy definition to whether compensation to a loan originator based on the geographic location of the property securing a refinancing would be considered a proxy for a transaction term. In the example, the loan originator would be paid a higher commission for refinancings secured by property in State A than in State B. The first prong of the proxy definition would be satisfied because, under the facts assumed in the example, refinancings secured by property in State A would have lower interest rates than credit transactions secured by property in State B; thus, the property's location would substantially correlate with a term of a transaction (*i.e.*, the interest rate). However, the second prong of the proxy definition would not be satisfied because the loan originator would not be able to change the presence or absence of the factor (*i.e.,* whether the refinancing is secured by property in State A or State B). Thus, geographic location, under the particular facts assumed in the example, would have not been considered a proxy for a transaction's term.

The Bureau believed that the proposed changes would simplify and reduce uncertainty regarding the proxy analysis and, more generally, would align the treatment of proxies with the principles underlying the prohibition on compensation based on a transaction's terms. The Bureau solicited comment on the proposal, alternatives the Bureau should consider, and whether any action to revise the proxy concept and analysis would be helpful and appropriate. The Bureau also invited specific comment on two aspects of the first prong of the proxy definition: (1) whether "substantially" was sufficient to explain the degree of correlation necessary under the proxy definition and, if not, what other term should be considered; and (2) how "correlation" to a term should be determined.

Many industry commenters opposed the Bureau's proposed amendments to the proxy analysis and requested that the existing analysis be removed. Other commenters supported the Bureau's efforts to clarify the proxy analysis but criticized the proposed standard or requested additional guidance.

A large bank, a few lender trade groups, and a number of credit unions and credit union leagues commented that the prohibition against compensation based on transaction terms in the Dodd-Frank Act was sufficient to protect consumers without the proxy concept. Many of these commenters also stated that the Dodd-Frank Act prohibition on compensation based on transaction terms was very clear and did not include the concept of a proxy analysis. These commenters further stated that inclusion of the proxy definition in the rule would impose a compliance burden that was not mandated by statute. Some of these commenters also indicated that the Bureau's approach to proxies created ambiguities that would make compliance difficult, which was particularly problematic given the significant liability that TILA would impose for non-compliance.

Another industry trade group stated that, instead of addressing proxies, the Dodd-Frank Act expressly addressed steering and related conduct. Therefore, it urged the Bureau to abandon the proxy concept and focus instead on implementing clear guidance for the anti-steering provisions in the Dodd-Frank Act. One credit union also stated that the final rule should clarify that incentive arrangements adopted pursuant to NCUA regulations would be permissible under Regulation Z.

One large national bank and an industry trade group criticized the proxy concept in the existing rule for presuming the existence of a proxy whenever a difference in transaction terms was correlated with a difference in compensation and the difference in compensation could not otherwise be justified on a permissible basis. One credit union league commenter stated that the Bureau's proposed changes would not reduce uncertainty and help simplify application of the prohibition of compensation based on transaction terms and urged the Bureau to refrain from amending the existing regulation and commentary. Several commenters stated that instead of, or in addition to, providing further clarification and a definition of proxies, the final rule should simply: (1) permit differences in compensation based on cost differences among products; (2) allow differences in compensation to incentivize the offering of socially beneficial credit products such as state agency or Community Reinvestment Act loans; and (3) contain an inclusive list of proxies and exceptions.

Several large industry groups, several large creditors, several State industry associations, and a credit union league made comments that were generally supportive of the Bureau's efforts to clarify the existing approach to proxies, but requested that the Bureau offer a more precise definition of the term "proxy." Some of these commenters stated that "substantially correlates with a term or terms of a transaction" was too speculative and subjective or required more explanation. One large bank commenter stated that the proposed two-pronged proxy definition would increase rather than reduce confusion. Despite the opposition to the proposed proxy definition voiced by the many commenters, there were no comments providing specific alternatives to the proposal's formulation.

With respect to the Bureau's proposed revisions to discussion in comment 36(d)(1)-2, most of the larger trade groups representing creditors ranging from community banks to the largest banks agreed that credit score should not be considered a proxy for a transaction term. These commenters noted that loan originators have no discretion or influence over the credit score even though the score influences the secondary market value of the extension of credit. One large national bank commenter, however, was concerned that, by not characterizing a credit score as a proxy for transaction terms, the proposal would permit creditors to compensate loan originators more for credit extended to consumers with high credit scores. Credit scores, the bank noted, invariably correlate with a credit transaction's interest rate. In this commenter's view, certain factors that correlate with a transaction's terms should not be the basis of differences in compensation. This commenter also stated that debt-to-income ratio and the collateral's loan-to-value ratios were common factors that affect the interest rate and could typically be modified by a loan originator, thus implying these factors too should be considered proxies for a transaction's terms but may not be under the proposal.

While the Bureau believes that the new definition of a "term of a transaction" in § 1026.26(d)(1)(ii) will help clarify the permissibility of varying compensation based upon many of the factors that commenters raised questions about, there will still be factors that would not meet this definition and thus be subject to the analysis under the proxy definition. Accordingly, the Bureau has revised the proposed proxy definition in the final rule, while preserving the proposal's basic approach. By prohibiting compensation based on a factor that serves as a proxy for a term of a transaction, the Bureau believes that it is within its specific authority under TILA section 105(a) to issue regulations to effectuate the purposes and prevent evasion or circumvention of TILA. A contrary approach would create an enormous loophole if persons were able to identify factors to base loan originator compensation on that, although not considered transaction terms, act in concert with particular terms. For example, many loan level price adjustments are not transaction terms per se, however, they often directly impact the price investors are willing to pay for a loan. Restated differently, the amount investors are willing to pay now for a stream of payments made by consumers in the future is highly dependent on the interest rate of the note. To the extent a loan originator is able to manipulate such factors the more attractive they become as a proxy for transaction terms upon which to base compensation. The Bureau further believes that by providing a proxy definition, the Bureau is also acting pursuant to its authority under TILA section 105(a) to facilitate compliance with TILA.

Revised § 1026.36(d)(1)(i) provides that "[a] factor that is not itself a term of a transaction is a proxy for a term of a transaction if the factor consistently varies with a 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." The final proxy definition revises the proposed definition in two ways: (1) under the first prong, a factor is analyzed by reference to whether it "consistently varies with a term over a significant number of transactions" instead of whether it "substantially correlates with a term"; and (2) under the second prong, the analysis focuses on whether the loan originator "has the ability to" manipulate the factor rather than whether a loan originator "can" manipulate the factor. The Bureau also maintains in the final rule two of the three examples of the application of the proxy analysis to specific compensation and fact patterns. However, the proxy examples have been renumbered given the removal of the example in comment 36(d)(1)-2.i.A. The example proposed in comment 36(d)(1)-2.i.A.analyzed a hypothetical situation involving a creditor that increased loan originator compensation based on the loan originator's tenure with the creditor. The final rule orients the focus of the proxy analysis on factors substituted for a term of the transaction. This example involved facts that were unrelated to this analysis and is not included in the final rule to reduce confusion and facilitate compliance. The remaining examples are located in comment 36(d)(1)-2.ii instead of comment 36(d)(1)-2.i to accommodate a reorganization of the comments to facilitate compliance. The terminology in these examples has additionally been revised to reflect changes to the definitions of a "term of a transaction" and "proxy" in the final rule.

As stated above, the final rule revises the first prong of the proxy definition from the proposed "substantially correlates with a term" to "consistently varies with a term over a significant number of transactions." First, the change is meant to avoid use of the word "correlates," which is given many conflicting technical meanings. Second, the inclusion of "over a significant number of transactions" is meant to explain that the nexus between the factor and a term of a transaction should be established over a sample set that is sufficiently large to ensure confidence that the variation is indeed consistent. Third, the emphasis on consistent variation with a term, over a significant number of transactions, like the use of correlation as proposed, is intended to make clear that there is no need to establish causation to satisfy the first prong. Finally, the consistent variation between the factor and term may be positive or negative.

The Bureau has also made a minor change to the proposed second prong of the definition. The final rule replaces "can" with "has the ability" to emphasize that the loan originator must have substantive and not conjectural capacity to add, drop, or change the factor. That is, the ability to influence the factor must be actual rather than just hypothetical.

The Bureau believes that the new definition for a "term of a transaction" and the revision to the proxy definition should help clarify whether a particular factor is a term of a transaction in the first place or is a proxy for a term of a transaction. To create further clarity, the Bureau is providing additional interpretation and examples on how the two definitions function together when applied to an analysis of the permissibility of compensating loan originators by reference to some of the numerous factors identified by commenters. Because the analysis of whether a factor upon which a loan originator would be compensated is a proxy is often dependent on particular facts, care should be taken before concluding that the Bureau has sanctioned any particular compensation factor in all circumstances.

For example, the Bureau believes that compensation based on which census tract, county, state, or region of the country the property securing a credit transaction is located generally is not a term of a transaction. However, the geographic factors compensation is based on, that is the census tract, county, state, or region of the country, would be subject to analysis under the proxy definition.[79] Location within a broad geographic unit is unlikely to be deemed a proxy for a term of a transaction. The factor must satisfy both prongs of the definition to be considered a proxy.

[79] The analysis would be different if, under specific facts and circumstances, geographic location were otherwise incorporated into the agreements that together constitute the credit transaction in a way that would satisfy the definition of a term of the transaction.

Loan originators have no ability to change the location of property that a consumer purchases. Thus, absent very unusual circumstances, the second prong and thus the larger test would not be satisfied. Thus, the geographic location in this example would not be considered a proxy for a term of a transaction.

For similar reasons, compensation based on whether a consumer is a low- to moderate-income borrower would also typically be neither compensation based on a term of a transaction nor compensation based on a proxy for a term of a transaction. First, whether a consumer is a low-to moderate-income borrower would typically not be a term of a transaction. Income level is not a right or obligation of the agreement. Moreover, income level is not a fee or charge. The determination of whether a particular consumer fits the definition of a low-to moderate-income borrower would depend on that consumer's income and the definition of low-to moderate-income pursuant to applicable government standards. With regard to the proxy text, credit extended to low-to moderate-income borrowers may tend to consistently have certain pricing or product features, but because a loan originator is typically unable to change whether a consumer is classified as a low-to moderate-income borrower, compensating based on this factor would not satisfy the second prong of the definition of a proxy.

Depending on the particular facts and circumstances, compensation based on a consumer's debt-to-income or loan-to-value ratio, although not typically a term of a transaction, could be considered compensation based on a proxy for a term of a transaction. Debt-to-income and loan-to-value ratios are not typically transaction terms. Applying the first prong of the proxy definition, these factors could consistently vary, over a significant number of transactions, with a term of a transaction such as the interest rate. Depending on the particular facts and circumstances, if either of these factors does meet the first prong, the factors could meet the second prong of the proxy definition because a loan originator could have the ability to alter these factors by encouraging consumers to take out larger or smaller amounts of credit.[80]

A diverse variety of industry commenters requested guidance on whether compensation based on variations in the amount of credit extended for different products, such as differentially compensating loan originators for jumbo loans, conventional loans, and credit extended pursuant to government programs for low-to moderate-income borrowers (which typically have smaller amounts of credit extended and smaller profit margins) would be prohibited as compensation based on a proxy for a term of a transaction. Commenters explained that loan originators paid as a percentage of the amount of credit extended are de-incentivized to extend credit to low-to moderate-income consumers because these consumers usually take out smaller amounts of credit. Commenters also stated that creditors cap the percentage of the amount of credit extended they are willing to pay loan originators for originating jumbo loans.

This issue is not properly a question that implicates a proxy analysis, but instead a question of the breadth of the exclusion of compensation based on a term of a transaction in § 1026.36(d)(1)(ii) for compensation based on the amount of credit extended. To the extent that commenters are asking whether it is permissible to compensate loan originators on the actual size of the amount of credit extended using a fixed percentage of credit extended as a factor, this is clearly permitted by § 1026.36(d)(1)(ii). On the other hand, § 1026.36(d)(1)(ii) does not permit loan originators to be compensated on a percentage that itself varies based on the amount of credit extended for a particular transaction. For example, existing comment 36(d)(1)-9 prohibits payment to a loan originator compensation that is 1.0 percent of the amount of credit extended for credit transactions of $300,000 or more, 2.0 percent for credit transactions between $200,000

[80] Section 1026.36(d)(1)(ii) expressly permits compensation based on the amount of credit extended, but does not permit compensation based on the amount of credit extended combined with another factor.

and $300,000 and 3.0 percent on credit transactions of $200,000 or less.[81] Existing § 1026.36(d)(1)(ii) and comment 36(d)(1)-9, however, also provide a permissible method by which a floor or ceiling may be placed on a particular loan originator's compensation on a per transaction basis. For example, a creditor may offer a loan originator 1.0 percent of the amount of credit extended for all credit transactions the originator arranges for the creditor, but not less than $1,000 or greater than $5,000 for each credit transaction.[82]

A mix of commenters requested clarification on whether compensation can vary based on the geographic location of the individual loan originator instead of the property so that for instance individual loan originators located in a high cost of living area are paid a higher fixed percentage of the amount of credit extended relative to individual loan originators located in lower cost areas. The existing rule does not apply to differences in compensation between different individual loan originators. The rule applies to the compensation received by a particular individual loan originator. For example, this rule does not prohibit a particular individual loan originator located in New York City from receiving compensation based on a higher percentage of the amount of credit extended than a loan originator located in Knoxville, Tennessee. The final rule does not change the existing rule in this respect.

A diverse group of commenters also requested clarification on whether compensation based on whether an extension of credit held in portfolio or sold into the secondary market would be considered compensation based on transaction terms. The Bureau finalizes as comment 36(d)(1)-2.ii.A the proposed example, described above, that discusses how, in specific

[81] Existing comment 36(d)(1)-9 is consistent with the Bureau's interpretation of TILA section 129B(c). To the extent there is any uncertainty in the statute regarding whether loan originators are prohibited from being compensated based on a percentage of the loan that itself varies based on the amount of credit extended for a particular transaction, the Bureau relies on its interpretive authority under TILA section 105(a) to effectuate the purposes of TILA, prevent circumvention or evasion, and facilitate compliance therewith.
[82] As discussed above, it is also not permissible to differentiate compensation based on credit product type, since products are simply a bundle of particular terms.

circumstances presented in the example, compensation based on whether an extension of credit is held in portfolio or sold into the secondary market would violate § 1026.36(d)(1). Under the example, whether the extensions of credit were held in portfolio was a factor that consistently varied with transaction terms over a significant number of transactions (*i.e.*, five-year term with a final balloon payment or a 30-year term). In the example, the loan originator also had the ability to encourage consumers to choose extensions of credit that were either held in portfolio or sold in the secondary market by steering them to terms that corresponded to their future status, *e.g.*, the five-year term transactions were destined for portfolio. Thus, whether compensation could vary based on these factors as described above without violating § 1026.36(d)(1) depends on the particular facts and circumstances.[83]

Permissible Methods of Compensation

To reduce further regulatory uncertainty surrounding the interplay between a term of a transaction and a proxy for a term of a transaction and in response to commenters' inquiries implicating the scope of the comment's examples, the final rule revises the content of existing comment 36(d)(1)-3 and moves that content to comment 36(d)(1)-2.i for organizational purposes. Existing comment 36(d)(1)-3 provides nine "illustrative examples of compensation methods that are permissible" and are "not based on the transaction's terms or conditions." The final rule removes two of the examples, clarifies the scope of several others, and clarifies that the revised and remaining examples are not subject to a proxy analysis.

[83] Commenters also requested clarification on whether compensation could vary based on whether an extension of credit was originated in wholesale or retail channels or whether credit was extended by a bank or the bank brokered the extension of credit to another creditor. Assuming that there was consistent variation between these factors and transaction terms, the analysis would depend on whether a loan originator could be deemed to vary the channel or control the creditor's role in the transaction.

Existing comment 36(d)(1)-3 declares compensation based on the following methods permissible: "loan originator's overall loan volume … delivered to the creditor"; "the long-term performance of the originator's loans"; "[a]n hourly rate of pay to compensate the originator for the actual number of hours worked"; "[w]hether the consumer is an existing customer of the creditor or a new customer"; a "payment that is fixed in advance for every loan the originator arranges for the creditor"; the "percentage of applications submitted by the loan originator to the creditor that results in consummated transactions"; "the quality of the loan originator's loan files (*e.g.,* accuracy and completeness of the loan documentation) submitted to the creditor"; a "legitimate business expense, such as fixed overhead costs"; and "the amount of credit extended, as permitted by § 1026.36(d)(1)(ii)."

The 2010 Loan Originator Final Rule did not explicitly address whether these examples should be subject to a proxy analysis. Nonetheless, the Board strongly implied that compensation based on these factors would not be compensation based on a proxy for transaction terms or conditions by referring to them as "permissible" methods. The Bureau believes that compensation based on these methods is not compensation based on a term of a transaction under § 1026.36(d)(1)(ii) and should not be subjected to the proxy analysis. Because the final rule further develops the proxy concept and places it in regulatory text, the Bureau is revising the list to clarify that these are still permissible bases of compensation.[84]

The Bureau recognizes that there are few ways to compensate loan originators under this rule that are not subject to proxy analysis. The Bureau further acknowledges that some institutions will not want to subject factors to the proxy definition to determine if they may be

[84] In addition, the Bureau has removed the language stating that the list is not exhaustive. The Bureau believes there are factors not in the list that would also not meet the definition of a term of the transaction. These factors would be subject to analysis under the proxy definition, however.

permissible because of the fact-dependent nature of the analysis. The Bureau believes it is important to allow persons to compensate loan originators based on factors that the Bureau considers to be neither a term of the transaction nor a proxy for a term of the transaction. The Bureau believes that, although some of the compensation methods may give rise to negligible steering incentives, the benefits of allowing a person to compensate under these methodologies outweigh any such potential steering incentives. For example, periodically setting compensation levels (*i.e.*, commissions) for loan originators based on the quality of loan files or long term performance of the credit transactions the loan originator has arranged should encourage behavior that benefits consumers and industry alike. The Bureau believes that providing this list of compliant factors will facilitate compliance with the rule.

The final rule list deletes the last example that allows for compensation based on the amount of credit extended. The Bureau believes that this example is unnecessary because, as the example itself notes, this exception is expressly set forth in § 1026.36(d)(1)(ii). Moreover, the corollary to "amount of credit extended" is embodied in the first example on the list that permits compensation based on the loan originator's overall loan volume, which is further explained as either the "total dollar amount of credit extended or total number of loans originated." The Bureau has moved the regulatory cross-reference to the first example.

The Bureau has also removed the existing example that permits a loan originator to be compensated based on a legitimate business expense, such as fixed overhead costs. The Bureau has understood that the example applies to loan originator organizations (which incur business expenses such as fixed overhead costs) and not to individual loan originators. An example of the application of this exception would be a loan originator organization that has a branch in New York City and another in Oklahoma. The loan originator organization would be able to receive compensation from a creditor pursuant to a formula that reflects the additional overhead costs of maintaining an office in New York City. While the Bureau believes that this practice would normally not constitute compensation based on a term of a transaction given the definition adopted in this final rule, the final rule removes this example because the Bureau does not believe that this method of compensation should be insulated from a proxy analysis in every instance. The Bureau is concerned that under certain circumstances, differential compensation for corporate loan origination organization branches from creditors could create steering incentives that violate § 1026.36(e). For example, loan originators working in a call center for the loan originator organization with the two branches described above could be incentivized to steer a consumer to the New York City branch that only offers subprime credit (and receives the most compensation per transaction from the creditor based on the additional overhead costs) to increase the amount of compensation the loan originator organization would receive.

Many commenters, including large industry associations, questioned the extent of protection offered by existing comment 36(d)(1)-3.iii, which provides that an hourly rate of pay to compensate the originator for the actual number of hours worked is not compensation based on transaction terms. Commenters asked whether an employer would be permitted under the comment to create commissions for specific credit products based on the estimated typical hours needed to originate or process the product. Commenters explained that the ability to set a commission based on estimated hours instead of actual hours worked would eliminate costs that would otherwise be expended on tracking and documenting the actual time spent on originating each particular credit transaction.[85]

[85] The comment from the industry groups urged the Bureau "to clarify that if a creditor or broker makes a good faith determination of the time and effort to process a loan based upon the loan product or process, then it may use that information to vary loan originator compensation by product or process."

During outreach before the proposal, the Bureau learned that historically loan originators and processers generally spend more time on certain credit products. The outreach participants also noted, however, that in the current market there is no consistent variation in the typical time needed to originate or process different credit products, such as an FHA loan or nonconventional loan versus a conventional loan. These participants explained that stricter underwriting requirements have caused many conventional loans to take as long as, or longer than, FHA loans or other government program credit products. For example, participants noted that processing conventional loans for consumers with a higher net worth but little income or a higher income with large amounts of debt often take longer than processing FHA or other nonconventional loans for low-to moderate-income consumers.

Permitting a creditor or loan originator organization to establish different levels of compensation for different types of products would create precisely the type of risk of steering that the Act seeks to avoid unless the compensation were so carefully calibrated to the level of work required as to make the loan originators more-or-less indifferent as to whether they originated a product with a higher or lower commission. The Bureau believes, however, that periodic changes in the market and underwriting requirements and changing or unique consumer characteristics would likely lead to inaccurate estimates for the time a specific credit product takes to originate and thus lead to compensation structures that create steering incentives. The Bureau further believes that the accuracy of the estimates would be difficult to verify without recording the actual number of hours worked on particular credit products anyway. The Bureau believes that this information would be necessary not only to set the estimate initially but also to calibrate the estimate as market conditions and consumer characteristics rapidly evolve and to correct inaccuracies. The Bureau believes that the potential for inaccuracy or deliberate abuse and burdens of remedying and tracking inaccurate estimates outweighs any benefit gained by permitting estimates of the actual hours worked. These types of estimates are not currently covered by the exemption in comment 36(d)(1)-3.iii, and the Bureau is not amending the comment to permit them.[86]

To provide further clarification the Bureau notes that certain “permissible methods of compensation” specifically allow compensation methods to be calculated with reference to and applied to a specific transaction while others allow for compensation methods to be calculated with reference to and applied to multiple transactions. For example, the permissible methods of compensation in comment 36(d)(1)-2.i.A (compensation adjustment for total dollar amount or total number of transactions), B (long term performance), E (adjustment after certain number of transactions), F (the percentage of applications that result in consummated transactions), and G (quality of the loan files submitted to the creditor) permit compensation adjustments to be calculated with reference to and applied to multiple transactions. The other permissible methods of compensation in comment 36(d)(1)-2.i.C (hourly rate of pay) and D (existing or new customer) permit compensation methods to be calculated with reference to and applied to a specific transaction. The Bureau further notes that the permissible methods of compensation to be calculated with reference to and applied to multiple transactions should be considered together with existing comment 36(d)(1)-6 that provides interpretation of “periodic changes in loan originator compensation.” That comment gives as an example 6-months as a permissible period for revising compensation after considering multiple transactions and other variables over time.

[86] If a loan originator’s compensation was calculated on an estimate of hours worked for a specific product, or by any other methodology to determine time worked other than accounting for actual hours worked, the methodology would be permissible only if it did not meet the definition of a proxy (and complied with other applicable laws).

Varies Based On

TILA section 129B(c)(1) prohibits a mortgage originator from receiving, and any person from paying a mortgage originator, "compensation that *varies* based on" the terms of the loan (emphasis added). The prohibition in existing § 1026.36(d)(1) is on "compensation in an amount that *is based on*" the transaction's terms and conditions (emphasis added). In the proposal, the Bureau stated its belief that the meaning of the statute's reference to compensation that "varies" based on transaction terms is already embodied in § 1026.36(d)(1). Thus, the Bureau's proposal would not have revised § 1026.36(d)(1) to include the word "varies."

The Bureau further stated its belief in the proposal that compensation to loan originators violates the prohibition if the amount of the compensation is based on the terms of the transaction (that is, a violation does not require a showing of any person's subjective intent to relate the amount of the payment to a particular loan term). Proposed new comment 36(d)(1)-1.i would have clarified these points. The Bureau further proposed new comment 36(d)(1)-1 be adopted in place of existing comment 36(d)(1)-1, the substance of which would have been moved to comment 36(a)-5, as discussed above.

The proposed comment also would have clarified that a difference between the amount of compensation paid and the amount that would have been paid for different terms might be shown by a comparison of different transactions, but a violation does not require a comparison of multiple transactions.

The Bureau did not receive any comments on this proposal. The Bureau is adopting the substance of the comment as proposed but further clarifying that when there is a compensation policy in place and the objective facts and circumstances indicate the policy was followed, the determination of whether compensation would have been different if a transaction term had been different is made by analysis of the policy. A comparison of multiple transactions and amounts of compensation paid for those transactions is generally needed to determine whether compensation would have been different if a transaction term had been different when there is no compensation policy, or when a compensation policy exists but has not been followed. The revised comment is intended to provide loan originator organizations, creditors, and other persons that maintain and follow permissible loan originator compensation policies greater certainty about whether they are in compliance.

For the reasons discussed above, this final rule adopts new comment 36(d)(1)-1 as proposed and moves existing comment 36(d)(1)-1 to comment 36(a)-5.

Pooled Compensation

Comment 36(d)(1)-2 currently provides examples of compensation that is based on transaction terms or conditions. Mortgage creditors and others have raised questions about whether loan originators that are compensated differently than one another and originate loans with different terms are prohibited under § 1026.36(d)(1) from pooling their compensation and sharing in that compensation pool. The Bureau proposed to revise comment 36(d)(1)-2.ii to make clear that, where loan originators have different commission rates or other compensation plans and they each originate loans with different terms, § 1026.36(d)(1) does not permit the pooling of compensation so that the loan originators share in that pooled compensation. For example, assume that Loan Originator A receives a commission of 2 percent of the loan amount for each loan that he or she originates and originates loans that generally have higher interest rates than the loans that Loan Originator B originates. In addition, assume Loan Originator B receives a commission of 1 percent of the loan amount for each loan that he or she originates and originates loans that generally have lower interest rates than the loans originated by Loan

Originator A. In this example, proposed comment 36(d)(1)-2.ii would have clarified that the compensation of the two loan originators may not be pooled so that the loan originators share in that pooled compensation.

In the supplementary information to the proposal, the Bureau stated its belief that this type of pooling is prohibited by § 1026.36(d)(1) because each loan originator receives compensation based on the terms of the transactions they collectively make. This type of pooling arrangement could provide an incentive for the participating loan originators to steer some consumers to loan originators that originate loans with less favorable terms (for example, that have higher interest rates) to maximize their overall compensation.

The Bureau received only one comment on this proposed revision, and that commenter favored the proposal. For the reasons discussed above, this final rule adopts comment 36(d)(1)-2.ii (redesignated as comment 36(d)(1)-2.iii) as proposed in substance, although the proposed language has been streamlined.

Creditor's Flexibility in Setting Loan Terms

Comment 36(d)(1)-4 currently clarifies that § 1026.36(d)(1) does not limit the creditor's ability to offer certain loan terms. Specifically, comment 36(d)(1)-4 specifies that § 1026.36(d)(1) does not limit a creditor's ability to offer a higher interest rate as a means for the consumer to finance the payment of the loan originator's compensation or other costs that the consumer would otherwise pay (for example, in cash or by increasing the loan amount to finance such costs). Thus, a creditor is not prohibited by § 1026.36(d)(1) from charging a higher interest rate to a consumer who will pay some or none of the costs of the transaction directly, or offering the consumer a lower rate if the consumer pays more of the costs directly. The comment states, for example, that § 1026.36(d)(1) does not prohibit a creditor from charging an interest rate of

6.0 percent where the consumer pays some or all of the transaction costs and an interest rate of 6.5 percent where the consumer pays none of those costs. The comment also clarifies that § 1026.36(d)(1) does not limit a creditor from offering or providing different loan terms to the consumer based on the creditor's assessment of credit and other risks (such as where the creditor uses risk-based pricing to set the interest rate for consumers). Finally, the comment notes that a creditor is not prohibited under § 1026.36(d)(1) from charging consumers interest rates that include an interest rate premium to recoup the loan originator's compensation through increased interest paid by the consumer (such as by adding a 0.25 percentage point to the interest rate on each loan transaction). This interpretation recognized that creditors that pay a loan originator's compensation generally recoup that cost through a higher interest rate charged to the consumer.

The Bureau proposed to revise comment 36(d)(1)-4 to harmonize it with the Bureau's proposal to implement TILA section 129B(c)(2)(B)(ii), which would have prohibited consumers from paying upfront points and fees on certain transactions. As discussed in the section-by-section analysis of § 1026.36(d)(2)(ii), the Bureau is not adopting this restriction in the final rule. Nevertheless, the Bureau believes it is appropriate to revise this comment for clarity. Specifically, as revised, comment 36(d)(1)-4 provides that, if a creditor pays compensation to a loan originator in compliance with § 1026.36(d), the creditor may recover the costs of the loan originator's compensation and other costs of the transaction by charging the consumer points or fees or a higher interest rate or a combination of these. Thus, the final comment clarifies the existing comment that in such transactions, a creditor may charge a higher interest rate to a consumer who will pay fewer of the costs of the transaction at or before closing, or it may offer the consumer a lower rate if the consumer pays more of the transaction costs at or before closing. For example, if the consumer pays half of the transaction costs at or before closing, a creditor may charge an interest rate of 6.0 percent but, if the consumer pays none of the transaction costs at or before closing, a creditor may charge an interest rate of 6.5 percent. In transactions where a creditor pays compensation to a loan originator in compliance with § 1026.36(d), a creditor also may offer different consumers varying interest rates that include a consistent interest rate premium to recoup the loan originator's compensation through increased interest paid by the consumer (such as by consistently adding 0.25 percentage points to the interest rate on each transaction where the loan originator is compensated based on a percentage of the amount of the credit extended).

Point Banks

The Bureau stated in the proposal that it had considered proposing commentary language addressing whether there are any circumstances under which point banks are permissible under § 1026.36(d).[87] Based on the views expressed by the SERs participating in the Small Business Review Panel process, other stakeholders during outreach, and the Bureau's own analysis, the Bureau stated that it believed that there should be no circumstances under which point banks are permissible, and the proposal would have continued to prohibit them in all cases. A few commenters, including a community bank and an organization representing State bank supervisors, expressed support for the Bureau's decision not to allow point banks, and no commenters objected to the Bureau's proposed approach. The Bureau is not adopting in this

[87] A point bank is a continuously maintained accounting balance of basis points credited to a loan originator by a creditor for originations. From the point bank, amounts are debited when "spent" by the loan originator to obtain pricing concessions from the creditor on a consumer's behalf for any transaction. For further explanation of how point banks operate, see the section-by-section analysis of proposed § 1026.36(d)(1)(i). 77 FR 55294 (Sept. 7, 2012).

final rule any provision purporting to describe circumstances under which point banks would be permissible under § 1026.36(d)(1).

Pricing Concessions

As an outgrowth of the general ban on varying compensation based on the terms of a transaction, the Board's 2010 Loan Originator Final Rule included commentary that interprets § 1026.36(d)(1)(i) to prohibit changes in loan originator compensation in connection with a pricing concession, *i.e.*, a change in transaction terms. Specifically, comment 36(d)(1)-5 clarifies that a creditor and loan originator may not agree to set the originator'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 Board adopted the commentary out of concern that permitting creditors to decrease loan originator compensation because of a change in terms favorable to the consumer would result in loopholes and permit evasions of the rule. 75 FR 58509, 58524 (Sept. 24, 2010). In particular, the Board reasoned, if a creditor could agree to set originators' compensation at a high level generally and then subsequently lower the compensation in selective cases based on the actual loan terms, that practice could have the same effect as increasing the originator's compensation for higher rate loans. *Id.* The Board stated that such compensation practices are harmful and unfair to consumers. *Id.*

The Bureau proposed three revisions to the § 1026.36(d)(1) commentary addressing whether a loan originator may bear the cost of a pricing concession through reduced compensation.[88] The first change proposed by the Bureau was to revise comment 36(d)(1)-5 to

[88] The revisions to comment 36(d)(1)-5 and 36(d)(1)-7 address the following scenarios: (1) where a creditor reduces the compensation paid to an individual loan originator in connection with a change in transaction terms; (2) where a creditor reduces the compensation paid to a loan originator organization in connection with a change in transaction terms, with or without a corresponding reduction by the loan originator organization in the compensation paid to an individual loan originator; or (3) in a transaction where the loan originator organization receives compensation

clarify that, while the *creditor* may change loan terms or pricing to match a competitor, to avoid triggering high-cost mortgage provisions, or for other reasons, the *loan originator's compensation* on that transaction may not be changed for those reasons. Revised comment 36(d)(1)-5 would have further clarified that a loan originator may not agree to reduce its compensation or provide a credit to the consumer to pay a portion of the consumer's closing costs, for example, to avoid high-cost mortgage provisions. The revised comment also would have included a cross-reference to new proposed comment 36(d)(1)-7 for further interpretation, as discussed below.

The proposal also would have removed existing comment 36(d)(1)-7, which states that the prohibition on compensation based on transaction terms does not apply to transactions in which any loan originator receives compensation directly from the consumer (*i.e.*, consumer-paid compensation) under the existing rule. As discussed above, the Dodd-Frank Act now applies the prohibition on compensation based on transaction terms to consumer-paid compensation. Thus, the Bureau stated that it believed it was appropriate to propose to remove existing comment 36(d)(1)-7 and to interpret comment 36(d)(1)-5 as applying to loan originator organizations that receive compensation directly from consumers as well as to loan originators that receive compensation from creditors.

Finally, in place of existing comment 36(d)(1)-7, the Bureau proposed to include a new comment 36(d)(1)-7, to clarify that the interpretation that § 1026.36(d)(1)(i) prohibits loan originators from decreasing their compensation to bear the cost of pricing concessions does not apply where the transaction terms change after the initial offer due to an unanticipated increase

directly from the consumer, where a loan originator organization reduces its own compensation with or without a corresponding reduction in compensation paid to an individual loan originator. Thus, these revisions do not address where a creditor or loan originator organization alters transaction terms that do not consist of or result in payment of loan originators.

in certain closing costs. The Bureau believed that it was appropriate to propose this clarification because such situations did not present a risk of steering and could allow additional flexibility to the parties to consummate a transaction after unexpected developments. Specifically, new comment 36(d)(1)-7 would have clarified that, notwithstanding comment 36(d)(1)-5, § 1026.36(d)(1) does not prohibit loan originators from decreasing their compensation to cover unanticipated increases in non-affiliated third-party closing costs that exceed limits imposed under the RESPA disclosure rules and other applicable laws. The RESPA disclosure rules (implemented in Regulation X) require creditors to estimate the costs for settlement services within a few days of application, and restrict the amount of cost increases beyond those estimates (*i.e.*, "tolerance" requirements[89]) depending on whether the settlement service provider is selected by the creditor, by the consumer from a list provided by the creditor, or by the consumer on the open market. Thus, the proposed comment would have permitted pricing concessions to cover unanticipated increases in non-affiliated third-party closing costs that exceed the

[89] Tolerance requirements (tolerances) are accuracy standards under Regulation X, with respect to the good faith estimate which summarizes estimated settlement charges and is provided to borrowers under RESPA section 5(c) (RESPA GFE). *See generally* 12 CFR 1024.7(e) and (f). Regulation X provides for three categories of tolerances. Section 1024.7(e)(1) of Regulation X provides that the actual settlement charges may not exceed the amounts included on the RESPA GFE for (1) the origination charge, (2) while the borrower's interest rate is locked, the credit or charge for the interest rate chosen, (3) while the borrower's interest rate is locked, the adjusted origination charge; and (4) transfer taxes (zero percent tolerance). Section 1024.7(e)(2) provides that the sum of the settlement charges for the following services may not be greater than 10 percent above the sum of the estimated charges for those services included on the RESPA GFE for (1) lender-required settlement services, where the lender selects the third-party settlement service provider, (2) lender-required services, title services and required title insurance, and owner's title insurance, when the borrower uses a settlement service provider identified by the loan originator, and (3) government recording charges (10 percent tolerance). Section 1024.7(e)(3) provides that all other estimated charges may change by any amount prior to settlement (no tolerance). Under Regulation X, the estimates included on the RESPA GFE generally are binding within the tolerances. 12 CFR 1024.7(f). In limited instances, however, a revised RESPA GFE may be provided reflecting an increase in settlement charges (*e.g.*, for changed circumstances, defined in 12 CFR 1024.2(b), that result in increased settlement charges or a change in the borrower's eligibility for the specific loan terms identified in the RESPA GFE). *Id.* In the 2012 TILA-RESPA Proposal, the Bureau proposed certain changes to the tolerances, such as subjecting settlement charges by lender-affiliated providers to zero percent tolerance. *See* 77 FR 51169-72 (Aug. 23, 2012). For a discussion of tolerances more generally, see the 2012 TILA-RESPA Proposal, 77 FR 51165-75 (Aug. 23, 2012).

Regulation X tolerances, provided that the creditor or the loan originator does not know or should not reasonably be expected to know the costs in advance.

Proposed comment 36(d)(1)-7 also would have explained, by way of example, that a loan originator is reasonably expected to know the amount of the third-party closing costs in advance if the consumer is allowed to choose from among only three pre-approved third-party service providers. In contrast, where a consumer is permitted to shop for the third-party service provider and selects a third-party service provider entirely independently of any pre-approval or recommendation of the creditor or loan originator, the loan originator might not be reasonably expected to know the amount of the closing costs in advance because of the lack of communication and coordination between the loan originator and the third-party service provider prior to provision of the estimate. The Bureau stated in the proposal that if a loan originator repeatedly reduces its compensation to bear the cost of pricing concessions for the same categories of closing costs across multiple transactions based on a series of purportedly unanticipated expenses, proposed comment 36(d)(1)-7 would not apply to this situation because the loan originator would be reasonably expected to know the closing costs across multiple transactions.

As noted above, the Bureau explained it believed the new comment was appropriate because reductions in loan originator compensation to bear the cost of pricing concessions, when made in response to unforeseen events outside the loan originator's control to comply with otherwise applicable legal requirements, do not raise concerns about the potential for steering consumers. The Bureau also stated that this further clarification would have effectuated the purposes of, and facilitated compliance with, TILA section 129B(c)(1) and § 1026.36(d)(1)(i) because, without it, creditors and loan originators might incorrectly conclude that a loan originator bearing the cost of these pricing concessions would violate those provisions, or creditors and loan originators could face unnecessary uncertainty with regard to compliance with these provisions and other laws, such as Regulation X's tolerance requirements (as applicable). The Bureau further solicited comment on whether the proposed revisions to the § 1026.36(d)(1) commentary would be appropriate, too narrow, or create a risk of undermining the principal prohibition of compensation based on a transaction's terms.

The Bureau received approximately 20 comments regarding the proposed revision to the § 1026.36(d)(1) commentary to allow loan originators to reduce their compensation to cover unanticipated increases in non-affiliated third-party closing costs that would exceed applicable legal requirements. Several consumer groups expressed opposition to this proposal, asserting that the Bureau should not allow reductions in loan originator compensation to bear the cost of pricing concessions under any circumstances. They stated that permitting loan originators to reduce their compensation to account for increases in third-party fees will weaken the incentive for third parties to provide accurate estimates of their fees (thereby undermining the transparency of the market); place upward pressure on broker compensation to absorb unanticipated closing cost increases; and encourage violations of RESPA section 8's prohibition on giving or accepting a fee, kickback, or any other thing of value in exchange for referrals of settlement service business involving a federally related mortgage loan. The consumer groups also criticized as unrealistic the proposal to permit reductions in loan originator compensation to bear the cost of pricing concessions only when a loan originator does not know or should not reasonably be expected to know the amount of the closing cost in advance. In the consumer groups views, loan originators, by virtue of their experience, will or should always know the actual closing costs;

thus, the Bureau's premise for the proposed exception to the prohibition on reducing loan originator compensation to bear the cost of a pricing concession will never occur in practice.

An organization commenting on behalf of State bank supervisors supported allowing reductions in compensation to bear the cost of pricing concessions made in response to unforeseen events genuinely outside the control of the loan originator. The group wrote that such reductions in loan originator compensation should not raise concerns about the potential for steering consumers to particular transaction terms. The group also stated that the proposed changes to the commentary to § 1026.36(d)(1) would provide needed clarity and coherence in this area.

Many industry commenters, including large and medium-sized financial institutions as well as several national trade associations, supported in principle the Bureau's interpretation of § 1026.36(d)(1) to permit reductions in loan originator compensation in the circumstances described in proposed revised comment 36(d)(1)-7. One community bank stated its appreciation for the Bureau providing better insight into an area that, according to the bank, has been vague since the existing regulation went into effect and asserted that the Bureau is correct in allowing for reductions in loan originator compensation to bear the cost of pricing concessions in certain instances where the consumer will not suffer material harm. The bank, however, criticized the circumstances described in proposed revised comment 36(d)(1)-7 as too subjective and narrow. A financial holding company commented that the language permitting a reduction in loan originator compensation to bear the cost of a pricing concession only if the loan originator does not know or is not reasonably expected to know the amount of the closing costs in advance was too ambiguous. A trade association representing the mortgage industry questioned the meaning in the proposed commentary provision of the term "unanticipated expenses" because, the association stated, these types of additional expenses would typically constitute changed circumstances, which are already the subject of redisclosure of the RESPA GFE.

Some industry commenters urged the Bureau to allow reductions in loan originator compensation to bear the cost of pricing concessions under additional circumstances, such as to cover closing cost increases within the Regulation X tolerance requirements (in contrast to the proposal, which would permit pricing concessions only where the closing cost increase exceeds limits imposed by applicable law); to avoid the triggering of Federal and State high-cost mortgage provisions; and to ensure that a credit transaction is a qualified mortgage under Federal ability-to-repay provisions.[90] One large depository institution asked that the commentary clarify that reductions in loan originator compensation to bear the cost of pricing concessions are permitted for closing cost increases quoted by pre-approved service providers if the increase was caused by an event that neither the service provider nor the loan originator reasonably could have predicted in the ordinary course of business. Several individual loan originators asked to allow reductions in loan originator compensation to cover rate-lock extensions. One mortgage broker suggested a cap of $500 for reductions in loan originator compensation to bear the cost of pricing concessions.

Several industry commenters requested that reductions in loan originator compensation to bear the cost of pricing concessions be permitted in the case of loan originator "error," though these commenters differed slightly on some details. For instance, one large depository institution urged the Bureau to allow reductions in loan originator compensation to bear the cost of pricing concessions to cover expenses incurred by the creditor as a result of inadvertent errors by the

[90] As discussed in part II.C above, the Bureau, as part of the Title XIV Rulemakings, has issued the 2013 ATR Final Rule and the 2013 ATR Concurrent Proposal, which together would implement Dodd-Frank Act provisions requiring creditors to determine that a consumer is able to repay a mortgage loan and establishing standards for compliance, such as by making a "qualified mortgage."

individual loan originator, such as misquoting a creditor or third-party charge and making clerical or other errors that result in a demonstrable loss to the creditor (*e.g.*, where the loan originator assures the consumer that the interest rate is being locked but fails to do so). In addition, the same depository institution urged the Bureau to permit reductions in loan originator compensation to allow the creditor to penalize loan originators for their failure to comply with the creditor's policies and procedures even in the absence of a demonstrable loss to the creditor. Another large depository institution asked the Bureau to allow reductions in loan originator compensation to bear the cost of pricing concessions where the loan originator made an error on the RESPA GFE. A national industry trade association asked that a loan originator be allowed to reduce compensation to address an erroneous or mistaken charge on the RESPA GFE, or where poor customer service has been reported. One financial institution also requested that reductions in loan originator compensation to bear the cost of pricing concessions be permitted when there is a misunderstanding over consumer information or to cover "reduced, waived, or uncollected third-party fees." One trade association asked that creditors be able to limit the discretion of loan originators to reduce their compensation to bear the cost of pricing concessions to avoid disparate impact issues under fair lending laws.

One large depository institution and two national trade associations commented that the Bureau should allow reductions in loan originator compensation to bear the cost of pricing concessions granted to meet price competition. One of the trade associations commented that prohibiting reductions in loan originator compensation in these circumstances punishes motivated and informed consumers who are seeking more competitive loan originator compensation from the person closest to the transaction, which is the individual loan originator, by denying such consumers the benefit of their wish to bargain. A trade association representing mortgage brokers similarly stated that loan originators should be permitted to reduce their compensation to provide closing cost credits to a consumer or to match a competitor's price quote. This trade association also asserted that not allowing loan originator organizations to reduce their compensation to bear the cost of pricing concessions for competition creates an "[un]level playing field" between loan originator organizations and creditors.

A State housing finance authority urged the Bureau not to impose the ban on reducing loan originator compensation to bear the cost of pricing concessions for loans purchased or originated by governmental instrumentalities. The commenter stated that, under its programs, creditors agree to receive below-market servicing release premiums, and they then pass on some or all of that loss by paying loan originators less for such transactions. The commenter stated further that the proposal would have disruptive effects on its programs because creditors have indicated that they cannot afford to participate if, as they interpret § 1026.36(d)(1)(i) as mandating, they must absorb all of the loss associated with the below-market servicing release premiums. A mortgage company asked that the Bureau allow it to reduce the basis points it pays its loan originators for originating jumbo loans.

The Bureau has considered the comments received and concluded that it is appropriate to finalize the basic approach to pricing concessions outlined in the proposal, while expanding the scope of circumstances in which the compensation paid to a loan originator may be reduced to bear the cost of pricing concessions provided to consumers in response to unforeseen settlement cost increases. The Bureau believes that it is critical to continue restricting reductions in loan originator compensation to bear the cost of pricing concessions to truly unforeseen circumstances, because broader latitude would create substantial opportunities to evade the general rule. The Bureau believes this approach will balance the concerns of industry that the proposed commentary provision regarding permissible reductions in loan originator compensation to bear the cost of pricing concessions was too narrowly crafted, and thus ultimately would have hurt consumers and industry alike, with the concerns of consumer groups that any exception to the existing prohibition would vitiate the underlying rule.

In this final rule, the Bureau is making only one substantive change and several technical changes to its proposed revisions to comment 36(d)(1)-5, which would have described in more detail the interpretation that § 1026.36(d)(1)(i) prohibits reductions in loan originator compensation to bear the cost of pricing concessions. Comment 36(d)(1)-5 now clarifies that a loan originator organization may not reduce its own compensation in a transaction where the loan originator organization receives compensation directly from the consumer (*i.e.*, consumer-paid compensation), with or without a corresponding reduction in compensation paid to an individual loan originator. This language is intended to make clearer that, in light of the deletion of existing § 1026.36(d)(1)(iii) and the removal of existing comment 36(d)(1)-7 (see discussion below), comment 36(d)(1)-5 applies to loan originator organizations that receive compensation directly from consumers.

When a loan originator organization charges consumers fees that are based on the terms of a transaction, the individual loan originators who work for the organization will tend to sell consumers the terms that generate higher income for the loan originator organization, even if the compensation of the individual loan originator is not based on those terms. That is presumably why Congress elected to extend the loan originator compensation rule to cover consumer-paid transactions.[91] The same risk exists if the loan originator organization establishes a uniform fee structure but then discounts its fees to fund pricing concessions. Thus, the Bureau believes that

[91] For more discussion regarding a consumer's payment to a loan originator organization, see this section-by-section analysis of § 1026.36(d)(1)(i) under the heading *Prohibition Against Payments Based on a Term of a Transaction*.

covering pricing concessions by a loan originator organization is required to faithfully implement the TILA section 129B(c)(1) prohibition on varying loan originator compensation based on the terms of a loan. While the Bureau bases this clarification on its interpretation of TILA section 129B(c)(1), it is also supported by its authority under TILA section 105(a) to prescribe rules providing adjustments and exceptions necessary or proper to facilitate compliance. See the section-by-section analysis of §1026.36(d)(1)(iii) for further discussion of these issues. As a technical matter, this final rule substitutes "transaction" for "loan," "high-cost mortgage" for "high-cost loan," and "credit" for "loan" where appearing in existing comment 36(d)(1)-5 to be consistent with terminology used in this final rule and in Regulation Z generally, and in a few instances the word "originator" is replaced with "loan originator" for consistency purposes.

The Bureau is finalizing the removal of existing comment 36(d)(1)-7, which states that the prohibition on compensation based on transaction terms does not apply to transactions in which any loan originator receives compensation directly from the consumer (*i.e.*, consumer-paid compensation) under the existing rule. The Bureau did not receive any comments addressing this specific proposal.[92] As discussed above, the Dodd-Frank Act now applies the prohibition on compensation based on transaction terms to consumer-paid compensation. Thus, the Bureau continues to believe that it is appropriate to propose to remove existing comment 36(d)(1)-7. As discussed above, the Bureau is also revising comment 36(d)(1)-5 to clarify its application to loan originator organizations that receive compensation directly from consumers.

In this final rule, comment 36(d)(1)-7 largely follows the approach set forth in the proposed comment 36(d)(1)-7, which would have permitted loan originators to reduce their compensation to bear the cost of pricing concessions in a very narrow set of circumstances where

[92] As noted above, the Bureau did receive several comments urging it to allow loan originator organizations to reduce their compensation to meet price competition.

there was an unanticipated increase in certain settlement costs beyond applicable tolerance requirements. The Bureau believes that allowing reductions in loan originator compensation in too permissive circumstances would undermine the prohibition against compensation based on a transaction's terms. Existing comment 36(d)(1)-5 prevents creditors and loan originators from evading the prohibition in § 1026.36(d)(1) by systematically setting loan originator compensation at a non-competitive, artificially high baseline and then allowing discretion to loan originators to lower their compensation (by giving the concession) in selective cases, either unilaterally or upon request by consumers. More sophisticated consumers who choose to negotiate the loan originator compensation may benefit from the ability of loan originators to grant concessions. On the other hand, if reductions in loan originator compensation to bear the cost of pricing concessions were allowed under all circumstances, those consumers who do not shop or who otherwise lack the knowledge or expertise to negotiate effectively may be vulnerable to creditors or loan originators that consistently inflate price quotes. Thus, an interpretation of § 1026.36(d)(1)(i) to allow reductions in loan originator compensation to bear the cost of a pricing concession in a broad set of circumstances could create an opening to upcharge consumers across the board.

For example, a creditor may have a standard origination fee of $2,000 that, pursuant to its arrangement with its individual loan originators, is split evenly between the creditor and the individual loan originators. The creditor budgets for this origination fee in terms of its expected revenues on each transaction. However, the creditor and its individual loan originators might have an additional arrangement whereby: (1) the individual loan originators initially estimate the origination fee as $3,000 to every consumer; (2) the individual loan originators are permitted to make pricing concessions to lower the quoted origination fee to a minimum of $2,000; and (3) the creditor and individual loan originators split equally the actual origination fee collected in each case, with or without any pricing concessions. Assume that sophisticated consumer X, when quoted the $3,000 origination fee, recognizes that the fee is not competitive and requests that the individual loan originator with whom the consumer is interacting to lower it, to which the individual loan originator agrees. On the other hand, less sophisticated consumer Y, when quoted the $3,000 origination fee, does not attempt to negotiate the fee. Consumer Y would thus be vulnerable to this means of evading § 1026.36(d)(1) that would exist but for comment 36(d)(1)-5 on reductions in loan originator compensation to bear the cost of pricing concessions.[93] The Bureau is concerned that this practice would significantly undermine the prohibitions on compensation based on transaction terms in § 1026.36(d)(1) and the similar statutory prohibition in Dodd-Frank Act section 1403, which this final rule is implementing.

In particular, the Bureau is not interpreting § 1026.36(d)(1) to permit loan originators to reduce their compensation to bear the cost of a pricing concession in connection with matching a competitor's credit terms, an approach that was suggested by two industry trade associations and one large financial institution. The Bureau believes this interpretation would greatly undermine the general rationale for the prohibition of pricing concessions. As discussed above, a primary purpose of existing comment 36(d)(1)-5 is to prevent creditors and loan originators from

[93] The Bureau believes that what would make this kind of arrangement viable, but for the interpretation in comment 36(d)(1)-5, is the fact that the individual loan originator would have discretion to reduce its compensation to bear the cost of a selective pricing concession, as necessary to retain sophisticated consumer X's business. The Bureau recognizes that, even with comment 36(d)(1)-5 in place, a creditor and individual loan originator still could engage in a similar business model involving non-competitive overall credit pricing to support inflated loan originator compensation—but they would have to be content to limit their business exclusively to less sophisticated consumers such as consumer Y because their inability to reduce their compensation to bear the cost of selective pricing concessions would mean foregoing more sophisticated consumers' business. The Bureau is skeptical that the regulatory limitations and market pressures would permit such a model to work on a large scale, if at all. Moreover, the 2013 ATR Final Rule and the 2013 HOEPA Final Rule include loan originator compensation in points and fees for the thresholds for both qualified mortgages and high-cost mortgages, so these points and fees limits impose additional constraints on the ability of creditors and loan originators to inflate loan originator compensation.

effectively evading § 1026.36(d)(1) by doing indirectly what it prohibits directly (*i.e.*, paying loan originators compensation that is based on transaction terms). Although more sophisticated consumers who shop and seek alternative offers may benefit from the ability of loan originators to reduce their compensation in the case of price competition, those consumers who do not shop or who otherwise lack the knowledge or expertise to negotiate effectively may be vulnerable to creditors or loan originators that consistently inflate price quotes. Moreover, in the 2010 Loan Originator Final Rule, the Board recognized that in some cases a creditor may be unable to offer the consumer a more competitively-priced loan without also reducing the creditor's own origination costs, but the Board also noted that creditors finding themselves in this situation frequently will be able to adjust their overall pricing and compensation arrangements to be more competitive generally with other creditors in the market. 75 FR 58509, 58524 (Sept. 24, 2010). The Bureau agrees with the Board's rationale. In light of these considerations, the Bureau is not revising comment 36(d)(1)-7 to permit reductions in loan originator compensation to bear the cost of pricing concessions for price competition.

Moreover, the Bureau also does not agree with the assertion by one trade association that loan originator organizations should be entitled to reduce their compensation for price competition—even if they do not pass along the cost of the pricing concession to their individual loan originators—as a means of attaining parity with creditors. Under the existing regulation, creditors may make pricing concessions in specific cases but may not pass along the cost of such concessions to their individual loan originators or to loan originator organizations. The Bureau believes that changing this rule would be inconsistent with TILA section 103(cc)(2)(F), which was added by Dodd-Frank Act section 1401. TILA section 103(cc)(2)(F) provides that the definition of "mortgage originator" expressly excludes creditors (other than creditors in table-funded transactions) for purposes of TILA section 129B(c)(1).[94] 15 U.S.C. 1602(cc)(2)(F). The Dodd-Frank Act thus contemplated treating brokers and retail loan officers equivalently—they are both individual loan originators—but did not likewise contemplate equivalent treatment between creditors (other than those in table-funded transactions) and loan originator organizations. Therefore, the Bureau is not permitting loan originator organizations to reduce their compensation to meet price competition.

At the same time, the Bureau believes it is appropriate to permit loan originators to reduce their compensation to bear the cost of pricing concessions in additional circumstances that, when appropriately cabined to prevent abuse, do not present a risk of steering and allow the parties to credit transactions greater flexibility to close transactions, which benefits consumers and industry alike. For example, several commenters questioned why the Bureau would prohibit a loan originator from covering a rate-lock extension fee when the original rate lock has expired through the loan originator's fault. The Bureau acknowledges that, even with the proposed new comment 36(d)(1)-7, the combined effect of Regulation X and Regulation Z disclosure rules and the prohibition on compensation based on transaction terms in § 1026.36(d)(1)(i) would have been to bar loan originators from reducing their compensation to bear the cost of pricing concessions in these (and many other) circumstances, which could prove detrimental to consumers in some cases.[95] Moreover, the proposal would have allowed reductions in loan

[94] As noted earlier, TILA section 129B(c)(1), as added by Dodd-Frank Act section 1403, provides that for any residential mortgage loan no mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal). 12 U.S.C. 1639b(c)(1).

[95] This could occur, for example, if the consumer enters into a rate-lock agreement with a creditor, a changed circumstance occurs under Regulation X the effect of which is a delay of the closing date, and the rate-lock expires during the delay. In such a scenario, if the consumer refuses to pay the rate-lock extension fee and the creditor is neither required nor willing to waive or reduce the fee, the transaction may never be consummated if the loan originator, although willing to do so, is not allowed to reduce its compensation to bear the cost of the rate-lock extension fee. *See* 12 CFR 1024.7(f).

originator compensation to bear the cost of pricing concessions only for unanticipated increases in non-affiliated third-party closing costs exceeding applicable legal limits. Where an increase in an actual settlement cost above that estimated on the RESPA GFE is not in excess of Regulation X tolerance limits, the proposed rule would not have permitted any reduction in loan originator compensation to cover the increase or a portion of it. Therefore, a consumer who wants to negotiate down a higher-than-estimated settlement cost could benefit from a loan originator being permitted to reduce its compensation to bear the cost of the reduction in the actual settlement cost.

The Bureau balances these considerations in the final rule. New comment 36(d)(1)-7.i clarifies that, notwithstanding comment 36(d)(1)-5, § 1026.36(d)(1) does not prohibit a loan originator from decreasing its compensation in unforeseen circumstances to defray the cost, in whole or part, of an increase in an actual settlement cost over an estimated settlement cost disclosed to the consumer pursuant to section 5(c) of RESPA or an unforeseen actual settlement cost not disclosed to the consumer pursuant to section 5(c) of RESPA.

The comment explains that, for purposes of comment 36(d)(1)-7, an increase in an actual settlement cost over an estimated settlement cost (or omitted from that disclosure) is unforeseen if the increase occurs even though the estimate provided to the consumer (or the omission from that disclosure) is consistent with the best information reasonably available to the disclosing person at the time of the estimate. The Bureau believes that repeated increases in or omissions of one or more categories of settlement costs over multiple transactions may indicate that the disclosing person is not estimating the settlement cost consistent with the best information reasonably available, which in turn may suggest that the person is systematically underestimating (or omitting) such cost.[96] While the Bureau bases this clarification on its interpretation of TILA section 129B(c)(1), it is also supported by its authority under TILA section 105(a) to prescribe rules providing adjustments and exceptions necessary or proper to facilitate compliance.

Comment 36(d)(1)-7 provides two examples of reductions in compensation to bear the cost of pricing concessions that would be permitted under § 1026.36(d)(1). Comment 36(d)(1)-7.i presents the example of a consumer who agrees to lock an interest rate with a creditor in connection with the financing of a purchase-money transaction. A title issue with the property being purchased delays closing by one week, which in turn causes the rate lock to expire. The consumer desires to re-lock the interest rate. Provided that the title issue was unforeseen, the loan originator may decrease the loan originator's compensation to pay for all or part of the rate-lock extension fee. Comment 36(d)(1)-7.ii presents the example of when applying the tolerance requirements under the regulations implementing RESPA sections 4 and 5(c), there is a tolerance violation of $70 that must be cured. The comment clarifies that, provided the violation was unforeseen, the rule is not violated if the individual loan originator's compensation decreases to pay for all or part of the amount required to cure the tolerance violation.

Regarding certain other comments from industry, the Bureau has not, in this final rule, tied the permissibility of reducing loan originator compensation to bear the cost of pricing concessions to the specific type of transaction or the nature of the originator or secondary market purchaser, as two commenters requested (*i.e.*, by urging the Bureau to exempt jumbo loans and loans purchased or originated by governmental instrumentalities). The Bureau believes that allowing reductions in loan originator compensation to bear the cost of pricing concessions on a

[96] In addition to reductions in loan originator compensation not being permitted under such circumstances pursuant to comment 36(d)(1)-7, such activity may also constitute a violation of the RESPA section 5(c) requirement of a good faith estimate.

categorical basis for certain loan types and originator or secondary market purchaser identity would ignore the possibility of steering incentives that may be present in such circumstances. Moreover, the Bureau believes that allowing reductions in compensation to bear the cost of pricing concessions for any reason up to a specified dollar amount, as one mortgage broker commenter suggested, would be inappropriate. In cases in which there are truly unforeseen circumstances, there is no reason to cap the dollar amount of the concession. And in other cases, a generic permissible amount of concessions could create precisely the type of incentive to upcharge across all consumers that the general prohibition is designed to prevent.

The Bureau has not revised comment 36(d)(1)-7 to permit expressly reductions in loan originator compensation to bear the cost of a pricing concession for "clerical error." As noted above, the commenters who suggested the Bureau permit reductions in compensation for "clerical error" gave different details about the scope of the suggested exception. The Bureau believes this term would be difficult to define. Moreover, the Bureau believes the scenarios cited by some commenters in urging the Bureau to allow concessions in these circumstances (*e.g.*, where the loan originator assures the consumer that the interest rate is being locked but fails to do so) would already be covered by revised comment 36(d)(1)-7, which allows reductions in loan originator compensation to bear the cost of pricing concessions where there has been an unforeseen increase in a settlement cost above that estimated on the disclosure delivered to the consumer pursuant to RESPA section 5(c) (or omitted from that disclosure).

The Bureau is not revising comment 36(d)(1)-7 to address expressly whether loan originators may reduce their compensation to bear the cost of pricing concessions made to avoid the triggering of Federal and State high-cost mortgage provisions or to ensure that a credit transaction is a qualified mortgage under Federal ability-to-repay provisions, as certain industry commenters requested. The Bureau believes that exceptions in these circumstances to the general prohibition on reducing loan originator compensation in connection with pricing concessions are not warranted because the rationale underlying the general prohibition is present. In other words, such an approach could incentivize creditors to systematically overestimate pricing in all circumstances and make selective concessions (of which loan originators would bear the cost) for the sole purpose of avoiding high-cost mortgage triggers or noncompliance with Federal ability-to-repay provisions.

The Bureau also believes that comment 36(d)(1)-7 need not address, as one commenter suggested, reductions in loan originator compensation to penalize a loan originator for its failure to comply with a creditor's policies and procedures in the absence of a demonstrable loss to the creditor. In this scenario, the consumer's transaction terms are not changing; there is no pricing concession. Thus, unless the proxy analysis under § 1026.36(d)(1)(ii) applies, the Bureau believes a reduction in loan originator compensation as a penalty for the loan originator's failure to follow the creditor's policies and procedures where there is no demonstrable loss to the creditor is outside the scope of § 1026.36(d)(1)(i) and thus need not be addressed by comment 36(d)(1)-7. Regarding one commenter's suggestion that the Bureau allow reductions in loan originator compensation if poor customer service is reported, the Bureau likewise does not believe it is necessary to address this issue in comment 36(d)(1)-7. Where poor customer service is reported and the creditor reduces the compensation of the loan originator, but the consumer's transaction terms do not change and the proxy analysis does not apply, the reduction in compensation is outside the scope of § 1026.36(d)(1)(i). If, however, the creditor were to agree to reduce its origination fee or change another transaction term in response to the complaint about poor customer service, allowing reductions in compensation under these circumstances could lead to creditors and loan originators systematically overestimating settlement costs and selectively reducing them in response to complaints of poor customer service. The baseline prohibition thus would apply in that circumstance.

Furthermore, the Bureau does not believe that reductions in loan originator compensation to bear the cost of pricing concessions should be permitted when, as one commenter suggested, there is a "misunderstanding over a consumer's information" or to cover "reduced, waived, or uncollected third-party fees." Regarding a "misunderstanding over consumer information," the principles the commenter suggested are too vague to be included as a separate rationale for allowing pricing concessions in comment 36(d)(1)-7, and thus potentially would be over-inclusive and confusing. However, these circumstances may already be covered by the language in comment 36(d)(1)-7 clarifying that the reduction in loan originator compensation may be made to defray an increase in an actual settlement cost above the estimated settlement cost disclosed to the consumer pursuant to section 5(c) of RESPA. Allowing reductions in loan originator compensation to cover reduced, waived, or uncollected third-party fees may not result in any discernible benefit to consumers, and in any event the reduction, waiver, or collection of third-party fees is better addressed separately by the loan originator and creditor outside the context of the transaction.

Finally, the Bureau has not revised comment 36(d)(1)-7 to state that creditors must control loan originators' reductions in compensation to prevent disparate impact issues under fair lending laws, as one commenter suggested. This clarification is not necessary because nothing in comment 36(d)(1)-7 requires reductions in loan originator compensation to bear the cost of pricing concessions or prevents creditors from exercising prudent control over them. Thus, creditors may prohibit their loan originators from reducing their compensation to bear the cost of concessions in certain circumstances, such as to prevent disparate impact issues under fair lending laws.

Compensation Based on Multiple Transactions of an Individual Loan Originator

Section 1026.36(d)(1)(i) prohibits payment of an individual loan originator's compensation that is directly or indirectly based on the terms of "the transaction." In the proposal, the Bureau stated that it believes that "transaction" should be read to include multiple transactions by a single individual loan originator because individual loan originators sometimes receive compensation derived from multiple transactions. Existing comment 36(d)(1)-3 lists several examples of compensation methods not based on transaction terms that take into account multiple transactions, including "[t]he percentage of applications submitted by the loan originator to the creditor that results in consummated transactions." *See* existing comment 36(d)(1)-3.vi. To avoid any possible uncertainty, however, the Bureau proposed to clarify, as part of proposed comment 36(d)(1)-1.ii, that § 1026.36(d)(1)(i) prohibits compensation based on the terms of multiple transactions by an individual loan originator. The Bureau did not receive any comments regarding this proposed clarification. The Bureau interprets TILA section 129B(c)(1) to prohibit compensation based on the terms of multiple transactions by the individual loan originator.[97] Further, the Bureau believes that its approach will prevent circumvention or evasion of the statute, consistent with TILA section 105(a). Thus, the Bureau is finalizing the clarification in proposed comment 36(d)(1)-1.ii that § 1026.36(d)(1)(i) prohibits compensation based on the terms of multiple transactions by an individual loan originator.

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[97] The Bureau believes this interpretation of section 129B(c)(1) is reasonable in light of the common principle that singular words in a statute refer to the plural, and vice versa. *See* 1 U.S.C. 1 ("[U]nless the context indicates otherwise," "words importing the singular include and apply to several persons, parties, or things; words importing the plural include the singular."); *see also* Congressional Research Report for Congress, Statutory Interpretation: General Principles and Recent Trends (Aug. 31, 2008) at 9, *available at* http://www.fas.org/sgp/crs/misc/97-589.pdf.

Compensation Based on Terms of Multiple Individual Loan Originators' Transactions

Although existing § 1026.36(d)(1)(i) prohibits payment of an individual loan originator's compensation that is "directly or indirectly" based on the terms of "the transaction," and TILA (as amended by the Dodd-Frank Act) similarly prohibits compensation that "directly or indirectly" varies based on the terms of "the loan," the existing regulation and its commentary do not expressly address whether a person may pay compensation that is based on the terms of multiple transactions of multiple individual loan originators. As a result, numerous questions have been posed regarding the applicability of the existing regulation to compensation programs of creditors or loan originator organizations, such as those that involve payment of bonuses or other deferred compensation under company profit-sharing plans[98] or contributions to certain tax-advantaged retirement plans under the Internal Revenue Code (such as 401(k) plans),[99] under which individual loan originators may be paid variable, additional compensation that is based in whole or in part on profitability of the creditor or loan originator organization.[100] As the Bureau

[98] As discussed below, the proposal sometimes used the term "profit-sharing plan" to describe compensation programs (including "bonus plans," "profit pools," and "bonus pools") under which individual loan originators are paid additional compensation based in whole or in part on the profitability of the company, business unit, or affiliate. As discussed below, this final rule effectively substitutes the term "non-deferred profits-based compensation plan" for "profit-sharing plan" but the term has a somewhat different meaning for purposes of § 1026.36(d)(1)(iv). When referring to the proposal, the Small Business Panel Review process, or comments in response thereto in this section-by-section analysis, the term "profit-sharing plan" is retained whereas when referring to the provisions of this final rule, the term "non-deferred profits-based compensation plan" is used. The discussion of the proposal, Small Business Panel Review process, or comments in response thereto also sometimes refers to "profit-sharing bonuses," whereas the final rule and the provisions of this section-by-section analysis of the final rule do not use that term.

[99] As discussed below, the proposal sometimes used the term "qualified plan" to describe certain tax-advantaged defined benefit and defined contribution plans. The proposal sometimes used the term "non-qualified plan" to refer to other defined benefit plans and defined contribution plans. Final § 1026.36(d)(1)(iii) and its commentary do not use the terms "qualified plan" and "non-qualified plan." Instead, they use the terms "designated tax-advantaged plans" (or "designated plans") and "non-designated plans," respectively. When referring to the proposal, the Small Business Panel Review process, or comments in response thereto in this section-by-section analysis, the terms "qualified plan" and "non-qualified plan" are retained. When referring to the provisions of this final rule, the terms "designated tax-advantaged plan" (or "designated plan") and "non-designated plan" are used.

[100] The Bureau issued a bulletin on April 2, 2012 to address many of these questions. CFPB Bull. No. 2012-2, *Payments to Loan Originators Based on Mortgage Transaction Terms or Conditions under Regulation Z* (Apr. 2, 2012), *available at* http://files.consumerfinance.gov/f/201204_cfpb_LoanOriginatorCompensationBulletin.pdf (CFPB Bulletin 2012-2). CFPB Bulletin 2012-2 stated that, until this final rule was adopted, employers could make

noted in the proposal, a profit-sharing plan, bonus pool, or profit pool set aside out of a portion of a creditor's or loan originator organization's profits from which bonuses are paid or contributions are made to qualified plans or non-qualified plans may reflect transaction terms of multiple individual loan originators taken in the aggregate. Consequently, these types of compensation programs create potential incentives for individual loan originators to steer consumers to particular transaction terms based on the interests of the loan originator rather than the consumer, which is one of the fundamental problems that TILA section 129B(c) and the existing regulation are designed to address. Moreover, limiting the scope of compensation restrictions in § 1026.36(d)(1)(i) to an overly narrow interpretation of "the transaction" could undermine the rule. For example, a creditor or loan originator organization could restructure its compensation policies to pay a higher percentage of compensation through bonuses under company profit-sharing plans, rather than through compensation, such as commissions, that is not based on the terms of multiple transactions of multiple individual loan originators.

To address these concerns, the Bureau proposed a new comment 36(d)(1)-1.ii in part to clarify that the prohibition on payment and receipt of compensation based on the transaction's terms under § 1026.36(d)(1)(i) covers compensation that directly or indirectly is based on the terms of multiple transactions of multiple individual loan originators employed by the person. Proposed comment 36(d)(1)-2.iii.C would have provided further clarification on these issues.

The Bureau stated in the section-by-section analysis of proposed § 1026.36(d)(1)(i) that the proposed approach was necessary to implement the statutory provisions, address the potential

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contributions to certain "Qualified Plans" (defined in CFPB Bulletin 2012-2 to include "qualified profit sharing, 401(k), and employee stock ownership plans") for individual loan originator employees even if the contributions were derived from profits generated by mortgage loan originations. It explicitly did not address how the rules applied to "profit-sharing arrangements/plans that are not in the nature of Qualified Plans," which the Bureau wrote would be addressed in this rulemaking. Until the final rule goes into effect, the clarifications in CFPB Bulletin 2012-2 will remain in effect.

incentives to steer consumers to particular transaction terms that are present with profit-sharing plans, and prevent circumvention or evasion of the statute. The Bureau noted, however, that any standard would need to account for circumstances where potential incentives were sufficiently attenuated to permit such compensation. To that end, proposed § 1026.36(d)(1)(iii) would have permitted contributions by creditors or loan originator organizations to qualified plans in which individual loan originators participate. The proposal also would have permitted payment of bonuses under profit-sharing plans and contributions to non-qualified plans even if the compensation were directly or indirectly based on the terms of multiple individual loan originators' transactions, so long as: (1) the revenues of the mortgage business did not constitute more than a certain percentage of the total revenues of the person or business unit to which the profit-sharing plan applies, as applicable, with the Bureau proposing alternative threshold amounts of 25 and 50 percent, pursuant to proposed § 1026.36(d)(1)(iii)(B)(*1*); or (2) the individual loan originator being compensated was the originator for a de minimis number of transactions (*i.e.*, no more than five transactions in a 12-month period), pursuant to proposed § 1026.36(d)(1)(iii)(B)(*2*). In all instances, however, the proposal stated that the creditor or loan originator organization could not take into account the terms of the individual loan originator's transactions, pursuant to the restriction on this compensation in proposed § 1026.36(d)(1)(iii)(A). Thus, the creditor or loan originator organization could not vary the amount of the contribution or distribution based on whether the individual loan originator is the loan originator for high rate loans, for example. These aspects of the proposal are discussed in more detail in the section-by-section analysis of § 1026.36(d)(1)(iii) and (iv) in this final rule, below.

The Bureau sought comment on three additional issues related to the proposed commentary that would have clarified that terms of multiple loan originators' transactions were subject to the compensation restrictions under § 1026.36(d)(1)(i). First, the proposal recognized that the strength of potential incentives to steer consumers to particular transaction terms presented in specific profit-sharing plans may vary based on many factors, including the organizational structure, size, diversity of business lines, and compensation arrangements. Thus, in certain circumstances, a particular combination of factors may substantially mitigate the potential steering incentives arising from profit-sharing plans.[101] The Bureau thereby solicited comment on the scope of the steering incentive problem presented by profit-sharing plans, whether the proposal effectively addressed these issues, and whether a different approach would better address these issues. The Bureau also stated in the proposal that it was cognizant of the burdens compensation restrictions may impose on creditors, loan originator organizations, and individual loan originators. In addition, the proposal expressed the Bureau's belief that bonuses and contributions to defined contribution and benefit plans, when paid for legitimate reasons, could serve as beneficial inducements for individual loan originators to perform well and become invested in the success of their organizations. The Bureau solicited comment on whether the proposed restrictions accomplished the Bureau's objectives without unduly restricting compensation arrangements that addressed legitimate business needs. Lastly, the Bureau noted that it was not proposing any clarifications to existing comment 36(d)(1)-1,[102] which addresses what constitutes compensation and refers to salaries, commissions, and similar payments,

[101] The Bureau discussed how, for example, the incentive of individual loan originators to upcharge likely diminishes as the total number of individual loan originators contributing to the profit pool increases. The incentives may be mitigated because: (1) each individual loan originator's efforts will have increasingly less impact on compensation paid under profit-sharing plans; and (2) the ability of an individual loan originator to coordinate efforts with the other individual loan originators will decrease. The Bureau cited a number of economic studies regarding this "free-riding" behavior. The Bureau also stated that this may be particularly true at large institutions with many individual loan originators because the nexus among the terms of the transactions of the multiple individual loan originators, the revenues of the organization, the profits of the organization, and the compensation decisions may be more diffuse in a large organization.
[102] As discussed in the section-by-section analysis of proposed § 1026.36(a), the Bureau proposed to move the text of this comment to proposed comment 36(a)-5.

because the payment of salary and commissions from revenues earned from a company's mortgage business typically does not raise the same types of concerns about steering consumers to different terms to increase the size of a profit-sharing or bonus pool.[103] The Bureau sought comment on whether the prohibition on compensation relating to transaction terms of multiple individual loan originators should encompass a broader array of compensation arrangements.

Consumer groups commenting on the proposal generally supported the clarification that the prohibition on compensation based on transaction terms would include the terms of multiple transactions of multiple individual loan originators. One consumer group wrote that the proposal generally would provide robust protections and reform in loan originator compensation, and that the proposed comment 36(d)(1)-1.ii would prevent the abuses associated with yield spread premium payments to loan originators. A housing advocacy organization wrote that the Bureau should state specifically that compensation from a loan originator organization to an individual loan originator cannot be tied to the terms of any loan, individually or in the aggregate. This organization cited two U.S. Department of Justice actions, later settled, that alleged that a large depository institution and a large mortgage company discriminated against African-American and Hispanic borrowers by steering them into subprime mortgages as evidence of the need of the Bureau to disallow any "loophole" in the final rule that could encourage similar practices. A coalition of consumer groups wrote that allowing individual loan originators to profit from compensation based on aggregate terms of loans they broker, such as higher interest rates, presents the same risks to consumers as allowing individual loan originators to profit from compensation based on terms of a single transaction. Anything short of a complete prohibition

[103] As the Bureau explained in the proposal, salary and commission amounts are more likely than bonuses to be set in advance. Salaries are typically paid out of budgeted operating expenses rather than a "profit pool"; commissions typically are paid for individual transactions and without reference to the person's profitability; and the salary and commission amounts often are stipulated by an employment or commission agreement.

on this practice, they wrote, would permit a payment structure that Congress intended to ban and that makes loan originator compensation even less transparent to consumers.

An organization writing on behalf of State bank supervisors noted that interpretation of existing loan originator compensation standards can be difficult for regulators and consumers and that adjustments to existing rules for purposes of clarity and coherence would be appropriate. The organization was generally supportive of the proposal to clarify and revise restrictions related to pooled compensation, profit-sharing, and bonus plans for originators, depending on the potential incentives to steer consumers to particular transaction terms.

Industry commenters generally opposed new comment 36(d)(1)-1.ii and its underlying premise that compensating individual loan originators based on the terms of multiple individual loan originators' transactions likely creates steering risk. A national trade association representing community banks wrote that the Bureau is right to be concerned with creating conditions that could lead some individual loan originators to steer consumers into transactions that may not be in the best interest of a consumer but would benefit an individual loan originator through greater bonus compensation. The association asserted, however, that the nature of any bonus pool shared by multiple individuals or deferred compensation of any type inherently mitigates steering risk.[104] A national trade association representing the banking industry acknowledged that bonuses can be improperly used as a "proxy" for transaction terms, but urged the Bureau not to deem every revenue-based bonus decision to be a proxy. Instead, the association asserted, the possible use of bonuses as a subterfuge for transaction terms should be a

[104] This commenter based this assertion on several points, including that participation by multiple employees dilutes the impact and reward for any one participant, the delayed nature of a bonus pool payout erodes the incentive to steer for quick gains, bonus pools merely supplement and augment an employee's compensation, and most bonus plans—especially for community bank loan originators—contain a variety of components other than mortgage revenue.

focus for enforcement and examination.[105] A large depository institution commenter acknowledged that each individual loan originator whose bonus comes from a profit-derived pool is indirectly incentivized to increase profits and thereby increase the pool's size, but stated that appropriately designed bonus plans consistent with risk management principles should be permissible when the bonus award is directly and primarily based on legitimate factors and incentives (*i.e.*, not directly based on the terms of the transactions of each loan originator). A national industry trade association suggested that the Bureau permit creditors and loan originator organizations to pay a bonus to an individual loan originator when the awarding of the bonus and its amount are "sufficiently attenuated" from the terms of the transaction "so as not to provide a material steering risk for the consumer." A State industry trade association commented that appropriately structured profit-sharing and bonus plans incentivize loan originators to make appropriate loans without taking on excessive risk or being overly cautious. Thus, the trade association stated that severely restricting certain types of profit-sharing or bonus plans would not provide consumers with significantly more protection but, instead, would limit the availability of credit to all but the most creditworthy consumers. A law firm that represents small and mid-sized bank clients suggested that the Bureau set forth factors that would be used to determine whether a bonus under a particular incentive compensation plan would be permissible because it was sufficiently attenuated from the terms of multiple loan originators' transactions.

[105] Several commenters echoed this argument that the types of practices the Bureau is regulating are better suited for examination and enforcement. One State trade association wrote that if bonuses are improperly designed to reward specific individual loan originators for transaction terms, this fact will be ascertainable through examination. A national trade association representing the mortgage industry suggested the Bureau use its authority under the Dodd-Frank Act to prevent unfair, deceptive, or abusive acts or practices. A State credit union trade association suggested the Bureau enforce existing regulations before imposing new regulations. One commenter claimed that the Bureau overreached in its proposal and needed to provide evidence that a profit motive in a transparent cost environment could be an example of an unfair or deceptive practice in order to support the approach it followed in the proposal.

Among industry commenters, credit unions and their trade associations expressed particular opposition to the proposal. A national trade association representing credit unions questioned the Bureau's authority to add comment 36(d)(1)-1.ii, stating that it stretched the bounds of section 1403 of the Dodd-Frank Act by interpreting the statutory prohibition against compensation that varies based on the terms of the "loan" to apply to multiple transactions of multiple individual loan originators. A State credit union association wrote that it was unnecessary to extend the prohibitions to compensation based on the terms of multiple loan originators' transactions because: (1) neither TILA nor existing regulations addresses payment of compensation based on terms of multiple individual loan originators; and (2) it would be tremendously difficult to construct a scheme to evade the existing requirements. This association also stated that the proposal was internally inconsistent because the proposal's section-by-section analysis acknowledged that profit-sharing plans could be a useful and important inducement by employers to individual loan originators to perform well. Another State credit union association stated that credit unions merited special treatment under the rule because there was nothing in the Bureau's administrative record to connect credit union compensation or salary practices to the abuses or practices that contributed to the financial crisis of 2008. This association also asserted that National Credit Union Administration (NCUA) regulations permit certain types of compensation that would be prohibited under the proposal and, thus, urged the Bureau to state that a federally insured credit union that adheres to these regulations is deemed compliant with the loan originator compensation provisions.[106] A State credit union association commented that the Bureau should exempt credit unions from the proposed restrictions because credit unions

[106] The association specifically cited 12 CFR 701.21(c)(8)(iii), which permits credit unions to pay bonuses or incentives to credit union employees either based on the credit union's overall financial performance or in connection with a loan or loans, provided that the credit union board of directors establishes written policies and internal controls for such incentives or bonuses.

were structured in a way that significantly decreases steering risks (*i.e.*, credit unions provide loan services to member-owners only and member-owners can file complaints in response to any activity detrimental to loan applicants).

Several commenters either asked for clarification on whether compensation tied to company-wide performance would be permitted under the proposal or stated their support for such an approach. A financial holding company suggested that bonus or incentive programs of this sort should be permitted because of the unlikelihood, it asserted, that the loan originator steering a consumer into a higher-profit product would improve the profitability of the entire bank. A large financial services company commented that some uncertainty remained as to when "indirect" compensation would be sufficiently remote to be outside the purview of the rule and, consequently, requested an express exemption for bonuses paid to individual loan originators when the company: (1) calculates the bonuses under a company-wide program that applies in a similar manner to individuals who are not loan originators; (2) uses predetermined company performance metrics to calculate the bonus; and (3) does not take transaction terms directly into account.[107] A State trade association representing creditors stated that the Bureau should permit compensation plans that relate not only to the performance of an overall organization, but also to the performance of a specific team, branch, or business unit.

A mortgage company wrote that limiting compensation that was indirectly based on terms of transactions would cover almost any form of compensation derived from lender profitability, and the rulemaking instead should focus on compensation specific to the loan

[107] This commenter also questioned the interplay of the proposal with the 2012 HOEPA Proposal insofar as the 2012 HOEPA Proposal would have redefined points and fees to include certain compensation paid to individual loan originators. As noted earlier in the section-by-section analysis of § 1026.36(a), however, the definition of points and fees across the 2013 HOEPA Final Rule and the 2013 ATR Final Rule includes only compensation that can be attributed to a particular transaction at the time the interest rate is set.

originator and the transaction. This commenter also disagreed with the Bureau's statement in the proposal that creditors would restructure their compensation policies to shift more compensation to bonuses in an effort to evade the strictures of the prohibition on compensation based on transaction terms because creating a profit-sharing plan involved many more considerations, particularly for diversified companies.[108]

A few industry commenters raised procedural criticisms and asked for differential treatment for particular institutions. One industry commenter wrote that, based on the volume of proposed rules and the relatively short comment periods, it did not have sufficient time to analyze fully and comprehend the proposal and its potential impact on the commenter's business. A community bank requested that the Bureau exempt all savings institutions with under $1 billion in assets from the rule's compensation restrictions. Another community bank asked the Bureau to make distinctions between portfolio lenders and lenders that generate most revenues from selling loans.

Some industry commenters expressed support for the Bureau's proposed approach on compensation based on transaction terms. A mortgage banker stated that any bonus pool or profit-sharing plan should not be permitted to be derived from the terms of loans because "the overages [could] work their way back into the pockets of loan originators." A mortgage company affiliated with a national homebuilder wrote that it was prudent practice not to compensate loan originators on the terms of the transaction other than the amount of credit extended. A community bank generally praised the proposal for taking into account the impacts of the Dodd-Frank Act on the mortgage banking industry and raised no specific objections to

[108] As a general matter, this commenter suggested an alternative approach whereby the creditor would provide a disclosure—in bold face or larger font and set off from other disclosures—urging the consumer to be aware that the loan originator's compensation may increase or decrease based on the profitability of the creditor and urging the consumer to shop for credit to ensure that he or she has obtained the most favorable loan terms.

proposed comment 36(d)(1)-1.ii. The bank, however, stated that to attract talented loan originators it needed the ability to offer flexible and competitive compensation programs that rewarded loan production.[109] A financial services company wrote that the provisions in the proposal provided helpful additional commentary to elucidate the rules, particularly because incentive compensation plans at small to mid-size financial institutions that may look to profitability as a component often include senior executive officers who may be covered under the definition of loan originator. Also, some industry commenters that were generally critical of proposed comment 36(d)(1)-1.ii acknowledged that the Bureau's concern that individual loan originators would steer consumers to obtain higher bonuses was not misplaced.

The Bureau is finalizing the substance of comment 36(d)(1)-1.ii largely as proposed. However, the principle that the terms of multiple transactions by an individual loan originator, or the terms of multiple transactions by multiple individual loan originators are encompassed by the baseline prohibition in § 1026.36(d)(1)(i) is now included in text of § 1026.36(d)(1)(i) itself. The Bureau believes that it is appropriate to state clearly in the regulatory text that compensation based on the terms of multiple transactions of multiple individual loan originators is invalid unless expressly permitted by other provisions of this final rule. A clear standard will enhance consumer protections by reducing the potential for abuse and evasion of the underlying prohibition on compensation based on a term of a transaction. Moreover, a clear standard also will reduce industry uncertainty about how the regulation applies to bonuses from non-deferred profits-based compensation plans and contributions to designated plans or non-designated plans in which individual loan originators participate.

[109] The community bank commenter also argued that, to attract quality loan originators without having the ability to pay incentive compensation, the bank would have to pay such a high salary that it could risk creating a disincentive for the individual loan originator to produce high volume.

In the final rule, comment 36(d)(1)-2.ii has been revised to clarify that compensation to a loan originator that is based upon profits that are determined with reference to mortgage-related business is considered compensation that is based on the terms of transactions of multiple individual loan originators, and thus would be subject to the prohibition on compensation based on a term of a transaction under § 1026.36(d)(1)(i) (although it may be permitted under § 1026.36(d)(1)(iii) or (iv)). The comment cross-references other sections of the regulatory text and commentary for discussion of exceptions permitting compensation based upon profits pursuant to either a "designated tax-advantaged plan" or a "non-deferred profits-based compensation plan," and for clarification about the term "mortgage-related business." This language has been added to make more explicit the Bureau's rationale in the proposal that profits from mortgage-related business (*i.e.*, from transactions subject to § 1026.36(d)) are inextricably linked to the terms of multiple transactions of multiple individual loan originators when taken in the aggregate and therefore create potential incentives for individual loan originators to steer consumers to particular transaction terms. The Bureau believes that creditor or loan originator organization profitability from mortgage-related business usually, if not always, depends on the terms of transactions of individual loan originators working for the creditor or loan originator organization.[110] Moreover, to the extent a creditor or loan originator organization wanted to demonstrate that there is no nexus whatsoever between transaction terms and profitability, it would have to disaggregate the components of its profitability. The Bureau is skeptical that this would be feasible and, if so, that it could be done in a way that would not create challenges for

[110] As discussed above, many industry commenters objected to the premise in the proposal that compensation programs that feature profits-based bonuses or contributions to qualified plans or non-qualified plans presumptively create steering incentives, but some of those that did so acknowledged that bonuses can be improperly used as a "proxy" for transaction terms and, in one case, specifically stated that each individual loan originator whose bonus comes from a profit-derived pool is indirectly incentivized to increase profits and thereby increase the pool's size.

examination (by requiring substantial analysis of, *e.g.*, company revenues and profits, and of relationships among business lines and between affiliate profits and revenues).

The Bureau agrees with industry commenters that the payment of profit-sharing bonuses and the making of contributions to designated plans in which individual loan originators participate do not create steering potential under all circumstances. As the Bureau acknowledged in the proposal,[111] any regulation of loan originator compensation needs to account for the variation in organization size, type, compensation scheme, and other factors that, individually or collectively, affect the calculus of whether the steering risk is sufficiently attenuated. For example, one commenter asked the Bureau to permit paying an individual loan originator a bonus as part of a compensation program that uses predetermined performance metrics to determine compensation for all company employees. This type of compensation program, depending on the circumstances, may not be tied directly or indirectly to transaction terms and thus may not implicate the basic rule or, even if tied to profits, may not be structured in a manner that would incentivize individual loan originators to place consumers in mortgages with particular transaction terms. The mitigation or absence of steering potential with respect to this compensation program in one particular setting, however, does not mean that a slightly different compensation program in the same setting or the same compensation program in a slightly different setting would sufficiently mitigate steering incentives.

The Bureau believes that it is preferable to adopt a baseline clear prohibition on the payment of compensation based on the terms of multiple transactions of multiple loan originators (with commentary clarifying that this encompasses compensation that is based upon profits that are determined with reference to mortgage-related business) than to adopt any sort of standard

[111] 77 FR 55296 (Sept. 7, 2012).

focused on attenuation, materiality, or other legal principles (a “principles-based” standard or approach) that would have to be applied to the design and operation of each company’s specific compensation program, as suggested by some commenters. Application of a principles-based standard would involve the application of the relevant principles to the design and operation of each company’s specific compensation program. Because the application of these principles would necessarily involve a substantial amount of subjectivity, and the design and operation of these programs are varied and complex, the legality of many companies’ programs would likely be in doubt. This uncertainty would present challenges for industry compliance, for agency supervision, and agency and private enforcement of the underlying regulation.

The Bureau believes, further, that the disparate standards suggested by industry commenters prove the inherent difficulty of crafting a workable principles-based approach. For example, as noted earlier, one commenter urged the Bureau to permit the use of “appropriately designed bonus plans consistent with risk management principles” when the bonus award is “directly and primarily based on legitimate factors and incentives” and where “sufficient mitigating and attenuating factors” exist, and another industry commenter suggested that the Bureau permit creditors and loan originator organizations to pay a bonus to an individual loan originator when the awarding of the bonus and its amount are “sufficiently attenuated” from the terms of the transaction “so as not to provide a material steering risk for the consumer.” These standards do not have commonly understood meanings and would need to be defined by the Bureau or left for elaboration through supervisory and enforcement activities and private litigation. Although these definitional and line-drawing judgments are not impossible, they would inevitably add complexity to the rule.

The Bureau, furthermore, disagrees with the industry commenters that asserted that the relationship between incentive compensation programs and individual loan originator steering behavior should be a focus of examination and enforcement to the exclusion of rulemaking. Given the multiplicity and diversity of parties and variability of compensation programs potentially subject to this rulemaking, robust supervision and enforcement in this area would be extremely difficult, if not impossible, without appropriate clarity in the regulation. As noted earlier, an organization commenting on behalf of State banking supervisors stated that the existing rules can be difficult for regulators and consumers to interpret and supported the proposed changes to the existing regulation for purposes of clarity and coherence.

The Bureau also shares the concerns expressed by consumer groups that failing to prohibit compensation based on the terms of multiple transactions of multiple individual loan originators would potentially undermine the existing prohibition on compensation based on transaction terms in § 1026.36(d)(1)(i) and Dodd-Frank Act section 1403. As the consumer groups asserted, setting a baseline rule too loosely could allow for a return of the types of lending practices that contributed to the recent mortgage-lending crisis. This, in turn, would significantly undermine the effect of the Dodd-Frank Act reforms and the 2010 Loan Originator Final Rule. The Bureau believes that defining "loan" to mean only a single loan transaction by a single individual loan originator is an overly narrow interpretation of the statutory text and could lead to evasion of the rule. To this end, the Bureau disagrees with the assertion by one commenter that the Bureau lacks authority to interpret the statute in this manner. The Bureau is squarely within its general interpretive authority to implement the Dodd-Frank Act provision. The Bureau is also fully within its specific authority under TILA section 105(a) to issue regulations to effectuate the purposes and prevent evasion or circumvention of TILA. Moreover, the Bureau disagrees with the suggestion by one commenter that it is unnecessary to clarify that § 1026.36(d)(1)(i) covers multiple transactions by multiple individual loan originators because neither TILA nor existing Regulation Z addresses payment of compensation based on the terms of multiple transactions of multiple loan originators. The Bureau believes that given the uncertainty described by some commenters, about the regulation's application to bonuses and qualified and non-qualified plans, industry would benefit from clarification.[112]

The Bureau declines to adopt a special rule for credit unions as proposed by two State credit union associations. The Bureau recognizes that credit unions as well as community banks have a business model and a set of incentives and constraints that set them apart from other types of institutions engaged in similar activities and also are of a smaller scale than many such institutions. However, the Bureau does not believe that individual loan originators who work for a credit union or community bank are less susceptible of steering influences if their compensation can be based on the terms of the transactions either directly or indirectly as through bonuses or contributions tied to profits generated through mortgage-related business. Thus, the Bureau does not believe that it is appropriate to create a blanket exemption for credit unions and community banks from this rule. Moreover, TILA generally is structured around regulating the extension of consumer credit based on the type of transaction, not type of creditor. 12 U.S.C. 5511(b)(4). Absent a sufficiently compelling reason, the Bureau declines to introduce such a differentiation contrary to that general approach.[113] As discussed below, the Bureau is, however, adopting a special safe harbor rule with respect to compensation under a non-deferred

[112] As noted earlier, numerous questions by industry to the Board and the Bureau precipitated the Bureau issuing CFPB Bulletin 2012-2 and clarifying these issues in this rulemaking.

[113] For similar reasons, the Bureau has also not made any changes to the proposal based on comments requesting the Bureau exempt certain institutions from the effect of § 1026.36(d), such as those with under $1 billion in assets and those that keep their loans in portfolio. The commenters provided little to no evidence about why they should be exempt and the factors that would mitigate the steering incentives this rule addresses.

profits-based compensation plan to individual loan originators who are loan originators for ten or fewer transactions (under § 1026.36(d)(1)(iv)(B)(*2*)), which rule, the Bureau expects, will be of particular importance to credit unions and community banks. Furthermore, the Bureau disagrees with commenters who argued that credit unions should be treated differently because NCUA regulations permit the payment of certain incentives or bonuses to credit union individual loan originators based on the credit union's overall financial performance or in connection with loans made by credit unions, some of which incentives would be restricted under the Bureau's rule.[114] Accepting the commenters' characterization of the NCUA's regulations as more permissive than the Bureau's, a credit union could comply with both sets of regulations by adhering to the more restrictive one.

Although the Bureau in this final rule generally prohibits compensation that is based on the terms of multiple transactions of multiple individual loan originators (as discussed above), § 1026.36(d)(1)(iii) and (iv) permit compensation that is directly or indirectly based on the terms of multiple individual loan originators' transactions provided that certain conditions are satisfied. These provisions effectively create exceptions to the underlying prohibition on compensation based on transaction terms under appropriately tailored circumstances. For the background discussion of these provisions, including a summary of comments received to proposed § 1026.36(d)(1)(iii) and the Bureau's response to these comments, see the section-by-section analysis of proposed § 1026.36(d)(1)(iii) and (iv).[115]

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[114] As noted earlier, 12 CFR 701.21(c)(8)(i) generally prohibits officials or employees and their immediate family members from receiving, "directly or indirectly, any commission, fee or other compensation in connection with any loan made by the credit union." 12 CFR 701.21(c)(8)(iii) provides that such prohibition does not cover, in relevant part: (1) an incentive or bonus to an employee based on the credit union's overall financial performance; and (2) an incentive or bonus to an employee in connection with a loan or loans made by the credit union, provided that the board of directors establishes written policies and internal controls for such incentives or bonuses.

[115] In some cases, the Bureau's response to the comments summarized above regarding comment 36(d)(1)-1.ii is subsumed into the section-by-section analysis of § 1026.36(d)(1)(iii) and (iv) because of the topic overlap.

36(d)(1)(ii)

Amount of Credit Extended

As discussed above, § 1026.36(d)(1)(i) currently provides that a loan originator may not receive and a person may not pay to a loan originator, directly or indirectly, compensation in an amount that is based on any of the transaction's terms or conditions. Section 1026.36(d)(1)(ii) provides that the amount of credit extended is not deemed to be a transaction term or condition, provided compensation is based on a fixed percentage of the amount of credit extended. Such compensation may be subject to a minimum or maximum dollar amount.

Use of the term "amount of credit extended." TILA section 129B(c)(1), which was added by section 1403 of the Dodd-Frank Act, provides that a mortgage originator may not receive (and no person may pay to a mortgage originator), directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal). 12 U.S.C. 1639b(c)(1). Thus, TILA section 129B(c)(1) permits mortgage originators to receive (and a person to pay mortgage originators) compensation that varies based on the "amount of the principal" of the loan. Section 1026.36(d)(1)(ii) currently uses the phrase "amount of credit extended" instead of the phrase "amount of the principal" as set forth in TILA section 129B(c)(1). Those phrases, however, typically are used to describe the same amount and generally have the same meaning. The term "principal," in certain contexts, sometimes may mean only the portion of the total credit extended that is applied to the consumer's primary purpose, such as purchasing the home or paying off the existing balance, in the case of a refinancing. When used in this sense, the "amount of the principal" might represent only a portion of the amount of credit extended, for example where the consumer also borrows additional amounts to cover transaction costs. However, the Bureau does not believe that

Congress intended "amount of the principal" in this narrower, less common way, because the exception appears intended to accommodate existing industry practices, under which loan originators generally are compensated based on the total amount of credit extended without regard to the purposes to which any portions of that amount may be applied.

For the foregoing reasons, pursuant to its authority under TILA section 105(a) to facilitate compliance with TILA, the Bureau proposed to retain the phrase "amount of credit extended" in § 1026.36(d)(1)(ii) instead of replacing it with the statutory phrase "amount of the principal." The Bureau believed that using the same phrase that is in the existing regulatory language will ease compliance burden without diminishing the consumer protection afforded by § 1026.36(d) in any foreseeable way. Creditors already have developed familiarity with the term "amount of credit extended" in complying with the existing regulation. The Bureau solicited comment on its proposal to keep the existing regulatory language in place and its assumptions underlying the proposal.

The Bureau did not receive comment on this aspect of the proposal. For the reasons described above, this final rule retains the phrase "amount of credit extended" in § 1026.36(d)(1)(ii) as proposed.

Fixed percentage with minimum and maximum dollar amounts. Section 1026.36(d)(1)(ii) currently provides that loan originator compensation paid as a fixed percentage of the amount of credit extended may be subject to a minimum or maximum dollar amount. In contrast, TILA section 129B(c)(1), as added by section 1403 of the Dodd-Frank Act, permits mortgage originators to receive (and a person to pay the mortgage originator) compensation that varies based on the "amount of the principal" of the loan, without addressing the question of whether such compensation may be subject to minimum or maximum limits. 12 U.S.C. 1639b(c)(1).

Pursuant to its authority under TILA section 105(a) to facilitate compliance with TILA, the Bureau proposed to retain the existing restrictions in § 1026.36(d)(1)(ii) governing when loan originators are permitted to receive (and when persons are permitted to pay loan originators) compensation that is based on the amount of credit extended. Specifically, proposed § 1026.36(d)(1)(ii) continued to provide that the amount of credit extended is not deemed to be a transaction term, provided compensation received by or paid to a loan originator is based on a fixed percentage of the amount of credit extended; however, such compensation may be subject to a minimum or maximum dollar amount. The Bureau also proposed to retain existing comment 36(d)(1)-9, which provides clarification regarding this provision and an example of its application.

The Bureau received comments on this aspect of the proposal from two industry commenters and one consumer group commenter, and those comments favored the proposal. This final rule retains § 1026.36(d)(1)(ii) as proposed. The Bureau believes that permitting creditors to set a minimum and maximum dollar amount is consistent with, and therefore furthers the purposes of, the statutory provision allowing compensation based on a percentage of the principal amount, consistent with TILA section 105(a). As noted above, the Bureau believes the purpose of excluding the principal amount from the "terms" on which compensation may not be based is to accommodate common industry practice. The Bureau also believes that, for some creditors, setting a maximum and minimum dollar amount also is common and appropriate because, without such limits, loan originators may be unwilling to originate very small loans and could receive unreasonably large commissions on very large loans. The Bureau therefore believes that, consistent with TILA section 105(a), permitting creditors to set minimum and maximum commission amounts may facilitate compliance and also may benefit consumers by ensuring that loan originators have sufficient incentives to originate particularly small loans.

In addition, comment 36(d)(1)-9 currently clarifies that § 1026.36(d)(1) does not prohibit an arrangement under which a loan originator is compensated based on a percentage of the amount of credit extended, provided the percentage is fixed and does not vary with the amount of credit extended. The comment also clarifies that compensation that is based on a fixed percentage of the amount of credit extended may be subject to a minimum or maximum dollar amount, as long as the minimum and maximum dollar amounts do not vary with each credit transaction. The comment provides as an example that a creditor may offer a loan originator 1 percent of the amount of credit extended for all loans the originator arranges for the creditor, but not less than $1,000 or greater than $5,000 for each loan. On the other hand, as comment 36(d)(1)-9 clarifies, a creditor may not compensate a loan originator 1 percent of the amount of credit extended for loans of $300,000 or more, 2 percent of the amount of credit extended for loans between $200,000 and $300,000, and 3 percent of the amount of credit extended for loans of $200,000 or less. For the same reasons discussed above, consistent with TILA section 105(a), the Bureau believes this interpretation is consistent with and furthers the statutory purposes of TILA. To the extent a creditor seeks to avoid disincentives to originate small loans and unreasonably high compensation amounts on larger loans, the Bureau believes the ability to set minimum and maximum dollar amounts meets such goals. The Bureau therefore is adopting comment 36(d)(1)-9 as proposed.

Reverse mortgages. Industry representatives have asked what the phrase "amount of credit extended" means in the context of closed-end reverse mortgages. Under the FHA's Home Equity Conversion Mortgage (HECM) program, a creditor calculates a "maximum claim amount," which is the appraised value of the property, as determined by the appraisal used in underwriting the loan, or the applicable FHA loan limit, whichever is less. *See* 24 CFR 206.3. For HECM loans, the creditor then calculates the maximum dollar amount the consumer is authorized to borrow (typically called the "initial principal limit") by multiplying the "maximum claim amount" by an applicable "principal limit factor," which is calculated based on the age of the youngest borrower and the interest rate. The initial principal limit sets the maximum proceeds available to the consumer for the reverse mortgage. For closed-end HECM reverse mortgages, a consumer borrows the initial principal limit in a lump sum at closing. There can also be payments from the loan proceeds on behalf of the consumer such as to pay off existing tax liens.

Reverse mortgage creditors have requested guidance on whether the maximum claim amount or the initial principal limit is the "amount of credit extended" in the context of closed-end HECM reverse mortgages. The Bureau indicated in the proposal that it believes that the initial principal limit is the most analogous amount to the amount of credit extended on a traditional "forward" mortgage. Thus, consistent with Dodd-Frank Act section 1403 and pursuant to its authority under TILA section 105(a) to facilitate compliance with TILA, the Bureau proposed to add comment 36(d)(1)-10 to provide that, for closed-end reverse mortgage loans, the "amount of credit extended" for purposes of § 1036.36(d)(1) means the maximum proceeds available to the consumer under the loan, which is the initial principal limit on a HECM loan.

The Bureau received only one comment on this proposed revision, and that commenter, an industry trade group that represents the reverse mortgage industry, favored the proposal. The trade group supported the proposal but noted that the terms "maximum claim amount," “principal limit factor,” and “initial principal limit” used by the Bureau in the supplementary information to the proposal are primarily HECM terms and are not terms used universally with all reverse mortgage programs. This trade group also requested that the Bureau expressly state in the commentary that maximum claim amount is not a proxy for a loan term under § 1026.36(d)(1).

This final rule revises proposed comment 36(d)(1)-10 to provide that for closed-end reverse mortgages, the “amount of credit extended” for purposes of § 1026.36(d)(1) means either (1) the maximum proceeds available to the consumer under the loan; or (2) the maximum claim amount as defined in 24 CFR 206.3 if the loan is a HECM loan or the appraised value of the property, as determined by the appraisal used in underwriting the loan, if the loan is not a HEMC loan. Upon further analysis, the Bureau believes that it is appropriate to consider these additional values to be the “amount of credit extended” for a closed-end reverse mortgage, as applicable, for purposes of § 1026.36(d)(1). While the maximum proceeds available to the consumer will be the amount of proceeds that the consumer borrows at consummation, the maximum claim amount on a HECM loan will be the maximum future value of the loan to investors at repayment, including compounded interest. For non-HECM loans, this final rule allows creditors to consider the appraised value of the property, as determined by the appraisal used in underwriting the loan, to be considered the “amount of credit extended.” The Bureau believes that the final rule gives additional flexibility to creditors, without raising concerns that a creditor could manipulate the “amount of credit extended” in order to produce greater compensation to the loan originator.

36(d)(1)(iii)

Consumer Payments Based On Transaction Terms

TILA section 129B(c)(1), which was added by section 1403 of the Dodd-Frank Act, provides that mortgage originators may not receive (and no person may pay to mortgage originators), directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of principal). 12 U.S.C. 1639b(c)(1). Thus, TILA section 129B(c)(1) imposes a ban on compensation that varies based on loan terms even in transactions where the mortgage originator receives compensation directly from the consumer. For example, under the amendment, even if the only compensation that a loan originator receives comes directly from the consumer, that compensation may not vary based on the loan terms.

As discussed above, § 1026.36(d)(1) currently provides that no loan originator may receive, and no person may pay to a loan originator, compensation based on any of the transaction's terms or conditions, except in transactions in which a loan originator receives compensation directly from the consumer and no other person provides compensation to a loan originator in connection with that transaction. Thus, even though, in accordance with § 1026.36(d)(2), a loan originator organization that receives compensation from a consumer may not split that compensation with its individual loan originator, existing § 1026.36(d)(1) does not prohibit a consumer's payment of compensation to the loan originator organization from being based on the transaction's terms or conditions.

Consistent with TILA section 129B(c)(1), the Bureau proposed to remove existing § 1026.36(d)(1)(iii) and a related sentence in existing comment 36(d)(1)-7. Thus, transactions where a loan originator receives compensation directly from the consumer would no longer be exempt from the prohibition set forth in § 1026.36(d)(1)(i). As a result, whether the consumer or another person, such as a creditor, pays a loan originator compensation, that compensation may not be based on the terms of the transaction. Comment 36(d)(1)-7 addresses when payments to a loan originator are considered compensation received directly from the consumer. The Bureau proposed to remove the first sentence of this comment and move the other content of this comment to new comment 36(d)(2)(i)-2.i.

The Bureau did not receive comments on its proposal to remove § 1026.36(d)(1)(iii). The Bureau did receive comments on the ability of loan originator organizations to make pricing concessions in the amounts of compensation they receive in individual transactions, including in transactions where these organizations receive compensation directly from consumers, as discussed in the section-by-section analysis of § 1026.36(d)(1)(i). For the reasons discussed above, this final rule removes existing § 1026.36(d)(1)(iii) as proposed.

The Bureau also did not receive any comments on deleting the first sentence of comment 36(d)(1)-7 and moving the other content of that comment to new comment 36(d)(2)(i)-2.i. The Bureau did receive one comment on the substance of proposed comment 36(d)(2)(i)-2.i, which is discussed in the section-by-section analysis of § 1026.36(d)(2). This final rule deletes the first sentence of comment 36(d)(1)-7, moves the other content of that comment to new comment 36(d)(2)(i)-2.i, and makes revisions to this other content as discussed in the section-by-section analysis of § 1026.36(d)(2).

Designated Tax-Advantaged Plans and Non-Deferred Profits-Based Compensation Plans

The Bureau proposed a new § 1026.36(d)(1)(iii), which would permit the payment of compensation that is directly or indirectly based on the terms of transactions of multiple individual loan originators in limited circumstances. In this final rule, the language in § 1026.36(d)(1)(iii) has been revised to focus specifically on designated tax-advantaged plans and a new § 1026.36(d)(1)(iv) has been added to address non-deferred profits-based compensation plans as discussed further below.

Designated Tax-Advantaged Plans. As noted above, following a number of inquiries about how the restrictions in the existing regulation apply to qualified retirement plans and other bonus and profit-sharing plans, the Bureau issued CFPB Bulletin 2012-2 stating that contributions to certain qualified plans out of loan origination profits were permissible under the existing rules.[116] The Bureau's position was based in part on certain structural and operational requirements that the Internal Revenue Code imposes on qualified plans, including contribution and benefit limits, deferral requirements (regarding both access to and taxation of the funds contributed), additional taxes for early withdrawal, non-discrimination provisions, and requirements to allocate among plan participants based on a definite allocation formula. Consistent with its position in CFPB Bulletin 2012-2, the Bureau stated in the proposal that it believed these structural and operational requirements would greatly reduce the likelihood that firms would use such plans to provide steering incentives.

Based on these considerations, proposed § 1026.36(d)(1)(iii) would have permitted a person to compensate an individual loan originator through a contribution to a qualified defined contribution or defined benefit plan in which an individual loan originator participates, provided that the contribution would not be directly or indirectly based on the terms of that individual loan originator's transactions. Proposed comments 36(d)(1)-2.iii.B and 36(d)(1)-2.iii.E would have discussed the meaning of qualified plans and other related terms as relevant to the proposal. Additionally, the Bureau solicited comment on whether any other types of retirement plans, profit-sharing plans, or other tax-advantaged plans should be treated similarly for purposes of

[116] CFPB Bulletin 2012-2 defined "Qualified Plans" to include "qualified profit sharing, 401(k), and employee stock ownership plans."

permitting contributions to such plans, even if the compensation relates directly or indirectly to the transaction terms of multiple individual loan originators.

Industry commenters generally supported the Bureau's proposal to permit creditors and loan originator organizations to contribute to individual loan originators' qualified plan accounts even if the contributions were based directly or indirectly on the terms of multiple individual loan originators' transactions. For example, a national trade association representing banking institutions wrote that it especially welcomed the "clean and straightforward" proposed clarifications regarding qualified plans. A national trade association representing mortgage lenders appreciated the clarification that contributions to the qualified plan accounts of individual loan originators would be permitted. A financial holding company commented that the proposal to allow contributions to qualified plans was necessary for creditors to adequately compensate their individual loan originators.

Several industry commenters, however, questioned certain aspects of how the Bureau proposed treating qualified plans under proposed § 1026.36(d)(1)(iii). A group commenting on behalf of community mortgage lenders wrote that the IRS governing rules and regulations regarding qualified retirement plans should govern whether any employees, including loan originators, should be eligible to participate in qualified plans. The commenter stated that any exclusion of a class of employees from a qualified plan would render the plan non-qualified under IRS regulations. A large mortgage lending company wrote that the Bureau's attempt to regulate employee benefit plans was complicated, fraught, and imposed unspecified "conditions" on the use of qualified plans. Another commenter specifically objected to the language in proposed § 1026.36(d)(1)(iii) requiring that the contribution to a qualified plan "not be directly or indirectly based on the terms of that individual loan originator's transactions." The commenter reasoned that these restrictions would interfere with other agencies' regulation of qualified plans and could cause employers to incur penalties under other regulations and statutes, which must be accounted for in pricing risk and could increase the costs of credit. One trade association expressed concern that smaller creditors would be disadvantaged by a rule that treats qualified plans more permissively than non-qualified plans because qualified plans can be prohibitively expensive and smaller creditors thus would likely be unable to take advantage of the exception in § 1026.36(d)(i)(iii).

SBA Advocacy commented that the Bureau should analyze the incentive issues arising from qualified plans before issuing clarifications on existing regulations or proposing new regulations. SBA Advocacy also reminded the Bureau of comments to this effect made by Small Entity Representatives during the Small Business Review Panel process.

Consumer groups commenting on the proposal did not specifically address qualified plans. They stated as a general matter, however, that permitting compensation to loan originators based on the terms of a transaction would be in contravention of the Dodd-Frank Act and would make loan originator compensation even less transparent to consumers. Three consumer groups, in a joint letter, commented that bonuses and retirement plan contributions change the behavior of individual loan originators and that permitting compensation from profit pools would not remove the danger that individual loan originators would seek to originate transactions with abusive terms to boost their overall compensation packages. These consumer groups also commented that allowing individual loan originators to profit from compensation based on aggregate terms of transactions they originate, such as higher interest rates, presents the same risks to consumers as allowing individual loan originators to profit from compensation based on terms in a single transaction. As discussed above, a housing advocacy organization expressed its concern that the exceptions in the proposed regulation would lead to a resurgence of the same individual compensation-driven loan origination tactics that were the subject of U.S. Department of Justice actions, later settled, that alleged steering of minority borrowers into subprime mortgages.

An organization submitting comments on behalf of State bank supervisors wrote that, as a general matter, adjustments to existing loan originator compensation rules for purposes of clarity and coherence are appropriate because existing standards can be difficult for regulators and consumers to interpret. The organization further stated that qualified plans are one of the primary areas under the rule that needs clarification, and it endorsed the Bureau's proposal to permit contributions to qualified plans.

The Bureau is finalizing the proposal's treatment of "qualified plans" (now referred to as "designated tax-advantaged plans" in § 1026.36(d)(1)(iii) and as that term or, alternatively, "designated plans" in this preamble) with limited substantive changes to clarify what plans can be exempted from the baseline prohibition in § 1026.36(d)(1)(i) of compensation that is based on the terms of multiple transactions of multiple individual loan originators. Section 1026.36(d)(1)(iii), as clarified by comment 36(d)(1)-3.i, provides that an individual loan originator may receive, and a person may pay to an individual loan originator, compensation in the form of a contribution to a defined contribution plan that is a designated tax-advantaged plan or a benefit under a defined benefit plan that is a designated tax-advantaged plan, even if the contribution or benefit, as applicable, is directly or indirectly based on the terms of the transactions of multiple individual loan originators. In the case of a contribution to a defined contribution plan, however, § 1026.36(d)(1)(iii) provides that the contribution must not be directly or indirectly based on the terms of that individual loan originator's transactions.

The final rule adds language to § 1026.36(d)(1)(iii) similar to what was previously proposed in commentary and also to define "designated tax-advantaged plans." Specifically, § 1026.36(d)(1)(iii) defines the term to include any plan that meets the requirements of Internal Revenue Code section 401(a), 26 U.S.C. 401(a); employee annuity plans described in Internal Revenue Code section 403(a), 26 U.S.C. 403(a); simple retirement accounts, as defined in Internal Revenue Code section 408(p), 26 U.S.C. 408(p); simplified employee pensions described in Internal Revenue Code section 408(k), 26 U.S.C. 408(k); annuity contracts described in Internal Revenue Code section 403(b), 26 U.S.C. 403(b); and eligible deferred compensation plans, as defined in Internal Revenue Code section 457(b), 26 U.S.C. 457(b). The term "designated tax-advantaged plan" corresponds to the proposed term "qualified plan," and the set of plans that qualify as "designated" plans under the final rule is largely the same as those that were "qualified" as described in proposed comment 36(d)(1)-2.iii.E.

The Bureau has, however, also substantially reorganized and clarified the proposed commentary. In particular, proposed comment 36(d)(1)-2.iii has been moved into a new comment 36(d)(1)-3 and restructured for internal consistency and clarity. New comment 36(d)(1)-3 clarifies that designated tax-advantaged plans are permitted even if the compensation is directly or indirectly based on the terms of multiple transactions of multiple individual loan originators. This language clarifies that § 1026.36(d)(1)(iii) (as well as § 1026.36(d)(1)(iv), which is discussed further below with regard to non-deferred profits-based compensation plans) permits certain types of compensation that are otherwise prohibited under § 1026.36(d)(1)(i). This is a technical change to improve on the consistency of the proposal's language.

There are two categories of designated tax-advantaged plans: (1) designated defined contribution plans; and (2) designated defined benefit plans. Comment (d)(1)-3.i explains that the Bureau uses these terms as defined in section 414 of the Internal Revenue Code, 26 U.S.C. 414. Thus, a "defined contribution plan" is one "which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." 26 U.S.C. 414(i). Any plans that do not meet this definition are called defined benefit plans. 26 U.S.C. 414(j).

Under the final rule, the Bureau permits individual loan originators to participate in designated defined contribution plans, provided that contributions to these plans are not based on the terms of the specific transactions of each individual loan originator, pursuant to § 1026.36(d)(1)(iii). The Bureau recognizes, as expressed by industry commenters, that creditors, loan originator organizations, and individual loan originators derive substantial benefits from being able to establish and participate in designated defined contributions plans. These types of plans provide specific tax advantages for employees saving for their eventual retirement, are commonly used across many markets and made available to employees across many income classes, and in a given firm generally are made equally available to employees across different job categories. The final rule permits individual loan originators to participate in these plans because the Bureau believes that certain structural, legal, and operational features of designated defined contribution plans, combined with the additional restriction of § 1026.36(d)(1)(iii), will significantly reduce the likelihood that participation in these plans will provide individual loan originators substantial incentives to steer consumers.

First, withdrawals from designated defined contribution plans are subject to time deferral requirements, and tax penalties generally apply to early withdrawals.[117] The fact that individual

[117] *See, e.g.*, 26 U.S.C. 72(t).

loan originators may not receive funds contributed to a designated defined contribution plan for years (or even decades) without paying an additional tax for early withdrawal reduces the incentive for an individual loan originator to steer consumers because the potential benefit from the potential steering can be so remote in time. Second, designated defined contribution plans are subject to limits in the Internal Revenue Code on the contributions to any individual participant's account.[118] This further reduces the degree to which a designated defined contribution plan can give an individual loan originator an incentive to steer simply to increase general company profits. Third, to maintain their tax-advantaged status, these plans are subject to a variety of rules under the Internal Revenue Code that limit their potential use as steering incentives and complement and buttress the anti-steering protections of § 1026.36(d)(1)(iii). These may include, for example, depending on the type of plan, rules about the manner in which contributions are allocated to participants and prohibitions on discriminating between highly-compensated employees and other employees.

Section 1026.36(d)(1)(iii) also permits participation in the second category of designated tax-advantaged plans, which are defined benefit plans. In this final rule, however, the Bureau has not applied additional restrictions on benefits payable under defined benefit plans as it has done in § 1026.36(d)(1)(iii) with regard to contributions under defined contribution plans, as described above. A defined benefit plan differs from a defined contribution plan in that, under the former, a participant's benefits depend on factors other than amounts contributed to an

[118] For example, for certain types of plan, contributions to an individual loan originator's account are generally limited to the lesser of 100 percent of the individual loan originator's yearly compensation (as defined in Internal Revenue Code section 415(c)(3)) or an annual dollar amount ($51,000 for 2013), which the IRS adjusts each year to account for inflation. *See* 26 U.S.C. 415(c); IRS Publication 560 at 15; Internal Revenue Service website, "IRS Announces 2013 Pension Plan Limitations; Taxpayers May Contribute Up To $17,500 To Their 401(k) Plans in 2013,"
http://www.irs.gov/uac/2013-Pension-Plan-Limitations (last accessed Dec. 17, 2012) (IRS 2013 Qualified Plan Adjustments). The annual cap includes the employee contributions, s*ee* 26 U.S.C. 415(c).), which may be subject to a separate annual limit.

account established for that individual participant (and the investment returns and expenses on such amounts). Commonly, benefits are paid to individuals at retirement or another point of eligibility based on a benefits formula. Indeed, employer contributions to a defined benefit plan are generally made to the plan as a whole, rather than being allocated to the accounts of individual participants. For these reasons, the Bureau believes that defined benefit plans further attenuate any potential steering incentives a firm might try to incorporate in a defined benefit plan. In addition, attempts by creditors or loan originator organizations to structure such plans to take into account the terms of the transactions of the individual loan originators participating in the plans would likely present considerable regulatory obstacles. The Bureau is continuing to study the structural differences in plan type and will issue additional guidance or restrictions in the future that are specific to the particular structures of defined benefit plans as necessary and appropriate to effectuate the intent of the Dodd-Frank Act in prohibiting steering incentives.

The Bureau disagrees with the few commenters who suggested that the Bureau's proposal places unwarranted restrictions on the use of designated plans that potentially conflict with other Federal regulations and adds uncertainty regarding an individual loan originator's eligibility to participate in a designated plan. To the contrary, § 1026.36(d)(1)(iii) explicitly contemplates that individual loan originators may participate in a designated plan. The creditor or loan originator organization would be free, to the extent permitted by other applicable law, to match an individual loan originator's contribution to a designated plan account or pay a fixed percentage of the individual loan originator's compensation in the form of a contribution to a designated plan account.

The rule simply prohibits a creditor or loan originator organization from basing the amount of contributions to an individual loan originator's designated plan account, in the case of a defined contribution plan, on the terms of that individual loan originator's transactions. The Bureau believes that implementing the statutory prohibition on compensation based on the terms of the loan under section 1403 of the Dodd-Frank Act requires a regulation that prohibits this practice. Compensating any individual loan originator more based on the terms of his or her transactions is a core, direct danger that the statute and this final rule are designed to counteract. The Bureau is not convinced that the structure or operation of designated defined contribution plans would sufficiently mitigate the steering incentives an employer could create by using such a practice. Moreover, the Bureau is not aware of any conflict between this final rule and other applicable Federal laws and regulations (*e.g.*, the Internal Revenue Code and its implementing regulations) that would prevent compliance with all applicable legal requirements.

Non-Deferred Profits-Based Compensation Plans. In addition to addressing qualified plans as described above, proposed § 1026.36(d)(1)(iii) would have provided that, notwithstanding § 1026.36(d)(1)(i), an individual loan originator may receive, and a person may pay to an individual loan originator, compensation in the form of a bonus or other payment under a profit-sharing plan or a contribution to some other form of non-qualified plan even if the compensation directly or indirectly was based on the terms of the transactions of multiple individual loan originators, provided that the conditions set forth in proposed § 1026.36(d)(1)(iii)(A) and (B) were satisfied. Proposed § 1026.36(d)(1)(iii)(A) would have prohibited payment of compensation to an individual loan originator that directly or indirectly was based on the terms of that individual loan originator's transaction or transactions. The Bureau explained in the section-by-section analysis of the proposal that this language was intended to prevent a person from paying compensation to an individual loan originator based on the terms of that individual loan originator's transactions regardless of whether the compensation would otherwise be permitted in the limited circumstances under § 1026.36(d)(1)(iii)(B).

Proposed § 1026.36(d)(1)(iii)(B)(*1*) would have permitted compensation in the form of a bonus or other payment under a profit-sharing plan or a contribution to a non-qualified plan, even if the compensation related directly or indirectly to the terms of the transactions of multiple individual loan originators, provided: (1) the conditions set forth in proposed § 1026.36(d)(1)(iii)(A) were met; and (2) not more than a certain percentage of the total revenues of the person or business unit to which the profit-sharing plan applies, as applicable, were derived from the person's mortgage business during the tax year immediately preceding the tax year in which the compensation is paid. The Bureau proposed two alternatives for the threshold percentage—50 percent, under Alternative 1, or 25 percent, under Alternative 2. The approach set forth under proposed § 1026.36(d)(1)(iii)(B)(*1*) is sometimes referred to as the "revenue test."

The Bureau explained in the proposal that to meet the conditions under proposed § 1026.36(d)(1)(iii)(B)(*1*), a person would measure the revenue of its mortgage business divided by the total revenue of the person or business unit, as applicable.[119] Proposed § 1026.36(d)(1)(iii)(B)(*1*) also would have addressed how total revenues are determined,[120] when the revenues of a person's affiliates are or are not taken into account, and how total

[119] Proposed comment 36(d)(1)-2.iii.G.*1* would have clarified that, under the proposed revenue test, whether the revenues of the person or business unit would be used would depend on the level within the person's organizational structure at which the profit-sharing plan was established and whose profitability was referenced for purposes of compensation payment.

[120] Proposed § 1026.36(d)(1)(iii)(B)(*1*) would have provided that total revenues would be determined through a methodology that: (1) is consistent with generally accepted accounting principles and, as applicable, the reporting of the person's income for purposes of Federal tax filings or, if none, any industry call reports filed regularly by the person; and (2) as applicable, reflects an accurate allocation of revenues among the person's business units. The Bureau solicited comment on: (1) whether this standard would be appropriate in light of the diversity in size of the financial institutions that would be subject to the requirement and, more generally, on the types of income that should be included; and (2) whether the definition of total revenues should incorporate a more objective standard.

revenues derived from the mortgage business are determined.[121] Proposed comment 36(d)(1)-2.iii would have provided additional interpretation of the terms "total revenue," "mortgage business," and "tax year"[122] used in proposed § 1026.36(d)(1)(iii)(B)(*1*).

Proposed comment 36(d)(1)-2.iii.A would have clarified that the term "profit-sharing plans" includes "bonus plans," "bonus pools," or "profit pools" from which individual loan originators are paid bonuses or other compensation with reference to company or business unit profitability, as applicable. The proposed comment also would have noted that a bonus made without reference to profitability, such a retention payment budgeted for in advance, would not violate the prohibition on compensation based on transaction terms. Proposed comment 36(d)(1)-2.iii.C would have clarified that compensation is "directly or indirectly based" on the terms of multiple transactions of multiple individual loan originators when the compensation, or its amount, results from or is otherwise related to the terms of multiple transactions of multiple individual loan originators. The proposed comment would have provided that, if a creditor did not permit its individual loan originators to deviate from the creditor's pre-established credit terms, such as the interest rate offered, then the creditor's payment of a bonus at the end of a calendar year to an individual loan originator under a profit-sharing plan would not be related to the transaction terms of multiple individual loan originators. The proposed comment also would

[121] Section 1026.36(d)(1)(iii)(B)(*1*) would have provided that the revenues derived from mortgage business are the portion of those total revenues that are generated through a person's transactions that are subject to § 1026.36(d). Proposed comment 36(d)(1)-2.iii.G would have explained that a person's revenues from its mortgage business include, for example: origination fees and interest associated with loans for purchase money or refinance purposes originated by individual loan originators employed by the person, income from servicing of loans for purchase money or refinance purposes originated by individual loan originators employed by the person, and proceeds of secondary market sales of loans for purchase money or refinance purposes originated by individual loan originators employed by the person. The proposed comment also would have noted certain categories of income and fees that would not be included under the definition of mortgage-related revenues, such as servicing income where the loans being serviced were purchased by the person after their origination by another person. The Bureau requested comment on the scope of revenues included in the definition of mortgage revenues.
[122] Proposed comment 36(d)(1)-2.iii.G.*1* would have clarified that a tax year is the person's annual accounting period for keeping records and reporting income and expenses.

have clarified that, if a loan originator organization whose revenues were derived exclusively from fees paid by the creditors that fund its originations pays a bonus under a profit-sharing plan, the bonus would be permitted. Proposed comment 36(d)(1)-2.iii.D would have clarified that, under proposed § 1026.36(d)(1)(iii), the time period for which the compensation was paid is the time period for which the individual loan originator's performance was evaluated for purposes of the compensation decision (*e.g.*, calendar year, quarter, month), whether the compensation was actually paid during or after that time period.

In the proposal, the Bureau explained that the revenue test was intended as a bright-line rule to distinguish circumstances in which a compensation plan creates a substantial risk of consumers being steered to particular transaction terms from circumstances in which a compensation plan creates only an attenuated incentive and risk of steering. The Bureau also explained that the proposal would treat revenue as a proxy for profitability and profitability as a proxy for terms of multiple transactions of multiple individual loan originators. Furthermore, the Bureau stated that it was proposing a threshold of 50 percent because, if more than 50 percent of the person's total revenues were derived from the person's mortgage business, the mortgage business revenues would predominate, which would increase the likelihood of steering incentives. The Bureau recognized, however, that a bright-line rule with a 50 percent revenue test threshold might still permit steering incentives in light of the differing sizes, organizational structures, and compensation structures of the persons affected by the proposed rule. The Bureau thus proposed an alternative threshold of 25 percent and more generally solicited comment on which threshold would best effectuate the purposes of the rule.

The Bureau also sought comment on the effect of this proposed provision on small entities. The Bureau stated in the proposal that it was aware of the potential differential effects the revenue test may have on small creditors and loan originator organizations that employ individual loan originators—particularly those institutions that originate mortgage loans as their exclusive, or primary, line of business (hereinafter referred to as "monoline mortgage businesses")—when compared to the effects on larger institutions that are more likely to engage in multiple business lines. In the proposal, the Bureau noted the feedback it had received during the Small Business Review Panel process regarding these issues.

The Bureau discussed in the proposal three possible alternative approaches to the revenue test in proposed § 1026.36(d)(1)(iii)(B)(*1*). First, the Bureau solicited comment on whether the formula under § 1026.36(d)(1)(iii)(B)(*1*) should be changed from the consideration of revenue to a consideration of profits. Under this profits test, total profits of the mortgage business would be divided by the total profits of the person or business unit, as applicable. The Bureau further solicited comment on how profits would be calculated if a profits test were adopted. The Bureau stated that it was soliciting comment on this approach because the test's use of revenue and not profits may result in an improper alignment with the steering incentives to the extent that it would be possible for a company to earn a large portion of its profits from a proportionally much smaller mortgage-business-related revenue stream.[123] But the Bureau stated that it recognized that a profits test would create definitional challenges and could lead to evasion if a person were to allocate costs in a manner across business lines that would understate mortgage business profits for purposes of the profits test.

[123] The Bureau posited an example where a company could derive 40 percent of its total revenues from its mortgage business, but that same line of business may generate 80 percent of the company's profits. In such an instance, the steering incentives could be significant given the impact the mortgage business has on the company's overall profitability. Yet, under the proposed revenue test this organization would be permitted to pay certain compensation based on terms of multiple individual loan originators' transactions taken in the aggregate.

Second, the Bureau solicited comment on whether to establish a "total compensation" test either in addition to or in lieu of the proposed revenue test. The total compensation test would cap the percentage of an individual loan originator's total compensation that could be attributable to the types of compensation addressed by the proposed revenue test (*i.e.*, bonuses under profit-sharing plans and contributions to non-qualified plans). The Bureau also solicited comment on the appropriate threshold amount if the Bureau were to adopt a total compensation test. The Bureau solicited comment on the total compensation test because it believed the proportion of an individual loan originator's total compensation that is attributable to mortgage-related business would provide one relatively simple and broadly accurate metric of the strength of individual loan originators' steering incentives.

Third, the Bureau solicited comment on whether it should include an additional provision under § 1026.36(d)(1)(iii)(B) that would permit bonuses under a profit-sharing plan or contributions to non-qualified plans where the compensation bears an "insubstantial relationship" to the terms of multiple transactions of multiple individual loan originators. The Bureau solicited comment on this approach because it recognized that the terms of multiple individual loan originators' transactions taken in the aggregate would not, in every instance, have a substantial effect on profitability. The Bureau stated, however, that any test would likely be both under- and over-inclusive, and it was unclear how such a test would work in practice and what standards would apply to determine if compensation bore an insubstantial relationship to the terms of multiple transactions of multiple individual loan originators.

Consumer groups generally criticized the revenue test as too permissive with regard to payment of compensation through profit-sharing bonuses or contributions to non-qualified plans. A coalition of consumer groups stated that the revenue test would merely create a "back door," whereby there would be indirect incentives to promote certain credit terms for an individual loan originator's personal gain. They urged the Bureau to restrict all profit-sharing bonuses or contributions to non-qualified plans to those based on volume of mortgages originated. One consumer advocacy organization, however, supported the revenue test with a 25 percent threshold. This commenter asserted that the larger the percentage of revenue derived from a company's mortgage lending unit, the more opportunity would exist for the mortgage unit to skew the results of the overall pool of funds available for distribution as profit-sharing bonuses or contributions to non-qualified plans.

Industry commenters, including small and large institutions and trade associations, nearly unanimously urged the Bureau not to finalize the revenue test. Industry opposition arose primarily for three reasons. First, many industry commenters asserted that the revenue test was unduly complex and would be very difficult to implement. Two large financial institutions stated that large creditors would face challenges in calculating total revenue and mortgage-related revenues under the revenue test if the creditor had different origination divisions or affiliates or typically aggregated closed-end and open-end transaction revenues. A national trade association representing community banks stated that community banks would have faced difficultly complying with the revenue test based on the proposed requirement that the determination of total revenue be consistent with the reporting of Federal tax filings and industry call reports, because, the association stated, revenue from various business units is not separated out in bank "call reports," and mortgage revenue comes from multiple sources. One commenter asserted that the terminology was confusing, citing the example of the proposal using the phrase "profit-sharing plan" to refer to profit pools and bonus pools in the non-qualified plan context when such phrase has a commonly understood meaning in the context of qualified plans.

Second, numerous industry commenters asserted that application of the revenue test would have a disparate negative impact on monoline mortgage businesses. These businesses, the commenters stated, would not be able to pay profit-sharing bonuses or make contributions to non-qualified plans because, under the revenue test, their mortgage-related revenue would always exceed 50 percent of total revenues. A trade association representing community mortgage bankers commented that the revenue test would favor large institutions that have alternate sources of income outside mortgage banking. Another trade association asserted that the revenue test would place smaller businesses at a competitive disadvantage for recruiting and retaining talented loan originators. A law firm that represents small and medium-sized financial institutions expressed particular concern about the impact of the revenue test on small entities, citing data from briefing materials circulated by the Bureau during the Small Business Review Panel process that a majority of small savings institutions would fail the revenue test if it were set at the higher proposed threshold of 50 percent.[124] This commenter also asserted that a "not insubstantial number" of savings institutions with between $175 million and $500 million in assets would also fail the revenue test if the threshold were set at 50 percent. One financial holding company stated that the revenue test would have a negative impact on creditors that keep mortgage loans in portfolio, which, it stated, would likely disproportionately affect smaller

[124] *See* Consumer Fin. Prot. Bureau, *"Small Business Review Panel for Residential Mortgage Loan Origination Standards Rulemaking: Outline of Proposals under Consideration and Alternatives Considered"* 18 (May 9, 2012), *available at* http://files.consumerfinance.gov/f/201205_cfpb_MLO_SBREFA_Outline_of_Proposals.pdf (Small Business Review Panel Outline). In the Small Business Review Panel Outline, the Bureau noted that at the proposed threshold of 50 percent for the revenue test then-under consideration, 56 percent of small savings institutions whose primary business focus is on residential mortgages would have been restricted from paying bonuses based on mortgage-related profits to their individual loan originators. In the Small Business Review Panel Outline, the Bureau noted that its estimate was based on 2010 call report data, and revenue from loan originations was assumed to equal fee and interest income from 1-4 family residences as reported. The Bureau noted that to the extent that other revenue on the call reports is tied to loan originations, the numbers may be underestimated. In the proposal, the Bureau discussed the same data but updated the figure to 59 percent. See 77 FR 55272, 55347 (Sept. 7, 2012).

creditors and community banks, because accrued interest on mortgages the creditor had originated and held over many years would count toward the calculation of mortgage-related revenues under the revenue test. The commenter urged the Bureau to craft a narrower definition of mortgage-related revenues that would capture only recent lending activity.

Third, several industry commenters expressed concern that application of the revenue test would lead to TILA liability if an accounting error in calculating total revenues or mortgage revenues resulted in bonuses being paid to loan originators improperly. A national trade association stated that none of its members would avail themselves of the revenue test because of their concern that, if the threshold percentage numbers were miscalculated, the entire pool of loans originated by that bank would be "poisoned," the compensation scheme would be deemed defective, and the bank would be subject to investor repurchase demands and full TILA liability. One State banking trade association expressed concern about the personnel repercussions of rescinding bonuses that were found to have been made improperly. A trade association that represents loan originators (both organizations and individuals) expressed concern that the compensation restrictions in the revenue test would lead to "unacceptable litigation" for creditors and loan originators.

A compensation consulting firm commented that drawing a bright line at 50 or 25 percent would be inherently subjective, would result in inequitable treatment, and would actually create a potential incentive for companies to manipulate financial statements to fall on the permissive side of the measurement to ensure the continued payment of profit-sharing bonuses or making of contributions to non-qualified plans compensation. The commenter asserted that this result would directly conflict with interagency guidance provided on incentive compensation policies,[125] and the commenter recommended that the Bureau instead adopt an approach modeled after the implementation of G-20 task force recommendations regarding incentive compensation.[126]

Industry commenters who expressed a preference, if the revenue test were nonetheless adopted, primarily favored a threshold of 50 percent rather than 25 percent. One large financial institution, while criticizing the complexity of the revenue test, recommended that the Bureau consider adopting it as a safe harbor. One mortgage company commenter suggested exempting organizations from the restrictions on the payment of profit-sharing bonuses and the making of contributions to non-qualified plans if they do not offer high or higher-cost mortgages and their individual loan originators have limited pricing discretion because, the commenter stated, the risk for steering of consumers would be extremely low or nonexistent.

SBA Advocacy urged the Bureau to analyze the incentive issues arising from non-qualified plans carefully before clarifying existing or proposing new regulations. SBA Advocacy reiterated concerns raised by the small entity representatives during the Small Business Review Panel process that: (1) even if the revenue test threshold were set at 50 percent,

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[125] In the proposal, the Bureau noted that incentive compensation practices at large depository institutions were the subject of final guidance issued in 2010 by the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (Interagency Group). 75 FR 36395 (June 17, 2010) (Interagency Guidance). The Bureau wrote that the Interagency Guidance was issued to help ensure that incentive compensation policies at large depository institutions do not encourage imprudent risk-taking and are consistent with the safety and soundness of the institutions. 77 FR 55272, 55297 (Sept. 7, 2012). The Bureau stated in the proposal that the Bureau's proposed rule would not affect the Interagency Guidance on loan origination compensation. *Id.* In addition, the Bureau stated that to the extent a person is subject to both the Bureau's rulemaking and the Interagency Guidance, compliance with Bureau's rulemaking is not deemed to be compliance with the Interagency Guidance. *Id.* The Bureau reiterates these statements for purposes of this final rule. The Bureau also acknowledges that the same statements apply with respect to the proposal by the Interagency Group to implement rules consistent with the standards set forth in the Interagency Guidance. *See* 76 FR 21170 (Apr. 14, 2011). The proposal by the Interagency Group has not yet been finalized.

[126] The G-20 recommendations to which the commenter was referring appear to be the Financial Stability Forum (FSF) Principles for Sound Compensation Practices, issued in April 2009 (FSF Principles). *See* http://www.financialstabilityboard.org/publications/r_0904b.pdf. The FSF Principles were intended to ensure effective governance of compensation, alignment of compensation with prudent risk-taking and effective supervisory oversight and stakeholder engagement in compensation. *See id.* at 2.

it may not provide relief for many small businesses because their revenues are often derived predominately from mortgage originations; (2) the Bureau should consider relaxing the revenue test to exclude revenue derived from existing loans held in portfolio; (3) the Bureau should provide further clarification on the definition of revenue; and (4) the Bureau should develop a mortgage-related revenue limit that reflects the unique business structure of smaller industry members and provides relief to small entities.[127] SBA Advocacy also referenced concerns raised at its outreach roundtable that the definition was too broad and that it would be difficult to determine what is and is not compensation. SBA Advocacy further referenced concerns that if a mistake was made on the compensation structure, all loans sold on the secondary market might be susceptible to repurchase demands. SBA Advocacy discussed the suggestion by participants at its outreach roundtable of a safe harbor to prevent one violation from poisoning an entire pool of loans.

An organization writing on behalf of State bank supervisors stated that the Bureau's proposed regulatory changes regarding profit-sharing bonuses and contributions to non-qualified plans were largely appropriate. The organization noted, however, that enforcing standards based on thresholds for origination, such as the approach in the proposed de minimis test, could be problematic because the number of transactions originated may have differing degrees of significance in different scenarios. The organization encouraged the Bureau either to justify the threshold levels through study or to adopt a more flexible approach that could be tailored to various situations appropriately.

A few industry commenters proposed alternative approaches to the revenue test or specifically responded to alternative approaches on which the Bureau solicited comment. A

[127] Similarly, a law firm that represents small and medium-sized banks commented that the Bureau should consider a higher threshold under the revenue test for small savings institutions.

trade association representing independent community banks recommended that the Bureau not finalize the revenue test and instead cap at 25 percent the percentage of an individual loan originator's total cash compensation paid during a calendar year from a non-qualified bonus plan. The association asserted that this structure would be easy to track, manage and monitor. A law firm that represents small and medium-sized banks discussed whether to permit profit-sharing bonuses or contributions to non-qualified plans where the creditor or loan originator organization can demonstrate that there is an insubstantial relationship between the compensation and the terms of multiple transactions of multiple individual loan originators. This commenter agreed with the Bureau's assertion in the proposal that this test would be difficult to implement in practice. One bank commenter, however, wrote that the marginal difference in loan originator compensation based on upcharging consumers is not a significant incentive to charge a customer a higher rate. The commenter provided an example of a loan originator receiving a $1,000 bonus of which only $20 was attributable to profit from transaction terms.

After consideration of comments received to the proposal and additional internal analysis, the Bureau has decided not to adopt the revenue test in this final rule. Based on this consideration and analysis, the Bureau believes the revenue test suffers from a variety of flaws.

First, the Bureau believes that the revenue test is not an effectively calibrated means of measuring the level of incentives present for individual loan originators to steer consumers to particular transaction terms. At a basic level, revenues would be a flawed measure of the relationship between the mortgage business and the profitability of the firm. Indeed, the Bureau believes that the revenue test would present a substantial risk of evasion. For example, if the revenue test were set at 50 percent, a creditor whose mortgage origination division generates 40 percent of the creditor's total revenues but 90 percent of the creditor's total profits could set a profit-sharing plan at the level of the entire company (rather than the mortgage business division) so that all company employees are eligible, but then pay out 90 percent of the bonuses to the individual loan originators. Although this compensation program would technically comply with the revenue test because less than 50 percent of total revenues would have been generated from mortgage business, steering incentives might still exist because individual loan originators would receive a disproportionate amount of bonuses relative to other individuals working for the creditor or loan originator organization. Moreover, firms would also have incentives to manipulate corporate structures to minimize mortgage revenues. The inherent misalignment between the revenue test and company profitability, which more directly drives decisions about compensation, would result in a rule that is both under-inclusive and over-inclusive. The revenue test's under-inclusiveness is illustrated by the example above in this paragraph. One example of the revenue test's over-inclusiveness is the effect of the revenue test on monoline mortgage businesses, discussed below. The Bureau believes that it would be difficult to fashion additional provisions for the revenue test to prevent such outcomes and any such provisions would add further complexity to a rule that as proposed was already heavily criticized for its complexity.

The Bureau believes that a test based on profitability instead of revenues, while designed to address the potential misalignment between revenues and profits discussed above, would present substantial risks. In the proposal, the Bureau solicited comment on this alternative approach, while expressing concern that using profitability as the metric could encourage firms to allocate costs across business lines to understate mortgage business profits. While revenues may be less prone to accounting manipulation than profits, a similar potential for accounting manipulation would also be present if the revenue test were adopted.

Second, the complexity of the rule also would prove challenging for industry compliance and supervision and enforcement. The Bureau is particularly mindful of the criticism by some commenters that the complexity of the proposal would have posed compliance burdens of such significance that creditors and loan originator organizations would have avoided paying profit-sharing bonuses to individual loan originators or making contributions to their non-qualified plans. Moreover, monitoring for evasion of the proposed rule would have required substantial analysis of how the company's mortgage-related revenue interplays with the revenue from other lines of business across the company and affiliates of the company (or a similar analysis for profits if profitability were used as an alternative metric). Assessing the relationship among different business lines within the company and affiliates would have been particularly challenging with a large, multi-layered organization.

Third, the Bureau has concluded, following consideration of the many comments from industry and SBA Advocacy, that the proposed revenue test would disadvantage monoline mortgage businesses, many of which are small entities, by effectively precluding them from paying profit-sharing bonuses and making contributions to non-qualified plans under any circumstances regardless of the particular aspects of their compensation programs. The Bureau believes that, as a general matter, steering incentives may be present to a greater degree with mortgage businesses that are small in size because the incentive of individual loan originators to upcharge likely increases as the total number of individual loan originators in an organization decreases.[128] The negative effect of the proposed rule, however, on monoline mortgage

[128] *See* earlier discussion of "free-riding" behavior in the section-by-section analysis of § 1026.36(d)(1)(i); *see also* 77 FR 55272, 55296-97 (Sept 7. 2012). In the proposal, the Bureau also noted that for small depository institutions and credit unions (defined as those institutions with assets under $175 million), regulatory data from 2010 indicate that for small savings institutions whose primary business focus is on residential mortgages, 59 percent of these firms would be restricted from paying bonuses based on mortgage-related profits to their individual loan originators

businesses would have been uniform; regardless of where the threshold would have been set, these businesses never would have been able to "pass" the revenue test. Thus, the revenue test would have been over-inclusive with respect to monoline mortgage businesses.

For these reasons, the Bureau does not believe that the revenue test (or a test that substitutes profitability for revenues) can be structured in a way that is sufficiently calibrated to prevent steering incentives. Thus, the Bureau is not adopting either type of test and, instead, as discussed below, is adopting a total compensation test consistent with an alternative on which the Bureau sought comment in the proposal.

36(d)(1)(iv)

As noted above, proposed § 1026.36(d)(1)(iii) would have permitted payment of compensation that is directly or indirectly based on the terms of transactions of multiple individual loan originators in limited circumstances. In this final rule, the provisions that would have been included in § 1026.36(d)(1)(iii) regarding the payment of compensation in the form of profit-sharing bonuses and contributions to non-qualified plans have been revised and redesignated as § 1026.36(d)(1)(iv), which addresses payments of compensation under "non-deferred profits-based- compensation plans" as defined in the rule. A non-deferred profits-based compensation plan is any arrangement for the payment of non-deferred compensation that is determined with reference to profits of the person from mortgage-related business. The commentary clarifying§ 1026.36(d)(1)(iv), previously contained in proposed comment 36(d)(1)-2.iii.G, has also been reorganized and incorporated into comment 36(d)(1)-3.v in the final rule.

under the revenue test if set at 50 percent. The Bureau noted that it lacks comprehensive data on nonbank lenders and, in particular, does not have information regarding the precise range of business activities that such companies engage in, and as a result, it was unclear the extent to which such nonbank lenders will face restrictions on their compensation practices. 77 FR 55272, 55347 (Sept. 7, 2012). While the Bureau has received additional data regarding nonbank lenders from the NMLSR confirming the original data, information regarding the range of revenue sources is still incomplete.

36(d)(1)(iv)(A)

Proposed § 1026.36(d)(1)(iii)(A) would have prohibited payment of compensation to an individual loan originator that directly or indirectly was based on the terms of that individual loan originator's transaction or transactions. The Bureau explained in the section-by-section analysis of the proposal that this language was intended to prevent a person from paying compensation to an individual loan originator based on the terms of that individual loan originator's transactions regardless of whether the compensation would otherwise be permitted in the limited circumstances under § 1026.36(d)(1)(iii)(B). Proposed comment 36(d)(1)-2.iii.F would have clarified the provision by giving an example and cross-referencing proposed comment 36(d)(1)-1 for further interpretation concerning whether compensation was "based on" transaction terms.

The Bureau did not receive comments specifically addressing this provision. The Bureau is finalizing this section and comment 36(d)(1)-2.iii.F as proposed, except that § 1026.36(d)(1)(iii)(A) has been redesignated as § 1026.36(d)(1)(iv)(A) and comment 36(d)(1)-2.iii.F has been redesignated as comment 36(d)(1)-3.iv for technical reasons.

36(d)(1)(iv)(B)

36(d)(1)(iv)(B)(1)

Although the Bureau is not adopting the revenue test, the Bureau still believes that the final rule should permit the payment of compensation under non-deferred profits-based compensation plans to individual loan originators under limited circumstances where the incentives for the individual loan originators to steer consumers to different loan terms are sufficiently attenuated. As noted earlier, the Bureau shares the concerns of consumer groups that setting a baseline rule too loosely would undermine the general prohibition of compensation based on transaction terms under TILA section 129B(c)(1) and § 1026.36(d)(1)(i), which could allow for a return of the types of lending practices that contributed to the recent mortgage-market crisis. However, as the Bureau stated above and in the proposal, compensation under non-deferred profits-based compensation plans does not always raise steering concerns, and this form of compensation, when appropriately structured, can provide inducements for individual loan originators to perform well and to become invested in the success of their organizations. The Bureau believes that allowing payment of compensation under non-deferred profits-based compensation plans under carefully circumscribed circumstances would appropriately balance these objectives. The Bureau also believes that implementing the TILA section 129B(c)(1) prohibition on compensation that varies based on loan terms to allow for these types of carefully circumscribed exceptions (with clarifying interpretation in the commentary) is consistent with the Bureau's interpretive authority under the Dodd-Frank Act and the Bureau's authority under section 105(a) of TILA to issue regulations to effectuate the purposes of TILA, prevent circumvention or evasion, or to facilitate compliance. Neither the TILA prohibition on compensation varying based on loan terms nor the existing regulatory prohibition on compensation based on transaction terms and conditions expressly addresses non-deferred profits-based compensation plans. Therefore, the clarity provided by § 1026.36(d)(1)(iv) and its commentary will help prevent circumvention or evasion of, and facilitate compliance with, TILA by clearly stating when these types of payments and contributions are permissible.

The Bureau, additionally, believes that a bright-line approach setting a numerical threshold above which compensation under a non-deferred profits-based compensation plan is prohibited is preferable to a principles-based approach, which was suggested by some commenters. Application of a principles-based approach would necessarily involve a substantial amount of subjectivity. Because the design and operation of these programs are varied and complex, the legality of many of them would likely be in doubt, creating uncertainty and challenges for industry compliance, agency supervision, and agency and private enforcement of the underlying regulation.[129]

Therefore, the Bureau is adopting, in § 1026.36(d)(1)(iv)(B)(*1*), a rule that permits an individual loan originator to receive, and a person to pay, compensation under a non-deferred profits-based compensation plan where the compensation is determined with reference to the profits of the person from mortgage-related business, provided that the compensation to the individual loan originator under non-deferred profits-based compensation plans does not, in the aggregate, exceed 10 percent of the individual loan originator's total compensation corresponding to the same time period. Section 1026.36(d)(1)(iv)(B)(*1*) permits this compensation even if it is directly or indirectly based on the terms of transactions of multiple individual loan originators, provided that, pursuant to § 1026.36(d)(1)(iv)(A), the compensation is not directly or indirectly based on the terms of the individual loan originator's transactions.[130]

Proposed comment 36(d)(1)-2.iii.A, which would have clarified the meaning of "profit-sharing plan" under proposed § 1026.36(d)(1)(iii), has been revised to clarify the meaning of "non-deferred profits-based compensation plan" under § 1026.36(d)(1)(iv) and is adopted as comment 36(d)(1)-3.ii. The Bureau is adopting in this final rule much of the language in the

[129] As noted earlier, one commenter urged the Bureau to look to the implementation of certain G-20 task force recommendations on incentive compensation practices (*i.e.*, the FSF Principles) as a model for a principles-based rather than a rules-based approach. However, the FSF Principles are primarily focused on compensation programs at significant financial institutions that incentivize imprudent risk-taking, which is not the subject of this rulemaking. FSF Principles at 1-2. Thus, the Bureau believes this suggested precedent for a qualitative, principles-based approach is inapposite.

[130] The provisions of § 1026.36(d)(1)(iv)(B)(*1*) are sometimes hereinafter referred to as the "10-percent total compensation test" or the "10-percent total compensation limit"; and the restrictions on compensation contained within the rule are sometimes hereinafter referred to as the "10-percent limit." Compensation paid under a non-deferred profits-based compensation plan is sometimes hereinafter referred to as "non-deferred profits-based compensation."

proposed comment, with a few exceptions (in addition to technical changes and reorganization). The comment clarifies that a non-deferred profits-based compensation plan is any compensation arrangement where an individual loan originator may be paid variable, additional compensation based in whole or in part on the profits of the mortgage-related business of the person paying the compensation. However, the comment now clarifies that a non-deferred profits-based compensation plan does not include a designated tax-advantaged plan (as defined in § 1026.36(d)(1)(iii)), or a deferred compensation plan that is not a designated plan as defined in the rule, including plans under Internal Revenue Code section 409A, 26 U.S.C. 409A.

The Bureau proposed to treat profits-based deferred compensation under non-qualified plans in the same manner as non-deferred profit-sharing payments (*e.g.*, bonuses). Although the proposal preamble discussion focused primarily on profit-sharing bonus programs, the reference to non-qualified plans also potentially could have included certain deferred-compensation plans (such as plans covered by Internal Revenue Code section 409A, 26 U.S.C. 409A) that do not receive the same tax-advantaged status as the plans covered by § 1026.36(d)(1)(iii) of the final rule. The Bureau also solicited comment on whether there are additional types of non-qualified plans that should be treated similar to qualified plans under the rule. The Bureau received only one response that specifically focused on this issue by urging that the Bureau not place restrictions on "nonqualified retirement arrangements" that restore benefits that are limited under designated tax-advantaged plans. The commenter asserted that companies use these agreements in an attempt to give favorable treatment to highly-compensated employees under their company retirement plans, but provided no data regarding how frequently they are used to compensate loan originators.

The Bureau has considered the comment but declines to either include such plans within the exception for non-deferred compensation plans or to provide a separate exception to § 1026.36(d)(1) for such deferred compensation plans at this time. Applying the 10 percent cap on compensation under non-deferred profits-based compensation plans to compensation under non-designated plans in general would be administratively complex given the variety of such plans and the consequent difficulty of constructing formulae for including them in the calculations of income required to apply the 10 percent cap. Nor is the Bureau prepared to create a separate rule for deferred compensation plans that are not designated plans. The Bureau understands that such plans are generally quite rare and has no detailed evidence as to the extent or nature of their use in compensating loan originators. The Bureau also notes that they are not generally subject to many of the same restrictions that apply to the designated tax-advantaged plans discussed in the section by section analysis of § 1026.36(d)(1)(iii). The Bureau also does not have enough information regarding the structure of non-designated plans to determine what measures would be appropriate or necessary to cabin any potential for them to create steering incentives. Accordingly, the Bureau does not believe that it would be appropriate to provide an exception for such plans at this time.

Comment 36(d)(1)-3.ii further clarifies that under a non-deferred profits-based compensation plan, the individual loan originator may, for example, be paid directly in cash, stock, or other non-deferred compensation, and the amount to be paid out under the non-deferred profits-based compensation plan and the distributions to the individual loan originators may be determined by a fixed formula or may be at the discretion of the person (*e.g.*, such person may elect not to make any payments under the non-deferred profits-based compensation plan in a given year), provided the compensation is not directly or indirectly based on the terms of the individual loan originator's transactions. The comment further elaborates that, as used in § 1026.36(d)(1)(iv) and its commentary, non-deferred profits-based compensation plans include, without limitation, bonus pools, profits pools, bonus plans, and profit-sharing plans established by the person, a business unit within the person's organizational structure, or any affiliate of the person or business unit within the affiliate's organizational structure. The comment also provides examples illustrating application of this interpretation to certain types of non-deferred profits-based compensation plans.

Comment 36(d)(1)-3.ii (proposed as comment 36(d)(1)-2.iii.A) has been revised in several additional respects. The comment now clarifies that compensation under a non-deferred profits-based compensation plan could include, without limitation, annual or periodic bonuses, or awards of merchandise, services, trips, or similar prizes or incentives where the bonuses, contributions, or awards are determined with reference to the profitability of the person, business unit, or affiliate, as applicable. Reference to "any affiliate" has been added to include compensation programs where compensation is paid through an affiliate of the person. Moreover, in the proposal, the term "business unit" was included in this comment without elaboration. The final comment clarifies that the term "business unit" as used in § 1026.36(d)(1)(iv) and its commentary means a division, department, or segment within the overall organizational structure of the person or affiliate, as applicable, that performs discrete business functions and that the person treats separately for accounting or other organizational purposes. The examples in the comment have been revised to reflect that a performance bonus paid out of a bonus pool set aside at the beginning of the company's annual accounting period as part of the company's operating budget does not violate the baseline prohibition on

§ 1026.36(d)(1)(i), meaning that the limitations of § 1026.36(d)(1)(iv) do not apply to such bonuses. Finally, several technical changes have been made to the comment.

Comment 36(d)(1)-3.v (which was proposed as comment 36(d)(1)-2.iii.G) contains six paragraphs and clarifies a number of aspects of the regulatory text in § 1026.36(d)(1)(iv)(B)(*1*). Comment 36(d)(1)-3.v.A clarifies that the individual loan originator's total compensation (*i.e.*, the denominator under the 10-percent total compensation test) consists of the sum total of: (1) all wages and tips reportable for Medicare tax purposes in box 5 on IRS form W-2[131] (or, if the individual loan originator is an independent contractor, reportable compensation on IRS form 1099-MISC[132]);[133] and (2) at the election of the person paying the compensation, all contributions by the creditor or loan originator organization to the individual loan originator's accounts in designated tax-advantaged plans that are defined contribution plans.

The Bureau believes that linking the definition of total compensation to the types of compensation required to be included on the IRS W-2 or 1099-MISC forms, as applicable, will make the calculation simpler for the 10-percent total compensation limit because loan originator organizations and creditors already must prepare W-2 and 1099-MISC forms for their employees and independent contractors, if any. Thus, creditors and loan originator organizations presumably already have systems in place to track and aggregate the types and amounts of individual loan originator compensation that are required to be reported on the IRS forms. Moreover, as explained in comment 36(d)(1)-3.v, a creditor or loan originator organization is not required to factor into the calculation of total compensation any contribution to a designated

[131] See the IRS Instructions to Form W-2, *available at* http://www.irs.gov/pub/irs-pdf/iw2w3.pdf.
[132] See the IRS Instructions to Form 1099-MISC, *available* at http://www.irs.gov/pub/irs-pdf/i1099msc.pdf.
[133] Total compensation of individual loan originators employed by the creditor or loan originator organization would be reflected on a W-2, whereas total compensation of an individual loan originator working for a creditor or loan originator organization as an independent contractor would be reflected on a 1099-MISC form. If an individual loan originator has some compensation that is reportable on the W-2 and some that is reportable on the 1099-MISC, the total compensation is the sum total of what is reportable on each of the two forms.

defined contribution plan other than amounts reported on the W-2 or 1099-MISC forms. In addition, the Bureau believes this approach will yield a more precise ratio of compensation paid under non-deferred profits-based compensation plans determined with reference to mortgage-related profits to total compensation than a definition that selectively includes or excludes certain types of compensation, and this more accurate result will more closely align with the incentives of loan originators.

Comment 36(d)(1)-3.v.B clarifies the requirement under § 1026.36(d)(1)(iv)(B)(*1*) that compensation paid to the individual loan originator that is determined with reference to the profits of the person from mortgage-related business is subject to the 10-percent total compensation limit (*i.e.*, the "numerator" of the 10-percent total compensation limit). The comment clarifies that "profits of the person" include, as applicable depending on where the non-deferred profits-based compensation plan is set, profits of the person, the business unit to which the individual loan originators are assigned for accounting or other organizational purposes, or an affiliate of the person. The comment notes that profits from mortgage-related business are any profits of the person or the business unit to which the individual loan originators are assigned for accounting or other organizational purposes that are determined with reference to revenue generated from transactions subject to § 1026.36(d), and that pursuant to § 1026.36(b) and comment 36(b)-1, § 1026.36(d) applies to closed-end consumer credit transactions secured by dwellings.

The comment further notes this revenue would include, without limitation, and as applicable based on the nature of the business of the person, business unit, or affiliate origination fees and interest associated with dwelling-secured transactions for which individual loan originators working for the person were loan originators, income from servicing of such transactions, and proceeds of secondary market sales of such transactions. The non-exhaustive list of mortgage-related business revenue provided in the comment largely parallels the definition of "mortgage-related revenue" that the Bureau had proposed in § 1026.36(d)(1)(iii)(B)(*1*) as part of the revenue test approach. The comment also clarifies that, if the amount of the individual loan originator's compensation under non-deferred profits-based compensation plans for a time period does not, in the aggregate, exceed 10 percent of the individual loan originator's total compensation corresponding to the same time period, compensation under non-deferred profits-based compensation plans may be paid under § 1026.36(d)(1)(iv)(B)(*1*) regardless of whether or not it was determined with reference to the profits of the person from mortgage-related business.

Comment 36(d)(1)-3.v.C discusses how to determine the applicable time period. The comment clarifies that the applicable time period is the time period for which the individual loan originator's performance, volume of loans originated, or other criteria is evaluated for purposes of the award of the compensation subject to the 10-percent limit and the total compensation. The timing of the actual payment does not matter. The comment also clarifies that a company may pay compensation subject to the 10-percent limit during different time periods falling within the company's annual accounting period for keeping records and reporting income and expenses, which may be a calendar year or a fiscal year depending on the person's annual accounting period, but in such instance, the 10-percent limit applies both as to each time period and cumulatively as to the annual accounting period. Comment 36(d)(1)-3.v.C also illustrates the clarification in the comment through two examples.

The Bureau believes that the time period for which the individual loan originator's performance, loan volume, or other factors was evaluated for purposes of determining the bonus that the individual loan originator is to receive is the most appropriate and practicable measuring period for the 10-percent total compensation limit. For example, the Bureau considered using as the measuring period for applying the 10-percent total compensation limit the time period during which the compensation subject to the 10-percent limit is actually paid. This measuring period would track when the bonuses are reportable as Federal income by the individual loan originators. However, if this measuring period were used, a year-end bonus determined with respect to one year and paid during January of the following year would result in the company having to project the total compensation for the entire year in which the bonus was paid to assess whether the bonus determined with reference to the previous year met the 10-percent limit.[134] This would make compliance difficult, if not impossible, and also lead to imprecision between the numerator (which is an actual amount) and the denominator (which is an estimated amount). Designating the measuring period as an annual period (whether a calendar or fiscal year) in all circumstances, for example, would raise similar issues about the need to project total compensation over a future period to determine whether a periodic bonus (such as a quarterly bonus) is in compliance with the 10-percent total compensation limit.

The Bureau acknowledges that the approach reflected in this final rule may require some adjustments to creditors' and loan originator organizations' systems of accounting and payment of bonuses if they do not pay compensation under a non-deferred profits-based compensation plan until after a quarter, calendar year, or other benchmark measuring period for which the compensation is calculated (namely, to ensure that total compensation in a given time period is net of any compensation under a non-deferred profits-based compensation paid during that give

[134] Paying a year-end bonus after the end of the calendar year does not render the bonus a form of deferred compensation since the bonus, once paid, is immediately taxable to the recipient.

time period but attributable to a previous time period). The Bureau believes that no other approach would align entirely with current industry practice, however.[135]

Comment 36(d)(1)-3.v.D discusses how profits-based awards of merchandise, services, trips, or similar prizes or incentives are treated for purposes of the 10-percent total compensation test. This comment clarifies that, if any compensation paid to an individual loan originator under § 1026.36(d)(1)(iv) pursuant to a non-deferred profits-based compensation plan consists of an award of merchandise, services, trips, or similar prizes or incentives, the cash value of the award is factored into the calculations of the compensation subject to the 10-percent limit and the total compensation under § 1026.36(d)(1)(iv)(B)(*1*). This comment also gives an example illustrating how the award of a trip to an individual loan originator would be treated under the rule in contrast to a cash bonus. The Bureau believes that this comment will ensure that non-cash bonus awards made with reference to mortgage-related business profits will be included and appropriately valued for purposes of calculating the 10-percent compensation and the total compensation under § 1026.36(d)(1)(iv)(B)(*1*).

Comment 36(d)(1)-3.v.E clarifies that the 10-percent total compensation limit under § 1026.36(d)(1)(iv) does not apply if the compensation under a non-deferred profits-based compensation plan is determined solely with reference to profits from non-mortgage-related business as determined in accordance with reasonable accounting principles. The comment further notes that reasonable accounting principles: (1) reflect an accurate allocation of revenues, expenses, profits, and losses among the person, any affiliate of the person, and any business units within the person or affiliates; and (2) are consistent with the accounting principles utilized by

[135] The Bureau understands there is variation in the market about whether creditors and loan originator organizations typically pay non-deferred profits-based compensation near the end of, but within, the time period evaluated for purposes of paying the non-deferred profits-based compensation or during a subsequent time period.

the person or the affiliate with respect to, as applicable, its internal budgeting and auditing functions and external reporting requirements. The comment also notes examples of external reporting and filing requirements that may be applicable to creditors and loan originator organizations are Federal income tax filings, Federal securities law filings, or quarterly reporting of income, expenses, loan origination activity, and other information required by GSEs.

To the extent a company engages in both mortgage-related and non-mortgage-related business, the potential exists for commingling of mortgage- and non-mortgage-related business profits. In this instance, the Bureau believes that non-deferred profits-based compensation for individual loan originators is to be exempt from the general rule under § 1026.36(d)(1), the determination of the amount of the non-mortgage-related business profits must be made in accordance with reasonable accounting principles. The Bureau does not believe this requirement will be burdensome because if a creditor or loan originator organization chooses to separately calculate profits from mortgage and non-mortgage related businesses either for internal accounting purposes, public reporting, or simply for the purposes of paying compensation under a non-deferred profits-based compensation plan pursuant to this regulation, the firm will do so in accordance with reasonable accounting principles. Where the firm does not segregate its profits in this way for Regulation Z purposes, all profits will be regarded as being from mortgage-related business.

Comment 36(d)(1)-3.v.F.*1* provides an additional example of the application of 1026.36(d)(1)(iv)(B)(*1*). The comment assumes that, in a given calendar year, a loan originator organization pays an individual loan originator employee $40,000 in salary and $125,000 in commissions, and makes a contribution of $15,000 to the individual loan originator’s 401(k) plan (for a total of $180,000). At the end of the year, the loan originator organization pays the individual loan originator a bonus based on a formula involving a number of performance metrics, to be paid out of a profit pool established at the level of the company but that is derived in part through the company's mortgage originations. The loan originator organization derives revenues from sources other than transactions covered by §1026.36(d). The comment notes that, in this example, the performance bonus would be directly or indirectly based on the terms of multiple individual loan originators' transactions pursuant to § 1026.36(d)(1)(i), as clarified by comment 36(d)(1)-1.ii, because it is being funded out of a profit pool derived in part from mortgage originations. Thus, the comment notes that the bonus is permissible under § 1026.36(d)(1)(iv)(B)(*1*) only if it does not exceed 10 percent of the loan originator's total compensation, which, in this example, consists of the individual loan originator's salary, commissions, and may include the performance bonus. The comment concludes that the loan originator organization may pay the individual loan originator a performance bonus of up to $20,000 (*i.e.*, 10 percent of $200,000 in total compensation).

Comment 36(d)(1)-3.v.F also gives an example of the different treatment under § 1026.36(d)(1)(iv)(B)(*1*) of two different profits-based bonuses for an individual loan originator working for a creditor: a "performance" bonus based on the individual loan originator's aggregate loan volume for a calendar year that is paid out of a bonus pool determined with reference to the profitability of the mortgage origination business unit, and a year-end "holiday" bonus in the same amount to all company employees that is paid out of a company-wide bonus pool. As explained in the comment, because the performance bonus is paid out of a bonus pool that is determined with reference to the profitability of the mortgage origination business unit, it is compensation that is determined with reference to mortgage-related business profits, and the bonus is therefore subject to the 10-percent total compensation limit. The comment notes that the "holiday" bonus is also subject to the 10-percent total compensation limit if the company-wide bonus pool is determined, in part, with reference to the profits of the creditor's mortgage origination business unit. The comment further clarifies that the "holiday" bonus is not subject to the 10-percent total compensation limit if the bonus pool was not determined with reference to the profits of the mortgage origination business unit as determined in accordance with reasonable accounting principles. The comment also clarifies that, if the "performance" bonus and the "holiday" bonus in the aggregate do not exceed 10 percent of the individual loan originator's total compensation, such bonuses may be paid under § 1026.36(d)(1)(iv)(B)(*1*) without the necessity of determining from which bonus pool they were paid or whether they were determined with reference to the profits of the creditor's mortgage origination business unit.

Comment 36(d)(1)-3.v.G clarifies that an individual loan originator is deemed to comply with its obligations regarding receipt of compensation under § 1026.36(d)(1)(iv)(B)(*1*) if the individual loan originator relies in good faith on an accounting or a statement provided by the person who determined the individual loan originator's compensation under a non-deferred profits-based compensation plan under § 1026.36(d)(1)(iv)(B)(*1*) and where the statement or accounting is provided within a reasonable time period following the person's determination. This comment is intended to reduce the compliance burdens on individual loan originators by providing a safe harbor for complying with the restrictions on receiving compensation under a non-deferred profits-based compensation plan under § 1026.36(d)(1)(iv)(B)(*1*).[136] The safe harbor will be available to any individual loan originator receiving compensation that is subject to the 10-percent limit where the person paying the compensation subject to the 10-percent limit elects to provide the individual loan originator with an accounting or statement in accordance

[136] The restrictions on non-deferred profits-based compensation under § 1026.36(d)(1)(iv)(B)(*1*) impose obligations on both the person paying the compensation and on the individual loan originator receiving the compensation.

with the specifications in the safe harbor and the individual relies in good faith on the accounting or statement.

In the proposal, the Bureau indicated that it crafted the proposal so as to implement the Dodd-Frank Act provisions on loan originator compensation in a way that would reduce the compliance burdens on covered persons. Furthermore, the Bureau sought comment on the potential impact on all types of loan originators of the proposed restrictions on the methods by which a loan originator is remunerated in a transaction. As noted above, a trade association that represents loan originators (both organizations and individuals) expressed concern that the compensation restrictions in the revenue test would lead to "unacceptable litigation" for individual loan originators (in addition to creditors and loan originator organizations).

In developing the final rule, the Bureau has paid particular attention to the compliance burdens on individual loan originators with respect to complying with the restrictions on receiving compensation subject to the 10-percent total compensation limit under § 1026.36(d)(1)(iv). The Bureau has crafted the final rule to facilitate the compliance of individual loan originators without undue burden or cost. The Bureau believes that in most cases, individual loan originators would not have the knowledge of or control over the information that would enable them to determine their compliance, and the Bureau does not believe it would be reasonable to expect them to do so. The Bureau has also crafted the final rule to avoid subjecting these individuals to unnecessary litigation and agency enforcement actions.[137]

The Bureau does not believe a similar safe harbor is warranted for creditors and loan originator organizations that elect to pay compensation under § 1026.36(d)(1)(iv). Creditors and

[137] As noted earlier, the Dodd-Frank Act extended the limitations period for civil liability under TILA section 130 from one year to three years and also made mortgage originators civilly liable for violations of TILA.

loan originator organizations can choose whether or not to pay this type of compensation, and if they do they should be expected to comply with the provisions. Moreover, in contrast to a recipient of compensation, a payer of compensation has full knowledge and control over the numerical and other information used to determine the compensation. The Bureau acknowledges that in response to the proposed revenue test, several industry commenters as well as SBA Advocacy (on behalf of participants at its roundtable) expressed concern about potential TILA liability or repurchase risk where an error is made under the revenue test calculation. Under the revenue test, an error in determining the amount of total revenues or mortgage-related revenues could have potentially impacted all awards of compensation under a non-deferred profits-based compensation plan to individual loan originators for a particular time period. Because the 10-percent total compensation test focuses on compensation at the individual loan originator level, however, the potential liability implications of a calculation error largely would be limited to the effect of that error alone. In other words, in contrast to the revenue test, an error under the 10-percent total compensation test would not likely have downstream liability implications as to other compensation payments across the company or business unit. The Bureau also believes that creditors and loan originator organizations will develop policies and procedures to minimize the possibility of such errors.

The Bureau is adopting the 10-percent total compensation test because the Bureau believes it will more effectively restrict the compensation programs that actually incentivize steering behavior on the part of individual loan originators than the proposed revenue test. Like the proposed revenue test, the 10-percent total compensation test clarifies the treatment of profits-based bonuses and aims to limit their payment to circumstances where incentives to individual loan originators to steer consumers to different loan terms are small. However, the

Bureau believes that the 10 percent compensation test will be more effective at accomplishing that goal because it calibrates the restriction not based on a general measurement of the company's profits or revenues, but rather on the amount of money paid to the individual loan originator, which provides the most concrete form of incentive. Moreover, the Bureau believes that the 10-percent total compensation test will avoid the revenue test's disparate impact on certain segments of the industry, will be less complex, and will be less prone to circumvention and manipulation.

Furthermore, the constitution of the individual loan originator's compensation package, including the presence and relative distribution of compensation under non-deferred profits-based compensation plans compared to other components of the total compensation, is a more direct and accurate indicator than company revenues or profitability of an individual loan originator's incentive to steer consumers to different loan terms. In contrast, a revenue or profitability test would completely bar all individual loan originators working for creditors or loan originator organizations that are above the relevant thresholds from certain compensation irrespective of the differential effects particular compensation arrangements would have on each individual's loan originator's incentives. Conversely, a revenue or profitability test would allow unchecked bonus and other compensation under a non-deferred profits-based compensation plan for individual loan originators working for a creditor or loan originator organization that falls below the relevant threshold. By their nature, these types of tests would create substantial problems of under- and over-inclusiveness.

The 10-percent total compensation test, unlike the revenue test, will not disadvantage creditors and loan originator organizations that are monoline mortgage businesses. The Bureau also believes that it will have less burdensome impact on small entities than the revenue test. As discussed above, the revenue test would have effectively precluded monoline mortgage businesses from paying profit-sharing bonuses to their individual loan originators or making contributions to those individuals' non-qualified plans because these institutions' mortgage-related revenues as a percentage of total revenues would always exceed 50 percent. A test focused on compensation at the individual loan originator level, rather than revenues at the level of the company or the division within the company at which the compensation program is set up, would be available to all companies regardless of the diversity of their business lines. Moreover, as the Bureau noted in the proposal, creditors and loan originator organizations that are monoline mortgage businesses disproportionately consist of small entities.[138] Unlike the revenue test, the 10-percent total compensation test will place restrictions on compensation under a non-deferred profits-based compensation plan (such as bonuses) that are neutral across entity size. The Bureau also believes that the relative simplicity of the 10-percent total compensation test in comparison to the revenue test or a principles-based approach suggested by some commenters will also benefit small entities.[139]

Moreover, the 10-percent total compensation test establishes a bright line rule that is less complex than the revenue test. The 10-percent total compensation test does not require the Bureau to establish, and industry to comply with, a definition of total revenues or assess how the revenues of affiliates would be treated for purposes of the test. If a mortgage business wishes to provide compensation to its loan originators up to the 10-percent limit, it need only determine the amount of compensation under a non-deferred profits-based compensation plan and the amount of total compensation. As described above, the denominator of the test, total compensation,

[138] See earlier discussion of the regulatory data on small savings institutions whose primary business focus is on residential mortgages that was cited in the proposal.
[139] The impacts on small entities are described in more detail in the Final Regulatory Flexibility Analysis (FRFA) contained in part VII below.

consists of the sum total of compensation that is reportable on box 5 of the IRS W-2 (or, as applicable, the 1099-MISC form) filed with respect to the individual loan originator plus any contributions to the individual loan originator's account under designated tax-advantaged defined contribution plans where the contributions are made by the person sponsoring the plan. Creditors and loan originator organizations presumably already have systems in place to track and aggregate this information. Creditors and loan originator organizations would need to calculate non-mortgage-related business profits only if they are paying compensation under a non-deferred profits-based compensation plan outside of the 10-percent limit. The Bureau expects that this will be largely unnecessary because of the ample other methods to compensate individual loan originators and the principle that most creditors and loan originator organizations will wish to compensate their individual loan originators from a non-deferred profits-based compensation plan that is established with reference to mortgage-related business profits (*i.e.*, to align the individual loan originators' incentives properly).[140]

The Bureau acknowledges that the 10-percent total compensation test is not completely without complexity and that some institutions may have more difficulty than others determining which bonuses are subject to the regulation. For example, as noted above, the 10-percent total compensation test requires creditors or loan originator organizations that wish to pay compensation under a non-deferred profits-based compensation plan to their individual loan originators in excess of the 10-percent limit to determine whether the non-deferred profits-based compensation is determined with reference to non-mortgage-related business profits, in accordance with reasonable accounting principles. Comment 36(d)(1)-3.v.E provides clarifications as to these requirements, as described above. As noted above, however, the Bureau

[140] Furthermore, many individual loan originators who originate loans infrequently and not typically as part of their job will be otherwise exempt pursuant to the de minimis test.

believes that creditors and loan originator organizations that are subject to this final rule and that choose to pay non-deferred profits-based compensation determined with reference to non-mortgage-related business profits already use, or would in the normal course use, reasonable accounting principles to make these calculations. Firms also could simply account for profits on a company-wide basis for purposes of meeting the 10-percent total compensation limit, which would negate the need for specifically calculating mortgage-related profits.

The Bureau believes that the 10-percent total compensation test also presents less complexity than the alternative principles-based standards suggested by some commenters. As discussed in the section-by-section analysis of § 1026.36(d)(1)(i), application of a principles-based standard as a general matter would necessarily involve a substantial amount of subjectivity and present challenges for industry compliance, agency supervision, and agency and private enforcement of the underlying regulation. Moreover, the disparate standards suggested by industry commenters reveal the inherent difficulty of crafting a workable principles-based approach. These standards would need to be defined by the Bureau to be applied consistently across creditors and loan originator organizations. The complexity involved in crafting such principles would make it difficult to calibrate properly the countervailing interests for industry compliance, agency supervision and enforcement, and private enforcement.

Some commenters supported the principles behind a test involving limits on individual loan originator's non-deferred profits-based compensation based on the Bureau's solicitation of comment on such an approach as an alternative to the revenue test. As noted above, a national trade association of community banks and depositories supported limiting compensation from a non-qualified bonus plan to no more than 25-percent of an individual loan originator's total compensation. As discussed above, a mortgage company commented that limiting compensation that is indirectly based on terms would cover almost any form of compensation determined with reference to lender profitability and urged that, instead, the rulemaking focus on compensation specific to the loan originator and the transaction.[141] As with any line-drawing exercise, there is no universally acceptable place to draw the line that definitively separates payments that have a low likelihood of causing steering behavior from those that create an unacceptably high likelihood. This Bureau believes, however, that the steering incentives would be too high were loan originators permitted to receive up to 25 percent of their compensation from mortgage-related profits, especially given the availability of compensation from mortgage-related profits through contributions to a designated tax-advantaged plan. Instead, a bonus of up to 10 percent of the individual loan originator's compensation will achieve the positive effects thought to be associated with non-deferred profits-based compensation plans.

The Bureau acknowledges that the 10-percent total compensation test does not fully reflect that different types of non-deferred profits-based compensation plans in particular market settings might be shown to create substantially fewer steering incentives. As noted above, this final rule is not without complexity, particularly regarding the definition of the numerator of the 10-percent total compensation test. On balance, however, the Bureau believes this approach is less complex than the revenue test, and the burdens for both compliance and supervision will be reduced in comparison to the revenue test.

Finally, the Bureau believes that the potential for circumvention and manipulation are less pronounced than under the revenue test. The revenue test would have required all regulated

[141] As noted above, this commenter recommended an alternative disclosure approach to make the consumer aware that the loan originator's compensation may increase or decrease based on the profitability of the creditor and urging the consumer to shop for credit to ensure that he or she has obtained the most favorable loan terms. The Bureau believes that this suggestion, while creative, would not have been feasible because there would have been no time to engage in consumer testing prior to the statutory deadline for issuing a final rule. Moreover, the Bureau does not believe a disclosure-only approach would implement the statute as faithfully, which as a substantive matter prohibits loan originator compensation that varies based on loan terms.

persons to calculate mortgage-related revenues and non-mortgage-related revenues separately to determine the relative contribution of the two to the firm's total revenues. Here, however, the Bureau believes that most creditors and loan originator organizations will not choose to account for their profits across business lines and instead will choose to limit the payment of non-deferred profits-based compensation to 10 percent of total compensation. For the firms that choose to do such disaggregated accounting, comment 36(d)(1)-3.v.E clarifies that they are to use reasonable accounting principles. If, notwithstanding the commentary, firms were to attempt to use unreasonable accounting principles or manipulate corporate structures to circumvent the rule, the Bureau will consider appropriate action.

In this final rule, the Bureau has made other changes to the commentary to § 1026.36(d)(1) that reflect substantive or technical changes from language that was in the proposal. The Bureau has made several technical changes to comment 36(d)(1)-1.ii. For example, where applicable, reference to "transaction terms" in this comment (and others) has been replaced with "a term of a transaction," consistent with the substitution of this term throughout § 1026.36(d)(1) and its commentary.

In addition to being redesignated as comment 36(d)(1)-3, proposed comment 36(d)(1)-2.iii has been revised in several respects from the proposal. Reference to § 1026.36(d)(1)(iv) has been added to the commentary to § 1026.36(d), where applicable, to track the distinctions between designated plan provisions in § 1026.36(d)(1)(iii) and non-deferred profits-based compensation plans in § 1026.36(d)(1)(iv). Moreover, language has been added clarifying that subject to certain restrictions, § 1026.36(d)(1)(iii) and (iv) permits the payment of certain compensation that otherwise would be prohibited by § 1026.36(d)(1)(i), because it is directly or indirectly based on the terms of multiple transactions of multiple individual loan originators.

The cross-references to other sections and commentary clarifying the scope of § 1026.36(d) have been excluded from the comment, because this clarification of the scope of § 1026.36(d) is not necessary in light of other changes to the regulatory text of § 1026.36(d) in this final rule. Several technical changes were made as well.

In this final rule, proposed comment 36(d)(1)-2.iii.B has been adopted as comment 36(d)(1)-3.i. This comment clarifies the meaning of defined benefit and defined contribution plans as such terms are used in § 1026.36(d)(1)(iii).

The Bureau has not finalized the portion of proposed comment 36(d)(1)-2.iii.C that would have clarified that if a creditor did not permit its individual loan originator employees to deviate from the creditor's pre-established loan terms, such as the interest rate offered, then the creditor's payment of a bonus at the end of a calendar year to an individual loan originator under a profit-sharing plan would not be related to the transaction terms of multiple individual loan originators, and thus would be outside the scope of the prohibition on compensation based on terms under § 1026.36(d)(1)(i). Upon further consideration of the issues addressed in this proposed comment, the Bureau believes that inclusion of the comment does not appropriately clarify the restrictions under § 1026.36(d)(1)(i) as clarified by comment 36(d)(1)-1.ii. The existence of a potential steering risk where loan originator compensation is based on the terms of multiple transactions of multiple individual loan originators is not predicated exclusively on whether an individual loan originator has the ability to deviate from pre-established loan terms. This is because the individual loan originator may have the ability to steer consumers to different loan terms at the pre-application stage, when the presence or absence of a loan originator's ability to deviate from pre-established loan terms would not yet be relevant during these interactions. For example, a consumer might contact the individual loan originator for a preliminary price quote or, if the process is further along, the consumer and individual loan originator might meet so that the individual loan originator can begin gathering the items necessary to constitute a loan application under RESPA (which triggers the RESPA good faith estimate and TILA early disclosure requirements). All of these interactions would take place prior to the application and underwriting. Yet, steering potential would exist to the extent the individual loan originator might have the ability, for example, to suggest the consumer consider different loan products based on the individual loan originator's knowledge and experience of the market or his or her anticipation of the underwriting decision based on the information delivered by the consumer. The Bureau recognizes that certain industry commenters supported the proposed comment. However, the Bureau believes that the comment could potentially lead to confusion and misinterpretation about the applicability of the underlying prohibition on compensation based on transaction terms.

The last sentence of proposed comment 36(d)(1)-2.iii.C (adopted as comment 36(d)(1)-3.iii in the final rule) also has been revised from the proposal. The proposed comment would have permitted a loan originator organization to pay a bonus to or contribute to a non-qualified profit-sharing plan of its loan originator employees from all its revenues provided those revenues were derived exclusively from fees paid by a creditor to the loan origination organization for originating loans funded by the creditor. The comment explains that a bonus or contribution in these circumstances would not be directly or indirectly based on multiple individual loan originators' transaction terms because § 1026.36(d)(1)(i) precludes the creditor from paying a loan originator organization compensation based on the terms of the loans it is purchasing. The Bureau is finalizing this portion of the comment as proposed, with three substantive changes. First, the comment now clarifies that loan originator organizations covered by the comment are those whose revenues are "from transactions subject to § 1026.36(d)," to emphasize that the revenues at issue are those determined with reference to transactions covered by this final rule. Second, the comment clarifies that such revenues must be "exclusively derived from transactions covered by §1026.36(d)" not that such revenues must be "derived exclusively from fees paid by creditors that fund its originations." This change reflects that the compensation referenced in the comment may not necessarily be called a fee and may come from creditors or consumers or both. Third, the Bureau has added some additional language to the portion of the comment clarifying that if a loan originator organization's revenues from transactions subject to § 1026.36(d) are exclusively derived from transactions subject to § 1026.36(d) (whether paid by creditors, consumers, or both), and that loan originator organization pays its individual loan originators a bonus under a non-deferred profits-based compensation plan, the bonus is not considered to be directly or indirectly based on the terms of multiple transactions of multiple individual loan originators. The Bureau also has made a few additional technical changes to the comment; no substantive change is intended.

This final rule does not include proposed comment 36(d)(1)-2.iii.D, which clarified that under § 1026.36(d)(1)(iii), the time period for which the compensation is paid is the time period for which the individual loan originator's performance was evaluated for purposes of the compensation determination (*e.g.*, calendar year, quarter, month), whether or not the compensation is actually paid during or after the time period. This comment clarified the measuring period for total revenues and mortgage-related revenue under the revenue test. Because the revenue test is not being finalized, this comment is not applicable. The commentary under § 1026.36(d)(1) reflects a re-designation of comment subsection references as a consequence of this proposed comment not being included in this final rule (*e.g.*, proposed comment 36(d)(1)-2.iii.E has been redesignated as comment 36(d)(1)-3.iv).

The final rule has made only a few technical changes to proposed comment 36(d)(1)-2.iii.F, which has been adopted as comment 36(d)(1)-3.iv in the final rule. The many revisions to proposed comment 36(d)(1)-2.iii.G (adopted as comment 36(d)(1)-3.v) are discussed earlier in this section-by-section analysis.

36(d)(1)(iv)(B)(2)

Proposed § 1026.36(d)(1)(iii)(B)(*2*) would have permitted a person to pay, and an individual loan originator to receive, compensation in the form of a bonus or other payment under a profit-sharing plan sponsored by the person or a contribution to a non-qualified plan if the individual is a loan originator (as defined in proposed § 1026.36(a)(1)(i)) for five or fewer transactions subject to § 1026.36(d) during the 12-month period preceding the compensation decision. This compensation would have been permitted even when the payment or contribution relates directly or indirectly to the terms of the transactions subject to § 1026.36(d) of multiple individual loan originators. Proposed § 1026.36(d)(1)(iii)(B)(*2*) is sometimes hereinafter referred to as the "de minimis origination exception."

The Bureau stated in the proposal that the intent of proposed § 1026.36(d)(1)(iii)(B)(*2*) would have been to exempt individual loan originators who engage in a de minimis number of transactions subject to § 1026.36(d) from the restrictions on payment of bonuses and making of contributions to non-qualified plans. An individual loan originator who is a loan originator for five or fewer transactions, the Bureau stated in the proposal, is not truly active as a loan originator and, thus, is insufficiently incentivized to steer consumers to different loan terms.

The de minimis origination exception was intended to cover, in particular, branch or unit managers at creditors or loan originator organizations who act as loan originators on an occasional, one-off basis to, for example, cover for individual loan originators who are out sick, on vacation, or need assistance resolving issues on loan applications. Existing comment 36(a)-4 clarifies that the term "loan originator" as used in § 1026.36 does not include managers, administrative staff, and similar individuals who are employed by a creditor or loan originator but do not arrange, negotiate, or otherwise obtain an extension of credit for a consumer, or whose compensation is not based on whether any particular loan is originated. In the proposal, the Bureau proposed to clarify in comment 36(a)-4 that a "producing manager" who also arranges, negotiates, or otherwise obtains an extension of consumer credit for another person is a loan originator and that a producing manager's compensation thus is subject to the restrictions of § 1026.36. The proposed regulatory text and commentary to § 1026.36(d)(1)(iii)(B)(*2*) did not distinguish among managers and individual loan originators who act as originators for five or fewer transactions in a given 12-month period, however.

The Bureau solicited comment on the number of individual loan originators who will be affected by the exception and whether, in light of such number, the de minimis test is necessary. The Bureau also solicited comment on the appropriate number of originations that should constitute the de minimis standard, over what time period the transactions should be measured, and whether this standard should be intertwined with the potential 10-percent total compensation test on which the Bureau is soliciting comment, discussed in the section-by-section analysis of proposed § 1026.36(d)(1)(iii)(B)(*1*). The Bureau, finally, solicited comment on whether the 12-month period used to measure whether the individual loan originator has a de minimis number of transactions should end on the date on which the compensation is paid, rather than the date on which the compensation decision is made.

Proposed comment 36(d)(1)-2.iii.H also would have provided an example of the de minimis origination exception as applied to a loan originator organization employing six individual loan originators. Proposed comment 36(d)(1)-2.iii.I.1 and -2.iii.I.2 would have illustrated the effect of proposed § 1026.36(d)(1)(iii)(A) and (B) on a company that has mortgage and credit card businesses and harmonizes through examples the concepts discussed in other proposed comments to § 1026.36(d)(1)(iii).

Consumer groups generally opposed permitting creditors and loan originator organizations to pay profit-sharing bonuses and make contributions to non-qualified plans where the individual loan originator is the loan originator for a de minimis number of transactions. A coalition of consumer groups asserted—consistent with their comments to the qualified plan and revenue test aspects of the proposal—that there should be no exceptions to the underlying prohibition on compensation based on transaction terms other than for volume of mortgages originated. These groups expressed concern that the proposal would allow an individual loan originator to be compensated based on the terms of its transactions so long as the individual loan originator is the originator for five or fewer transactions.[142]

Industry commenters generally either did not object to the proposed de minimis origination exception or expressly supported the exception if the threshold were set at a number greater than five. A national trade association representing the banking industry supported establishing a de minimis origination exception but asked that the threshold be increased to 15.

[142] As discussed below, proposed § 1026.36(d)(1)(iii)(A) prohibits an individual loan originator from being compensated based directly or indirectly on the terms of the individual loan originator's transactions, and this prohibition applies to individual loan originators who otherwise would fall under the de minimis origination exception in proposed § 1026.36(d)(1)(iii)(B)(*2*).

The association reasoned that a threshold of five would not have been high enough to capture managers in community banks and smaller mortgage companies across jurisdictions who step in to act as loan originators on an ad hoc basis to assist individual loan originators under their employ. In most instances, the association stated, these so called "non-producing managers" would not receive transaction-specific compensation, yet under the proposal their participation in a few transactions would have potentially disqualified them from incentive compensation programs in which other managers could participate. The association stated that should the Bureau deem 15 as too high of a threshold, it could adopt 15 as the threshold applicable to managers and administrative staff only. A bank and a credit union commenter urged the Bureau to increase the threshold to 25 for similar reasons (*i.e.*, to allow managers who occasionally originate loans more flexibility to participate in bonus programs).

A few industry commenters criticized the de minimis origination exception. One national trade association stated that the exception would be of only limited use and benefit, *e.g.*, for branch managers who assist with originations in very rare circumstances. A trade association representing community mortgage lenders commented that the de minimis exception, in conjunction with the revenue test, would have disparate impacts on small mortgage lenders that do not have alternate revenue sources. A compensation consulting firm stated that, similar to its comment on the revenue test, any bright line threshold will result in inequitable treatment.[143]

As discussed previously with respect to comments received on the revenue test, an organization writing on behalf of State bank supervisors stated that the Bureau's proposed regulatory changes regarding profit-sharing bonuses and contributions to non-qualified plans

[143] The commenter posited an example of a branch manager who originates five loans with an aggregate principal amount of $2 million and another branch manager who originates six loans with aggregate principal amount of $1 million.

were largely appropriate, but the organization noted that enforcing standards based on thresholds for origination can be problematic because the number of transactions originated may have differing degrees of significance in different scenarios. The organization specifically noted the de minimis origination exception as an example of a potentially problematic threshold. The organization encouraged the Bureau either to justify the threshold levels through study or adopt a more flexible approach that can be tailored to various situations appropriately.

The Bureau is finalizing § 1026.36(d)(1)(iii)(B)(*2*) as proposed with four changes. First, the Bureau has redesignated proposed § 1026.36(d)(1)(iii)(B)(*2*) as § 1026.36(d)(1)(iv)(B)(*2*) in the final rule. This change was made to distinguish the regulatory text addressing non-deferred profits-based compensation plans from the regulatory text addressing designated plans.

Second, § 1026.36(d)(1)(iv)(B)(*2*) now reads "a" loan originator rather than "the" loan originator, as proposed. This change was made to emphasize that a transaction may have more than one loan originator under the definition of loan originator in § 1026.36(a)(1)(i).

Third, § 1026.36(d)(1)(iii)(B)(*2*) clarifies that the "transactions" subject to the minimis threshold are those transactions that are consummated. Where the term is used in § 1026.36 and associated commentary, "transaction" is deemed to be a consummated transaction; this clarification merely makes the point expressly clear for purposes of the de minimis origination exception, where the counting of transactions is critical toward establishing the application of the exception to a particular individual loan originator.

Fourth, the Bureau has increased the de minimis origination exception threshold number from five to ten transactions in a 12-month period. The Bureau is persuaded by feedback from several industry commenters that the proposed threshold number of five would likely have been too low to provide relief for managers who occasionally act as loan originators in order, for example, to fill in for individual loan originators who are sick or on vacation.[144] The higher threshold will allow additional managers (or other individuals working for the creditor or loan originator organization) who act as loan originators only on an occasional, one-off basis to be eligible for non-deferred profits-based compensation plans that are not limited by the restrictions in § 1026.36(d)(1)(iv). Without a de minimis exception, for example, a manager or other individual who is a loan originator for a very small number of transactions per year may, depending on the application of the restrictions on non-deferred profits-based compensation under § 1026.36(d)(1)(iv), be ineligible to participate in a company-wide bonus pool or other bonus pool that is determined in part with reference to mortgage-related profits. The Bureau believes this exception is appropriate because the risk that the manager or other individual will steer consumers to particular transaction terms is more attenuated than for individuals working for the creditor or loan originator organization whose loan origination activities constitute a primary or even secondary (as opposed to occasional) portion of their job responsibilities. The steering risk is also more attenuated, because managers or other individuals who act as loan originators for a small number of closed transactions per year are less likely to be able to significantly influence the amount of funds available from which to pay these individuals bonuses or other compensation under non-deferred profits-based compensation plans.

In the proposal, the Bureau solicited comment on the appropriate threshold number for the de minimis origination exception. The Bureau received no quantitative data on the number

[144] Some commenters referred to the individuals that the de minimis origination exception is intended in part to cover as "non-producing managers." In this final rule, comment 36(a)-4 has been revised to clarify that a loan originator includes a manager who takes an application, offers, arranges, assists a consumer with obtaining or applying to obtain, negotiate, or otherwise obtain or make a particular extension of credit for another person, if the person receives or expects to receive compensation for these activities. The comment further clarifies that an individual who performs any of these activities in the ordinary course of employment is deemed to be compensated for these activities. Therefore, the de minimis exception is intended to cover producing managers as the term is used in comment 36(a)-1.4.v.

of originations typically engaged in by managers, however, and little to no anecdotal data generally. The commenters who requested 15 and 25 as the threshold amount did not provide data on why that number was appropriate.

The Bureau has chosen ten as the threshold amount, rather than 15 or 25 as suggested by some commenters, because the Bureau believes those numbers stray too far from a threshold that suggests only occasional loan originator activity (which, in turn, suggests insufficient incentive to steer consumers to different loan terms). The Bureau stated in the proposal that an individual engaged in five or fewer transactions per calendar year is not truly active as an individual loan originator, citing by analogy the TILA provision implemented in § 1026.2(a)(17)(v) providing that a person does not "regularly extend credit" unless, for transactions there are five such transactions in a calendar year with respect to consumer credit transactions secured by a dwelling. The Bureau continues to believe that the TILA provision is a useful analogue to determining when an individual loan originator would be active and thus sufficiently incentivized to steer consumers to different loan terms, but the analogue is not determinative, and the Bureau is sensitive to the industry comments regarding the capture of non-producing managers under the exception. In light of these countervailing considerations, the Bureau is raising the threshold to ten.

The Bureau is not aware of available data or estimates of the typical number of originations by producing managers. The Bureau is similarly not aware of available data or estimates of the distribution of origination activity by originators of different asset size classes. In aggregate, however, loan originators at depository institutions are estimated to originate 43 loans per year.[145] As such, the Bureau believes that an origination threshold of 10 would not capture a typical individual loan originator who acts as loan originator in a regular or semi-regular capacity for a typical institution of any asset class. In light of the limited data, however, the Bureau does not believe these data provide sufficient evidence to justify raising the threshold number to higher than ten.

The Bureau acknowledges that increasing the threshold number from five to ten may exempt from the restrictions on non-deferred profits-based compensation under § 1026.36(d)(1)(iv) individual loan originators who act as loan originators in a relatively small number of transactions but do so in a regular capacity. The Bureau believes that the steering incentives for such individuals would be minimal because their origination activity is low, regardless of the fact that loan origination is a regular or semi-regular part of their job description, and they thus will not substantially increase the availability of mortgage-related profits or expect to gain much compensation from these profits. Moreover, based on the data noted above, the Bureau does not believe that increasing the threshold number from five to ten would capture more than a marginal amount of these types of additional individual loan originators.

The Bureau has also made some technical changes to the provision. In § 1026.36(d)(1)(iv)(B)(*2*), the words "payment or contribution" have been replaced with "compensation" to reflect a change in terminology in an earlier portion of the regulatory

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[145] Based on data from HMDA and Call Report data, the Bureau estimates that there were approximately 5.6 million closed-end mortgage originations by depository institutions in 2011. Data from the BLS indicate that there were 132,400 loan officers at depository institutions in 2011. Thus, these estimates imply an aggregate ratio of roughly 43 originations per loan originator. Bureau estimates using other methodologies yield similar results. The Bureau also notes that loan originators at the threshold of 10 loans, would earn roughly $19,000 per year assuming compensation of one point per loan and an average loan size of $190,000 (approximately the average loan amount of home-secured mortgages reported in the 2011 HMDA data).

provision. The phrase "compensation decision" has been replaced with "compensation determination" to be consistent with the wording of § 1026.36(d)(1)(iv)(B)(*1*) and commentary regarding the time period for which compensation is "determined." In the final rule, comment 36(d)(1)-2.iii.H has been redesignated as comment 36(d)(1)-3.vi and has been revised to reflect the Bureau's decision to raise the de minimis origination exception threshold number from five to ten, including the examples illustrating where certain individual loan originators would fall above or below the threshold. The examples presented in the comment also have been revised to reflect that one of the individual loan originators is a manager, to illustrate that managers will be covered by § 1026.36(d)(1)(iv)(B)(*2*) depending on the circumstances.

In this final rule, proposed comment 36(d)(1)-2.iii.I has been deleted because it is duplicative with other comments providing illustrative examples of the provisions of § 1026.36(d)(1)(iii) and (iv).

36(d)(2) Payments by Persons Other Than the Consumer

36(d)(2)(i) Dual Compensation

Background

Existing § 1026.36(d)(2) restricts loan originators from receiving compensation in connection with a transaction from both the consumer and other persons. As discussed in more detail below, section 1403 of the Dodd-Frank Act amended TILA to codify the same basic prohibition against dual compensation, though it also imposed additional requirements related to consumers' payment of upfront points and fees that could significantly change the rule's scope and impact.

Specifically, § 1026.36(d)(2) currently provides that, if any loan originator receives compensation directly from a consumer in a consumer credit transaction secured by a dwelling:

(1) no loan originator may receive compensation from another person in connection with the transaction; and (2) no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to a loan originator in connection with the transaction. When the Dodd-Frank Act was enacted, this provision had been proposed but not finalized; the Board subsequently adopted § 1026.36(d)(2) in its 2010 Loan Originator Final Rule, which is discussed in more detail in part I.

Comment 36(d)(2)-1 currently clarifies that the restrictions imposed under § 1026.36(d)(2) 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. Thus, the phrase "in connection with the transaction" as used in § 1026.36(d)(2) does not refer to salaries, hourly wages, or other forms of compensation that are not tied to a specific transaction.

Thus, under existing § 1026.36(d)(2), a loan originator that receives compensation directly from the consumer may not receive compensation in connection with the transaction (*e.g.*, a commission) from any other person (*e.g.*, a creditor). In addition, if any loan originator is paid compensation directly by the consumer in a transaction, no other loan originator may receive compensation in connection with the transaction from a person other than the consumer. Moreover, if any loan originator receives compensation directly from a consumer, no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to a loan originator in connection with the transaction. For example, assume that a loan originator that is not a natural person (*i.e.*, a loan originator organization) receives compensation directly from the consumer in a mortgage transaction subject to existing § 1026.36(d)(2). The loan originator organization may not receive compensation in connection with that particular transaction (*e.g.*, a commission) from a person other than the consumer (*e.g.*, the creditor). In addition, because the loan originator organization is a person other than the consumer, the loan originator organization may not pay individual loan originators any compensation in connection with that particular transaction, such as a transaction-specific commission. Consequently, under existing rules, in the example above, the loan originator organization must pay individual loan originators only in the form of a salary or an hourly wage or other compensation that is not tied to the particular transaction. As a result of the 2010 Loan Originator Final Rule, loan originator organizations have expressed concern that currently it is difficult to structure transactions where consumers pay loan originator organizations compensation directly, because it is not economically feasible for the organizations to pay their individual loan originators purely a salary or hourly wage, instead of a commission that is tied to the particular transaction either alone or in combination with a base salary.

The Dodd-Frank Act

Section 1403 of the Dodd-Frank Act added TILA section 129B(c) which states that, for any mortgage loan, a mortgage originator generally may not receive from any person other than the consumer any origination fee or charge except bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of either. TILA section 129B(c)(2)(A); 12 U.S.C. 1639b(c)(2)(A). Likewise, no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third-party charges as described above. Notwithstanding this general prohibition on payments of any origination fee or charge to a mortgage originator by a person other than the consumer, however, TILA section 129B(c)(2)(B) provides that a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if: (1) "the mortgage originator does not receive any compensation directly from the consumer;" and (2) "the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third-party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator)." TILA section 129B(c)(2)(B) also provides the Bureau authority to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points, or origination fees where it determines that doing so is in the interest of consumers and in the public interest.

The Bureau's Proposal

Setting aside the ban on payment of certain points and fees as explained in more detail below, the Bureau interprets the general restrictions on dual compensation set forth in TILA section 129B(c)(2) to be consistent with the restrictions on dual compensation set forth in existing § 1026.36(d)(2) despite the fact that the statute is structured differently and uses different terminology than existing § 1026.36(d)(2).

Nonetheless, the Bureau proposed several changes to existing § 1026.36(d)(2) (redesignated as § 1026.36(d)(2)(i)) to provide additional clarity and flexibility to loan originators. For example, § 1026.36(d)(2) currently prohibits a loan originator organization that receives compensation directly from a consumer in connection with a transaction from paying compensation in connection with that transaction to individual loan originators (such as its employee loan officers), although the organization could pay compensation that is not tied to the transaction (such as salary or hourly wages) to individual loan originators. As explained in more detail below, the Bureau proposed to revise § 1026.36(d)(2) (redesignated as § 1026.36(d)(2)(i)) to provide that, if a loan originator organization receives compensation directly from a consumer in connection with a transaction, the loan originator organization may pay compensation in connection with the transaction to individual loan originators and the individual loan originators may receive compensation from the loan originator organization. As explained in more detail below, the Bureau believed that allowing loan originator organizations to pay compensation in connection with a transaction to individual loan originators, even if the loan originator organization has received compensation directly from the consumer in that transaction, is consistent with the statutory purpose of ensuring that a loan originator organization is not compensated by both the consumer and the creditor for the same transaction.

As discussed in more detail below, the Bureau also explained in the proposal that it believes the original purpose of the restriction in existing § 1026.36(d)(2) that prevents loan originator organizations from paying compensation in connection with a transaction to individual loan originators if the loan originator organization has received compensation directly from the consumer in that transaction is addressed separately by other revisions pursuant to the Dodd-Frank Act. Under existing § 1026.36(d)(1)(iii), compensation paid directly by a consumer to a loan originator effectively is free to be based on transaction terms or conditions. Consequently, individual loan originators could have incentives to steer a consumer into a transaction where the consumer compensates the loan originator organization directly, resulting in greater compensation to the loan originator organization than it likely would receive if compensated by the creditor subject to the restrictions of § 1026.36(d)(1). The Dodd-Frank Act, however, amended TILA to prohibit compensation based on loan terms even when a consumer is paying compensation directly to a mortgage originator. Thus, under the statute and the final rule, if an individual loan originator receives compensation in connection with the transaction from the loan originator organization (where the loan originator organization receives compensation directly from the consumer), the amount of the compensation paid by the consumer to the loan originator organization, and the amount of the compensation paid by the loan originator organization to the individual loan originator, may not be based on transaction terms.

In addition, the Bureau explained that it believed relaxing the rule might make more loan originator organizations willing to structure transactions where consumers pay loan originator compensation directly. The Bureau believed that this result may enhance the interests of consumers and the public by giving consumers greater flexibility in structuring the payment of loan originator compensation.

The Final Rule

As discussed in more detail below, the final rule adopts the Bureau's proposals relating to dual compensation with some revisions.

Compensation in connection with the transaction. Under existing § 1026.36(d)(2), if any loan originator receives compensation directly from a consumer in a transaction, no person other than the consumer may provide any compensation to a loan originator, directly or indirectly, in connection with that particular credit transaction. The Bureau believes that additional clarification may be needed about the term "in connection with" for purposes of § 1026.36(d)(2) (redesignated as § 1026.36(d)(2)(i)). Accordingly, the final rule revises comment 36(d)(2)-1 (redesignated as comment 36(d)(2)(i)-1) to clarify that, for purposes of § 1026.36(d)(2)(i), compensation is considered "in connection with" a particular transaction, regardless of whether this compensation is paid before, at, or after consummation. The Bureau believes that limiting the term "in connection with" a particular transaction for purposes of § 1026.36(d)(2) to compensation that is paid at or before consummation could allow creditors to evade the restriction in § 1026.36(d)(2) by simply paying the compensation after consummation, to the detriment of consumers.

The Bureau also believes that additional clarification is needed on whether the prohibition on dual compensation in § 1026.36(d)(2) (redesignated as § 1026.36(d)(2)(i)) restricts a creditor from providing any funds for the benefit of the consumer in a transaction, if the loan originator receives compensation directly from a consumer in connection with that transaction. The final rule amends comment 36(d)(2)-1 (redesignated as comment 36(d)(2)(i)-1) to provide that 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. See the section-by-section analysis of § 1026.36(a)(3) for a discussion of the definition of "compensation."

Compensation received directly from the consumer. As discussed above, under existing § 1026.36(d)(2), a loan originator that receives compensation directly from the consumer may not receive compensation in connection with the transaction (*e.g.*, a commission) from any other person (*e.g.*, a creditor). In addition, if *any* loan originator is paid compensation directly by the consumer in a transaction, no *other* loan originator (such as an employee of a loan originator organization) may receive compensation in connection with the transaction from another person. Moreover, if any loan originator receives compensation directly from a consumer, no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to a loan originator, directly or indirectly, in connection with the transaction. Existing comment 36(d)(1)-7 interprets when payments to a loan originator are considered compensation received directly from the consumer. As discussed in more detail in the section-by-section analysis of § 1026.36(d)(1)(iii), consistent with TILA section 129B(c)(1), the Bureau proposed to remove existing § 1026.36(d)(1)(iii), which allowed a loan originator to receive compensation based on any of the terms or conditions of a transaction, if the loan originator received compensation directly from the consumer in connection with the transaction and no other person provides compensation to a loan originator in connection with that transaction. The Bureau also proposed to remove the first sentence of existing comment 36(d)(1)-7, which stated that the prohibition in § 1026.36(d)(1)(i) that restricts a loan originator from receiving compensation based on the terms or conditions of a transaction does not apply to transactions in which any loan originator receives compensation directly from the consumer. The Bureau proposed to delete this first sentence as no longer relevant given that the Bureau proposed to remove § 1026.36(d)(1)(iii). The Bureau also proposed to move the other content of this comment to proposed comment 36(d)(2)(i)-2.i; no substantive change was intended.

The Bureau received one comment on proposed comment 36(d)(2)(i)-2.i. One industry commenter that specializes in the financing of manufactured housing indicated that the comment was confusing because its first sentence states that payments to a loan originator from loan proceeds are considered compensation received directly from the consumer, while payments derived from an increased interest rate are not considered compensation received directly from the consumer. The commenter believed that the second sentence of the proposed comment seemed to contradict the first sentence by stating that points paid on the loan by the consumer to the creditor are not considered payments to the loan originator that are received directly from the consumer whether they are paid directly by the consumer (for example, in cash or by check) or out of the loan proceeds. The commenter requested that the Bureau make clear that when a creditor, in establishing a charge to be imposed on a consumer, considers the average cost incurred by the creditor to originate residential mortgage loans of that type (including the compensation paid to an employee in connection with that particular transaction), then that compensation is deemed to be paid by the creditor and will not trigger any dual compensation prohibitions.

This final rule revises the first two sentences of proposed comment 36(d)(2)(i)-2.i, and deletes the third sentence of that proposed comment. The Bureau believes that these revisions will clarify that, while payments *by a consumer to a loan originator* from loan proceeds are considered compensation received directly from the consumer, payments *by the consumer to the creditor* are not considered payments to the loan originator that are received directly from the consumer whether they are paid in cash or out of the loan proceeds.

Existing comment 36(d)(2)-2 references Regulation X, which implements RESPA, and provides that a yield spread premium paid by a creditor to the loan originator may be characterized on the RESPA disclosures as a "credit" that will be applied to reduce the consumer's settlement charges, including origination fees. Existing comment 36(d)(2)-2 clarifies that a yield spread premium disclosed in this manner is not considered to be received by the loan originator directly from the consumer for purposes of § 1026.36(d)(2). The Bureau proposed to move this clarification to proposed comment 36(d)(2)(i)-2.ii and revise it, eliminating the reference to yield spread premiums and instead using the terms "rebate" and "credit." Rebates are disclosed as "credits" under the existing Regulation X disclosure regime.

The Bureau did not receive comments specifically on this aspect of the proposal. This final rule, however, revises proposed comment 36(d)(2)(i)-2.ii to further clarify the intent of the comment. Specifically, comment 36(d)(2)(i)-2.ii as adopted provides that funds from the creditor that will be applied to reduce the consumer's settlement charges, including origination fees paid by a creditor to the loan originator, that are characterized on the disclosures made pursuant to RESPA as a "credit" are nevertheless not considered to be received by the loan originator directly from the consumer for purposes of § 1026.36(d)(2)(i).

The Bureau also proposed to add § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii to provide additional clarity on the meaning of the phrase "compensation directly from the consumer" as used in new TILA section 129B(c)(2)(B), as added by section 1403 of the Dodd-Frank Act, and § 1026.36(d)(2) (as redesignated proposed § 1026.36(d)(2)(i)). Mortgage creditors and other industry representatives have raised questions about whether payments to a loan originator on behalf of the consumer by a person other than the creditor are considered compensation received directly from a consumer for purposes of existing § 1026.36(d)(2). For example, non-creditor sellers, home builders, home improvement contractors, or real estate brokers or agents may agree to pay some or all of the consumer's closing costs. Some of this payment may be used to compensate a loan originator. The Bureau proposed in § 1026.36(d)(2)(i)(B) to interpret the phrase "compensation directly from the consumer," as used in new TILA section 129B(c)(2)(B) and proposed § 1026.36(d)(2)(i), to include payments to a loan originator made pursuant to an agreement between the consumer and a person other than the creditor or its affiliates. Proposed comment 36(d)(2)(i)-2.iii would have clarified that whether there is an agreement between the parties will depend on State law. *See* § 1026.2(b)(3). Also, proposed comment 36(d)(2)(i)-2.iii would have clarified that the parties do not have to agree specifically that the payments will be used to pay for the loan originator's compensation, just that the person will make a payment toward the consumer's closing costs. For example, assume that a non-creditor seller has an agreement with the consumer to pay $1,000 of the consumer's closing costs on a transaction. Any of the $1,000 that is used to pay compensation to a loan originator is deemed to be compensation received directly from the consumer, even if the agreement does not specify that some or all of the $1,000 must be used to compensate the loan originator. In such cases, the loan originator would be permitted to receive compensation from both the consumer and the other person who has the agreement with the consumer (but not from any other person).

A few commenters raised concerns about these proposed revisions. A trade group representing mortgage brokers raised concerns that, without guidance on how and where to apply contributions from sellers and others, these proposed revisions would generate uncertainty leading to further frustration of both consumers and industry participants.

Three consumer groups, in a joint letter, indicated that the people the Bureau identifies—such as sellers, home improvement contractors, and home builders—have been implicated in every form of abusive lending. They cited as a risk of this proposal that third parties will simply inflate their charges by the amount of the payment toward the closing costs. They also stated that, in recent years, HUD has spent considerable energy investigating kickback arrangements between creditors and home builders. These consumer groups suggested an alternative to the proposal whereby, if a consumer and a third party have an agreement of the kind envisioned by the proposal, the third party can simply give the consumer a check, rather than permitting these payments to be "laundered" through the closing.

After consideration of the comments received, the Bureau has decided to revise proposed § 1026.36(d)(2)(i)(B) to clarify the intent of the provision. Specifically, § 1026.36(d)(2)(i)(B) is revised to provide that compensation received directly from a consumer includes payments to a loan originator made pursuant to an agreement between the consumer and a third party (*i.e.*, the seller or some other person that is not the creditor, loan originator, or an affiliate of either), under which such other person agrees to provide funds toward the consumer's cost of the transaction (including loan originator compensation). This final rule also revises related comments to provide additional interpretation. Specifically, comment 36(d)(2)(i)-2.i is revised to state that payments by the consumer to the creditor are not considered payments to the loan originator that are received directly from the consumer. Accordingly, comment 36(d)(2)(i)-2.iii has been revised to also state that payments in the transaction to the creditor on behalf of the consumer by a person other than the creditor or its affiliates are not considered payments to the loan originator that are received directly from the consumer. As proposed, comment 36(d)(2)(i)-2.iii stated that payments by a person other than the creditor or its affiliates *to the loan originator* pursuant to an agreement with the consumer are compensation directly by the consumer. Comment 36(d)(2)(i)-2.iii has been revised to state also that payments by a person other than the creditor or its affiliates *to the creditor* are not considered payments of compensation to the loan originator directly by the consumer. The Bureau believes that these revisions will help avoid the uncertainty cited by the industry commenters.

With regard to the comments received from several consumer groups discussed above, the Bureau notes that RESPA will still apply to these transactions to prevent illegal kickbacks, including kickbacks between the loan originator and a person that is not the creditor or its affiliate. For purposes of the dual compensation rules set forth in § 1026.36(d)(2), the Bureau continues to believe that arrangements where a person other than a creditor or its affiliate pays compensation to a loan originator on behalf of the consumer do not raise the same concerns as when that compensation is being paid by the creditor or its affiliates. The Bureau believes that one of the primary goals of section 1403 of the Dodd-Frank Act is to prevent a loan originator from receiving compensation both directly from a consumer and from the creditor or its affiliates, which more easily may occur without the consumer's knowledge. Allowing loan originators to receive compensation from both the consumer and the creditor can create inherent conflicts of interest, of which consumers may not be aware. When a loan originator organization charges the consumer a direct fee for originating the consumer's mortgage loan, this charge may lead the consumer to infer that the broker accepts the consumer-paid fee to represent the consumer's financial interests. Consumers also may reasonably believe that the fee they pay is the originator's sole compensation. This may lead reasonable consumers erroneously to believe that loan originators are working on their behalf and are under a legal or ethical obligation to help them obtain the most favorable loan terms and conditions. Consumers may regard loan originators as "trusted advisors" or "hired experts," and consequently rely on originators' advice. Consumers who regard loan originators in this manner may be less likely to shop or negotiate to assure themselves that they are being offered competitive mortgage terms.

The Bureau believes, however, that the statutory goals discussed above are facilitated by § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii. Under the final rule, a payment by a person other than a creditor or its affiliates to the loan originator is considered received directly from the consumer for purposes of § 1026.36(d)(2) only if the payment is made pursuant to an agreement between the consumer and that person. Thus, if there is an agreement, the consumer will be aware of the payment to the loan originator. In addition, because this payment to the loan originator would be considered compensation directly received from the consumer, the consumer remains the only person permitted to pay compensation in connection with the transaction to the loan originator, in accordance with § 1026.36(d)(2)(i). For example, the creditor or its affiliates could not pay compensation in connection with the transaction to the loan originator.

Moreover, the Bureau believes that § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii also benefit consumers in transactions where the consumer directly pays compensation to the loan originator. If a payment to the loan originator by a person other than the creditor or its affiliates were not deemed to be compensation coming directly from the consumer, the person would be prevented under existing § 1026.36(d)(2) from paying some of the compensation to the loan originator on behalf of the consumer pursuant to an agreement, if the consumer also pays some of the compensation to the loan originator. Thus, consumers could not receive the benefit of contributions by persons other than the creditor or its affiliates in these transactions unless such contributions were at least large enough to cover the loan originator's entire compensation.

As adopted in this final rule, under § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii, payment of loan originator compensation by an affiliate of the creditor, including a seller, home builder, or home improvement contractor, to a loan originator is not deemed to be made directly by the consumer for purposes of § 1026.36(d)(2)(i), even if the payment is made pursuant to an agreement between the consumer and the affiliate. That is, for example, if a home builder is an affiliate of a creditor, § 1026.36(d)(2)(i) prohibits this person from paying compensation in connection with a transaction if a consumer pays compensation to the loan originator in connection with the transaction. This final rule is consistent with existing § 1026.36(d)(3), which states that for purposes of § 1026.36(d) affiliates must be treated as a single "person." In addition, considering payments of compensation to a loan originator by an affiliate of the creditor to be payments made directly by the consumer could allow creditors to circumvent the restrictions in § 1026.36(d)(2)(i). A creditor could provide compensation to the loan originator indirectly by structuring the arrangement such that the creditor pays the affiliate and the affiliate pays the loan originator.

Prohibition on a loan originator receiving compensation in connection with a transaction from both the consumer and a person other than the consumer. As discussed above, under existing § 1026.36(d)(2), a loan originator that receives compensation directly from the consumer in a closed-end consumer credit transaction secured by a dwelling may not receive compensation from any other person in connection with the transaction. In addition, in such cases, no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to the loan originator in connection with the transaction. Existing comment 36(d)(2)-1 provides that, for purposes of § 1026.36(d)(2), compensation that is "in connection with the transaction" means 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. To illustrate: Assume that a loan originator organization receives compensation directly from the consumer in a mortgage transaction subject to § 1026.36(d)(2). Because the loan originator organization is receiving compensation directly from the consumer in this transaction, the loan originator organization is prohibited under § 1026.36(d)(2) from receiving compensation in connection with that particular transaction (*e.g.*, a commission) from a person other than the consumer (*e.g.*, the creditor). Similarly, a person other than the consumer may not pay the loan originator any compensation in connection with the transaction.

The Bureau generally proposed to retain the prohibition described above in existing § 1026.36(d)(2) (redesignated as proposed § 1026.36(d)(2)(i)), as consistent with the restriction on dual compensation set forth in TILA section 129B(c)(2). Specifically, TILA section

129B(c)(2)(A) provides that, for any mortgage loan, a mortgage originator generally may not receive from any person other than the consumer any origination fee or charge except bona fide third-party charges not retained by the creditor, the mortgage originator, or an affiliate of either. Likewise, no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third-party charges as described above. In addition, TILA section 129B(c)(2)(B) provides that a mortgage originator may receive an origination fee or charge from a person other than the consumer if, among other things, the mortgage originator does not receive any compensation directly from the consumer.

Pursuant to its authority under TILA section 105(a) to effectuate the purposes of TILA and facilitate compliance with TILA, in the proposal, the Bureau proposed to interpret "origination fee or charge" to mean compensation that is paid "in connection with the transaction," such as commissions, that are specific to, and paid solely in connection with, the transaction. In the proposal, the Bureau explained its belief that, if Congress intended the prohibitions on dual compensation to apply to salary or hourly wages that are not tied to a specific transaction, Congress would have used the term "compensation" in TILA section 129B(c)(2), as it did in TILA section 129B(c)(1), which prohibits compensation based on loan terms. Thus, the Bureau explained that, like existing § 1026.36(d)(2), TILA section 129B(c)(2) prohibits a mortgage originator that receives compensation directly from the consumer in a closed-end consumer credit transaction secured by a dwelling from receiving compensation, directly or indirectly, from any person other than the consumer in connection with the transaction.

Several industry trade groups and individual creditors disagreed with the Bureau's interpretation of the statutory term "origination fee or charge." Two trade groups believed that the Bureau should interpret the term "origination charge or fee" to include compensation paid in connection with a transaction only when that compensation is paid by the consumer to the creditor or the loan originator organization, or is paid by the creditor to the loan originator organization. These trade groups argued that the term "origination fee or charge" commonly refers to an amount paid to a creditor or loan originator organization, and is not generally understood to mean an amount of compensation paid to an individual loan originator. In addition, one of these trade groups indicated that there is no indication that Congress intended "origination fee or charge" to be considered compensation in connection with a transaction. This trade group commenter argued that Congress separately uses the term "origination fee or charge," the term "compensation," and the term "compensation that varies based on the terms of the loan," and that therefore, if Congress intended an origination fee or charge to be considered compensation in connection with a transaction, it could easily have written the statute that way. The other trade group argued that the statute's use of a variety of specific terms (*i.e.*, "origination fees or charges," "compensation," and "discount points, origination points, or fees") in TILA section 129B(c)(2) indicates that the provision was intended to apply only to circumstances in which a broker is involved and the creditor seeks to pay the broker's compensation. This commenter argued that, under that scenario, TILA section 129B(c)(2) would make sense, as typically a broker may receive amounts labeled as "origination fees or charges," or amounts labeled as "compensation." This commenter also argued that it is unlikely Congress intended to address circumstances in which a third party pays an origination fee or charge to an individual loan originator of the creditor, which is not a common practice.

In addition, a creditor commenter argued that the Bureau should interpret "origination fee or charge" to exclude compensation paid in connection with a transaction by a creditor to an individual loan originator. The creditor commenter noted that Regulation Z treats an origination fee or charge paid by the consumer to the creditor as a part of the finance charge but excludes salaries and commissions paid by creditors to retail loan originators from the finance charge. This commenter pointed out that other consumer credit laws and regulations, including statutes and regulations now administered by the Bureau, do not use the terms "origination fee" and "charge" to cover salaries or commissions paid to retail loan originators.

The Bureau continues to believe that the best interpretation of the statutory term "origination fee or charge" is that it means compensation that is paid "in connection with the transaction," such as commissions, that are specific to, and paid solely in connection with, the transaction. While the finance charge includes payments by the consumer to the creditor or mortgage broker, the Bureau does not believe that the finance charge is dispositive or, accordingly, that limiting the term "origination fee or charge" to payments by the consumer to the creditor or mortgage broker for purposes of this statutory provision is appropriate. TILA section 129B(c)(2) clearly contemplates that an "origination fee or charge" includes payments to a loan originator by a person other than the consumer. The provision in TILA section 129B(c)(2) prohibiting a loan originator from receiving an "origination fee or charge" from a person other than the consumer except in certain circumstances would be meaningless if the term "origination fee or charge" did not include payments from a person other than the consumer to a loan originator.

Because the term "origination fee or charge" must include payments from a person other than the consumer to at least some loan originators, the Bureau believes that the better reading of this term is to treat payments to loan originators consistently, regardless of whether the loan originator is an individual loan originator or a loan originator organization. Otherwise, compensation paid in connection with a transaction (such as a commission) paid by a creditor to a loan originator organization would be considered an "origination fee or charge," but a similar payment to an individual loan originator by the creditor would not be considered an "origination fee or charge." The Bureau notes that other provisions in TILA section 129B(c), such as the prohibition on loan originators receiving compensation based on loan terms, apply to loan originators uniformly, regardless of whether the loan originator is an individual loan originator or a loan originator organization.

TILA section 129B(c)(2) does not prohibit a mortgage originator from receiving payments from a person other than the consumer for bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator, even if the mortgage originator receives compensation directly from the consumer. For example, assume that a loan originator receives compensation directly from a consumer in a transaction. TILA section 129B(c)(2) does not bar the loan originator from receiving payment from a person other than the consumer (*e.g.*, a creditor) for bona fide and reasonable charges, such as credit reports, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. Because the loan originator does not retain such charges, they are not considered part of the loan originator's compensation for purposes of § 1026.36(d).

Consistent with TILA section 129B(c)(2), the Bureau proposed to amend existing comment 36(d)(1)-1.iii (redesignated as proposed comment 36(a)-5.iii) to clarify that the term "compensation" does not include amounts a loan originator receives as payment for bona fide and reasonable charges, such as credit reports, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. Thus, under proposed § 1026.36(d)(2)(i) and comment 36(a)-5.iii, a loan originator that receives compensation directly from a consumer would be permitted to receive a payment from a person other than the consumer for bona fide and reasonable charges where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator.

For example, assume a loan originator receives compensation directly from a consumer in a transaction. Further assume the loan originator charges the consumer $25 for a credit report provided by a third party that is not the creditor, its affiliate, or the affiliate of the loan originator, and this fee is bona fide and reasonable. Assume also that the $25 for the credit report is paid by the creditor but the loan originator does not retain this $25. Instead, the loan originator pays the $25 to the third party for the credit report. The loan originator in that transaction is not prohibited by proposed § 1026.36(d)(2)(i) from receiving the $25 from the creditor, even though the consumer paid compensation to the loan originator in the transaction.

In addition, under proposed § 1026.36(d)(2)(i) and comment 36(a)-5.iii, a loan originator that receives compensation in connection with a transaction from a person other than the consumer could receive a payment from the consumer for a bona fide and reasonable charge where the amount of that charge is not retained by the loan originator but is paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. For example, assume a loan originator receives compensation in connection with a transaction from a creditor. Further assume the loan originator charges the consumer $25 for a credit report provided by a third party that is not the creditor, its affiliate, or the affiliate of the loan originator, and this fee is bona fide and reasonable. Assume the $25 for the credit report is paid by the consumer to the loan originator but the loan originator does not retain this $25. Instead, the loan originator pays the $25 to the third party for the credit report. The loan originator in that transaction is not prohibited by proposed § 1026.36(d)(2)(i) from receiving the $25 from the consumer, even though the creditor paid compensation to the loan originator in connection with the transaction.

As discussed in more detail in the section-by-section analysis of proposed § 1026.36(a), proposed comment 36(a)-5.iii also recognized that, in some cases, amounts received for payment for such third-party charges may exceed the actual charge because, for example, the loan originator cannot determine precisely what the actual charge will be at the time the charge is imposed and instead uses average charge pricing (in accordance with RESPA). In such a case, under proposed comment 36(a)-5.iii, the difference retained by the originator would not have been deemed compensation if the third-party charge collected from the consumer or a person other than the consumer was bona fide and reasonable, and also complied with State and other applicable law. On the other hand, if the originator marks up a third-party charge and retains the difference between the actual charge and the marked-up charge (a practice known as "upcharging"), the amount retained is compensation for purposes of § 1026.36(d) and (e). Proposed comment 36(a)-5.iii contained two illustrations, which are discussed in more detail in the section-by-section analysis of § 1026.36(a).

As discussed in more detail in the section-by-section analysis of § 1026.36(a), the final rule adopts 36(a)-5.iii as proposed in substance, except that the interpretation discussing situations where the amounts received for payment for third-party charges exceeds the actual charge has been moved to comment 36(a)-5.v.

In addition, the final rule adds comment 36(a)-5.iv to clarify whether payments for services that are not loan origination activities are compensation under § 1026.36(a)(3). As adopted in the final rule, comment 36(a)-5.iv.A clarifies that the term "compensation" for purposes of § 1026.36(a)(3) does not include: (1) a payment received by a loan originator organization for bona fide and reasonable charges for services it performs that are not loan origination activities; (2) a payment received by an affiliate of a loan originator organization for bona fide and reasonable charges for services it performs that are not loan origination activities; or (3) a payment received by a loan originator organization for bona fide and reasonable charges for services that are not loan origination activities where those amounts are not retained by the loan originator organization but are paid to the creditor, its affiliate, or the affiliate of the loan originator organization. Comment 36(a)-5.iv.C as adopted clarifies that loan origination activities, for purposes of that comment means activities described in § 1026.36(a)(1)(i) (*e.g.*, taking an application, arranging, assisting, offering, negotiating, or otherwise obtaining an extension of consumer credit for another person) that would make a person performing those activities for compensation a loan originator as defined in § 1026.36(a)(1)(i).

Thus, under § 1026.36(d)(2)(i) and comment 36(a)-5.iv as adopted in the final rule, a loan originator organization that receives compensation in connection with a transaction from a person other than the consumer (*e.g.*, creditor) would not be prohibited under § 1026.36(d)(2)(i) from receiving a payment from the consumer for a bona fide and reasonable charge for services that are not loan origination activities where (1) the loan originator organization itself performs those services; or (2) the payment amount is not retained by the loan originator organization but is paid to the creditor, its affiliate, or the affiliate of the loan originator organization, as described in comment 36(a)-5.iv.A.*1* and .*3*. Likewise, a loan originator organization that receives compensation directly from a consumer would not be prohibited under § 1026.36(d)(2)(i) from receiving a payment from a person other than the consumer for bona fide and reasonable charges for services that are not loan origination activities as described above.

In addition, a loan originator organization's affiliate would not be prohibited under § 1026.36(d)(2)(i) from receiving from a consumer a payment for bona fide and reasonable charges for services it performs that are not loan origination activities; as described in comment 36(a)-5.iv.A.*2*, even if the loan originator organization receives compensation in connection with a transaction from a person other than the consumer (*e.g.*, the creditor). Similarly, a loan originator organization's affiliate would not be prohibited under § 1026.36(d)(2)(i) from receiving from a person other than the consumer (*e.g.*, a creditor) a payment for bona fide and reasonable charges for services the affiliate performs that are not loan origination activities; as described in comment 36(a)-5.iv.A.*2*, even if the loan originator organization receives compensation directly from a consumer in connection with a transaction.

Moreover, as discussed above, the final rule moves the interpretation in proposed comment 36(a)-5.iii discussing situations where the amounts received for payment for third-party charges exceeds the actual charge to comment 36(a)-5.v, and revises it. The final rule also extends this interpretation to amounts received by the loan originator organization for payment for services that are not loan origination activities where those amounts are not retained by the loan originator but are paid to the creditor, its affiliate, or the affiliate of the loan originator organization. See the section-by-section analysis of § 1026.36(a)(3) for a more detailed discussion.

If any loan originator receives compensation directly from the consumer, no other loan originator may receive compensation in connection with the transaction. Under existing

§ 1026.36(d)(2), if any loan originator is paid compensation directly by the consumer in a transaction, no other loan originator may receive compensation in connection with the transaction from a person other than the consumer. For example, assume that a loan originator organization receives compensation directly from the consumer in a mortgage transaction subject to § 1026.36(d)(2). The loan originator organization may not receive compensation in connection with the transaction (*e.g.*, a commission) from a person other than the consumer (*e.g.*, the creditor). In addition, the loan originator organization may not pay individual loan originators any transaction-specific compensation, such as commissions, in connection with that particular transaction. Nonetheless, the loan originator organization may pay individual loan originators a salary or hourly wage or other compensation that is not tied to the particular transaction. *See* existing comment 36(d)(2)-1. In addition, a person other than the consumer (*e.g.*, the creditor) may not pay compensation in connection with the transaction to any loan originator, such as a loan originator that is employed by the creditor or by the loan originator organization.

TILA section 129B(c)(2), which was added by section 1403 of the Dodd-Frank Act, generally is consistent with the above prohibition in existing § 1026.36(d)(2) (redesignated as proposed § 1026.36(d)(2)(i)). 12 U.S.C. 1639b(c)(2). TILA section 129B(c)(2)(B) provides that a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if: (1) "the mortgage originator does not receive any compensation directly from the consumer;" and (2) "the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third-party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator)." As discussed above, the Bureau interprets "origination fee or charge" to mean compensation that is paid "in connection with the transaction," such as commissions, that are specific to, and paid solely in connection with, the transaction. The individual loan originator is the one that is receiving compensation in connection with a transaction from a person other than the consumer, namely the loan originator organization. Thus, TILA section 129B(c)(2)(B) permits the individual loan originator to receive compensation tied to the transaction from the loan originator organization if: (1) the individual loan originator does not receive any compensation directly from the consumer; and (2) the consumer does not make an upfront payment of discount points, origination points, or origination fees, however denominated (other than bona fide third-party charges not retained by the individual loan originator, creditor, or an affiliate of the creditor or originator). The individual loan originator is not deemed to be receiving compensation in connection with the transaction from a consumer simply because the loan originator organization is receiving compensation from the consumer in connection with the transaction. The loan originator organization and the individual loan originator are separate persons. Nonetheless, the consumer is making "an upfront payment of discount points, origination points, or fees" in the transaction when it pays the loan originator organization compensation. The payment of the origination point or fee by the consumer to the loan originator organization is not a bona fide third-party charge under TILA section 129B(c)(2)(B)(ii). Thus, because the loan originator organization has received an upfront payment of origination points or fees from the consumer in the transaction, unless the Bureau exercises its exemption authority as discussed in more detail below, no loan originator (including an individual loan originator) may receive compensation tied to the transaction from a person other than the consumer.

Nonetheless, TILA section 129B(c)(2)(B) also provides the Bureau authority to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points or origination fees, where it determines that doing so is in the interest of consumers and in the public interest. Pursuant to this waiver or exemption authority, the Bureau proposed to add § 1026.36(d)(2)(i)(C) to provide that, even if a loan originator organization receives compensation directly from a consumer in connection with a transaction (*i.e.*, in the form of the upfront payment of discount points, origination points or origination fees), the loan originator organization may pay compensation to individual loan originators, and the individual loan originators may receive compensation from the loan originator organization (but the individual loan originators may not receive compensation directly from the consumer). The Bureau also proposed to amend comment 36(d)(2)-1 (redesignated as proposed comment 36(d)(2)(i)-1) to be consistent with proposed § 1026.36(d)(2)(i)(C).

In the supplementary information to the proposal, the Bureau stated its belief that the risk of harm to consumers that the existing restriction was intended to address would be likely no longer present, in light of new TILA section 129B(c)(1). Under existing § 1026.36(d)(1)(iii), compensation paid directly by a consumer to a loan originator is permitted to be based on transaction terms or conditions. Thus, if a loan originator organization were allowed to pay an individual loan originator it employs a commission in connection with a transaction, the individual loan originator could have incentives to steer the consumer into a loan with terms and conditions that would produce greater compensation to the loan originator organization, and the individual loan originator, because of this steering, could receive greater compensation if he or she were allowed to receive compensation in connection with the transaction. However, the risk is now expressly addressed by the Dodd-Frank Act. Specifically, TILA section 129B(c)(1), as added by section 1403 of the Dodd-Frank Act, prohibits any compensation based on loan terms, including compensation paid by a consumer directly to a mortgage originator. 12 U.S.C. 1639b(c)(1). Thus, pursuant to TILA section 129B(c)(1), and under proposed § 1026.36(d)(1) as amended in this final rule, even if an individual loan originator is permitted to receive compensation in connection with the transaction from the loan originator organization where the loan originator organization receives compensation directly from the consumer, the amount of the compensation paid by the consumer to the loan originator organization, and the amount of the compensation paid by the loan originator organization to the individual loan originator, cannot be based on transaction terms.

In the supplementary information to the proposal, the Bureau also stated its belief that it would be in the interest of consumers and in the public interest to allow loan originator organizations to pay compensation in connection with the transaction to individual loan originators, even when the loan originator organization is receiving compensation directly from the consumer. As discussed above, the Bureau believed the risk of the harm to the consumer that the restriction was intended to address would be remedied by the statutory amendment prohibiting even compensation that is paid by the consumer from being based on the terms of the transaction. With that protection in place, allowing this type of compensation to the individual loan originator no longer would present the same risk to the consumer of being steered into a transaction involving direct compensation from the consumer because both the loan originator organization and the individual loan originator can realize greater compensation. In addition, with this proposed revision, more loan originator organizations might be willing to structure transactions where consumers pay loan originator compensation directly. Loan originator organizations had expressed concern that currently it is difficult to structure transactions where consumers pay loan originator organizations compensation directly, because it is not economically feasible for the organizations to pay their individual loan originators purely a salary or hourly wage, instead of a commission that is tied to the particular transaction either alone or in combination with a base salary. The Bureau believed that this proposal would enhance the interests of consumers and the public by giving consumers greater flexibility in structuring the payment of loan originator compensation. In a transaction where the consumer pays compensation directly to the loan originator, the amount of the compensation may be more transparent to the consumer. In addition, in these transactions, the consumer may have more flexibility to choose the pricing of the loan. In a transaction where the consumer pays compensation directly to the loan originator, the consumer would know the amount of the loan originator compensation and could pay all of that compensation up front, rather than the creditor determining the compensation and recovering the cost of that compensation from the consumer through the rate, or a combination of the rate and upfront origination points or fees.

The Bureau received comments from two trade groups representing mortgage brokers, which favored this aspect of the proposal. In addition, in the Bureau's outreach, consumer groups agreed that loan originator organizations that receive compensation directly from a consumer in a transaction should be permitted to pay individual loan originators that work for the organization compensation in connection with the transaction, such as a commission. For the reasons discussed above, the final rule adopts § 1026.36(d)(2)(i)(C) and related provisions in comment 36(d)(2)(i)-1 as proposed. The Bureau has determined that it is in the interest of consumers and in the public interest to allow a loan originator organization to pay individual loan originators compensation in connection with the transaction. It is in the public interest even when the loan originator organization has received compensation in connection with the transaction directly from the consumer, given than neither the organization's nor the individual originator's compensation may be based on the terms of the transaction.

36(d)(2)(ii) Exemption

The Dodd-Frank Act

The Dodd-Frank Act contains a number of discrete provisions addressing points and fees paid by consumers in connection with mortgages. Section 1412 of the Dodd-Frank Act adds new TILA section 129C(b) which defines the criteria for a "qualified mortgage" as to which there is a presumption of compliance with the new ability-to-repay rules prescribed in accordance with TILA section 129C(a), as added by section 1411 of the Dodd-Frank Act. Under new TILA section 129C(b), one of the criteria for a qualified mortgage is that the total "points and fees" paid do not exceed 3 percent of the loan amount.[146] *See* TILA section 129C(b)(2)(A)(vii), as added by section 1412 of the Dodd-Frank Act. In making this calculation, up to two "bona fide discount points" may be excluded from the 3 percent threshold.[147] TILA section 129C(b)(2)(C)(ii). In a similar vein, section 1431 of the Dodd-Frank Act amends TILA section 103(aa)(1) to create a new definition of "high cost mortgage."[148] Under that new definition, a mortgage qualifies as a "high cost mortgage" if any of the prescribed coverage tests are met, including if the "points and fees" charged on the mortgage exceed defined thresholds.[149] TILA

[146] The term "points and fees" for purposes of new TILA section 129C(b) is defined in new TILA section 129C(b)(2)(C), as added by section 1412 of the Dodd-Frank Act.
[147] The term "bona fide discount points" for purposes of new TILA section 129C is defined in new TILA section 129C(b)(2)(C)(iii).
[148] The Dodd-Frank Act amends existing TILA section 103(aa) and renumbers it as section 103(bb).
[149] The term "points and fees" for purposes of TILA section 103(bb)(1) is defined in TILA section 103(bb)(4), as revised by section 1431 of the Dodd-Frank Act.

section 103(bb)(1). For these purposes too, up to two “bona fide discount points” may be excluded.[150] TILA section 103(dd).

At the same time that Congress enacted these provisions, new TILA section 129B(c)(2) was added by section 1403 of the Dodd-Frank Act. That new TILA section provides in relevant part that a mortgage originator can receive an “origination fee or charge” from someone other than a consumer (*e.g*. from a creditor or loan originator organization) if, but only if, “the mortgage originator does not receive any compensation directly from the consumer” and the consumer “does not make an upfront payment of discount points, origination points, or fees (other than bona fide third-party charges not retained by the mortgage originator, creditor or an affiliate of the creditor or originator”).” However, TILA section 129B(c)(2)(B), as amended by section 1100A of the Dodd-Frank Act, also provides the Bureau authority to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points or origination fees where the Bureau determines that doing so “is in the interest of consumers and in the public interest.”

The Bureau understands and interprets the phrase “origination fee or charge” as used in new TILA section 129B(c)(2) to mean compensation that is paid “in connection with the transaction,” such as commissions that are specific to, and paid solely in connection with, the transaction. Thus, if the statutory ban were allowed to go into effect as it reads, the prohibition in TILA section 129B(c)(2)(B)(ii) on the consumer paying upfront discount points, origination points, or origination fees would apply in residential mortgage transactions where: (1) the creditor pays compensation in connection with the transaction (*e.g.*, a commission) to individual loan originators, such as the creditor’s employees; (2) the creditor pays a loan originator

[150] The term “bona fide discount points” for purposes of TILA section 103(bb)(1) is defined in new TILA section 103(dd), as added by section 1431 of the Dodd-Frank Act.

organization compensation in connection with a transaction, regardless of how the loan originator organization pays compensation to individual loan originators; and (3) the loan originator organization receives compensation directly from the consumer in a transaction and pays individual loan originators compensation in connection with the transaction.[151] The prohibition in TILA section 129B(c)(2)(B)(ii) on the consumer paying upfront discount points, origination points, or origination fees in a residential mortgage transaction generally would not apply where: (1) the creditor pays individual loan originators, such as the creditor's employees, only in the form of a salary, hourly wage or other compensation that is not tied to the particular transaction; or (2) the loan originator organization receives compensation directly from the consumer and pays individual loan originators that work for the organization only in the form of a salary, hourly wage, or other compensation that is not tied to the particular transaction.

The Bureau understands that in most mortgage transactions today, loan originators typically receive compensation tied to a particular transaction (such as a commission) from a person other than the consumer. For example, in transactions that involve loan originator organizations, creditors typically pay a commission to the loan originator organization. In addition, in transactions that do not involve loan originator organizations, creditors typically pay a commission to the individual loan originators that work for the creditors. Thus, absent a waiver or exemption by the Bureau, substantially all mortgage transactions would be covered by TILA section 129B(c)(2) and would be subject to the statutory ban on upfront points and fees.

[151] In this final rule, the Bureau uses its exemption authority in TILA section 129B(c)(2)(B)(ii) to permit a loan originator organization to pay compensation in connection with a transaction to individual loan originators, even if the loan originator organization received compensation directly from the consumer, so long as the individual loan originator does not receive compensation directly from the consumer. *See* the section-by-section analysis of § 1026.36(d)(2)(i) for a detailed discussion. Nonetheless, these transactions would be subject to the restriction on upfront points and fees in TILA section 129B(c)(2)(B)(ii), unless the Bureau exercises its exemption authority.

Such a ban on upfront points and fees would have two foreseeable impacts. First, the ban would result in a predictable increase in mortgage interest rates. Creditors incur significant costs in originating a mortgage, including marketing, sales, underwriting, and closing costs. Typically, creditors recover some or all of those costs through upfront charges paid by the consumer. These charges can take the form of flat fees (such as an application fee or underwriting fee) or fees stated as a percentage of the mortgage ("origination points"). If creditors were prohibited from assessing these upfront charges, creditors would necessarily need to increase the interest rate on the loan to recoup the upfront costs. Creditors who hold loans in portfolio would then earn back these fees over time through higher monthly payments; creditors who sell loans into the secondary market would expect to earn through the sale what would otherwise have been earned through upfront points and fees.

Second, implementation of the statutory ban on points and fees would necessarily limit the range of pricing options available to consumers. Creditors today typically offer a variety of pricing options on closed-end mortgages, such that consumers generally have the ability to buy down the interest rate on a loan by paying "discount points." *i.e.*, upfront charges, stated as a percentage of the loan amount, and offered in return for a reduction in the interest rate. For creditors who hold loans in portfolio, discount points are intended to make up for the revenue that will be foregone over time due to lower monthly payments; for creditors who sell loans into the secondary market, the discount points are designed to compensate for the lower purchase price that the mortgage will attract because of its lower interest rate. In a similar vein, many creditors offer consumers the opportunity to, in essence, buy "up" the interest rate in order to reduce or eliminate the upfront costs that would otherwise be assessed. If the statutory ban were allowed to go into effect, creditors would no longer be able to offer pricing options to consumers in any transaction in which a loan originator is paid compensation (*e.g.*, commission) tied to the transaction.

The Bureau's Proposal

In developing its proposal, the Bureau concluded that, in light of concerns about the impact of the statutory ban on the price of mortgages, the range of consumers' choices in mortgage pricing, and consumers' access to credit, it would not be in the interest of consumers or in the public interest to permit the prohibition to take effect. The Bureau sought instead to develop an alternative which would establish conditions under which upfront points and fees could be charged that would better serve the interest of consumers and the public interest than simply waiving the prohibition or allowing it to take effect.

During the Small Business Review Panel process, as discussed in part II, the Bureau sought comment on an alternative which would have allowed creditors to charge discount points and origination fees that could not vary with the size of the transaction (*i.e.*, flat fees) but would not have permitted creditors to charge origination points. The alternative would have also required creditors to provide consumers with a bona fide reduction in the interest rate for each discount point paid and to offer an option of a no discount point loan. The intent of this alternative was to address potential consumer confusion between discount points, which are paid by the consumer at the consumer's option to obtain a reduction in the interest rate, and other origination charges which the originator assesses. The Small Entity Representatives who participated in the Small Business Review Panel process were unanimous in opposing the requirement that fees could not vary with the size of the transaction and generally opposed the bona fide discount point requirement. The Bureau also reviewed the alternative with various industry and consumer stakeholders. The industry stakeholders were also generally opposed to both the requirement that fees could not vary with the size of the transaction and the bona fide discount point fee requirement, while consumer groups held mixed views. As a result of the lack of general support for the Bureau's approach to flat fees, the view that some costs do vary with the size of the transaction, and the fact that the distinction between origination and discount points may not be the most relevant one from the consumer's perspective, the Bureau abandoned the flat fee aspect of the alternative in developing its proposal.

Instead, proposed § 1026.36(d)(2)(ii) would have generally required that, before a creditor or loan originator organization may impose upfront points or fees on a consumer in a closed-end mortgage transaction in which the creditor or loan originator organization will also pay a loan originator compensation tied to the transaction, the creditor must make available to the consumer a comparable, alternative loan with no upfront discount points, origination points, or origination fees that are retained by the creditor, broker, or an affiliate of either (a "zero-zero alternative"). The requirement would not have been triggered if the only upfront charges paid by a consumer are charges that are passed on to independent third parties that are not affiliated with the creditor or loan originator organization. The requirement also would not have applied where the consumer is unlikely to qualify for the zero-zero alternative. To facilitate shopping based on the zero-zero alternative, the proposal would have provided a safe harbor for compliance with the requirement to make available the zero-zero alternative to a consumer if any time prior to providing the disclosures required by RESPA after application that the creditor provides a consumer an individualized quote for the interest rate or other key terms for a loan that includes upfront points and fees, the creditor also provides a quote for a zero-zero alternative.

Thus, the Bureau proposed to structure the use of its exemption authority to enable consumers to receive the benefits of obtaining loans that do not include discount points, origination points or origination fees, while preserving consumers' ability to choose a loan with upfront points and fees. The Bureau believed the proposal would address the problems in the current mortgage market that the Bureau believes the prohibition on discount points, origination points or origination fees was designed to address by advancing two goals: (1) facilitating consumer shopping by enhancing the ability of consumers to make comparisons using transactions that do not include discount points, origination points or origination fees available from different creditors as a basis for comparison; and (2) enhancing consumer decision-making by facilitating a consumer's ability to understand and make meaningful trade-offs on transactions available from a particular creditor of paying discount points, origination points or origination fees in exchange for a lower interest rate. Underlying both these goals was the concern that some consumers may be harmed by paying points and fees in certain circumstances.

The Bureau also sought comment on a number of related issues, including:

- whether the Bureau should adopt a "bona fide" requirement to ensure that consumers receive value in return for paying upfront points and/or fees and, if so, the relative merits of several alternatives on the details of 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 require that a consumer may not pay upfront points and fees unless the consumer qualifies for the zero-zero alternative; and
- whether to require information about the zero-zero alternative to be provided not just in connection with customized quotes given prior to application, but also in

advertising and at the time that consumers are provided disclosures within three days after application.

Comments Received on the Proposal

Consumer group commenters. There was no consensus among consumer groups on whether, and how, the Bureau should use its exemption authority regarding the statutory ban on consumers paying upfront points and fees. Four consumer groups argued that the Bureau should allow the statutory ban to go into effect. These consumer groups asserted that paying points is generally a bad idea for most consumers given the time it takes to recoup the cost, the difficulty of predicting whether the consumer will refinance or sell before that time comes, the mathematical difficulty of calculating when that time is, and the difficulty of comparing a variety of different offers. These consumer groups indicated that in transactions where the creditor compensates the loan originator, creditors typically increase the interest rate to some extent to recoup at least in part the compensation paid to the loan originators. These consumer groups indicated that consumers pay fees in the expectation of decreasing the interest rate. The consumer groups asserted that when both upfront fees and interest rates that are increased to pay loan originator compensation are present in the transaction, the consumer's payment of cash, paid to buy down the interest rate, is wasted because the creditor has brought the interest rate up. These consumer groups also asserted that this "see-saw" of incentive payments obscures the cost of credit to consumers and results in higher costs for consumers.

These consumer groups also opposed the Bureau's proposal on the zero-zero alternative based on concerns that the Bureau's proposal would be a very difficult rule to enforce and very easy to manipulate. These consumer groups indicated that additional rules to address these risks will only add greater complexity to the rules. These consumer groups stated that if the Bureau decides to use its exemption authority, creditors should only be allowed to offer or disclose a loan with upfront points and fees upon a consumer's written request.

Other consumer groups, however, advocated different approaches. One consumer group supported the Bureau's use of its exemption authority because this group believed that use of origination fees to cover origination costs and discount points to reduce the interest rate for a loan can provide value to the borrower in certain circumstances and that other protections regarding points and fees in the Dodd-Frank Act will decrease the risks to consumers from paying upfront points and fees. Specifically, this commenter pointed out additional protections on points and fees contained in the Dodd-Frank Act, such as limits on points and fees for qualified mortgages as implemented by the 2013 ATR Final Rule, and new disclosures to be issued by the Bureau when the 2012 TILA-RESPA Proposal is finalized that will provide a clearer description of points and fees paid on loans. Nonetheless, this consumer group did not support the Bureau's proposal regarding the zero-zero alternative. This consumer group believed that requiring creditors to offer a product with no upfront origination fees or discount points would not provide significant protections to borrowers, would likely be confusing to consumers, and could also harm creditors. For example, this commenter stated that while the zero-zero alternative offered by a particular creditor may be less complicated than other options that creditors offer, it may not be the best deal for the consumer. Because the zero-zero alternative would be a required disclosure, creditors may be discouraged from making the case to the consumer that a zero-zero alternative is less advantageous, even when it really is. This consumer group suggested that in lieu of the zero-zero alternative, creditors should be required to disclose all points and fees charged when they give a quote to a borrower.

Other consumer groups generally supported the Bureau's use of its exemption authority and supported the proposal regarding the zero-zero alternative with some revisions. Suggestions for revisions included requiring information about zero-zero alternatives to be provided at the time that consumers are provided disclosures within three days after application.

Industry commenters. All of the industry commenters stated that the Bureau should use its exemption authority so that the statutory ban on upfront points and fees does not go into effect. Most industry commenters raised concerns about access to credit if the statutory ban on upfront points and fees went into effect, or if a creditor was restricted in making a loan with upfront points and fees unless the creditor also makes available the zero-zero alternative. Several industry commenters indicated that some consumers will not qualify for the loans without upfront points and fees because of debt-to-income requirements. If the statutory ban were allowed to go into effect, these consumers would not have the opportunity to pay upfront points and fees to lower the interest rate so that they could qualify for the loan.

Some industry commenters also indicated that loans without upfront points and fees are not always feasible for all consumers and all types of loans. In some cases, creditors cannot recover foregone origination fees by increasing the interest rate on the loan because the incremental premium paid by the secondary market for loans with higher interest rates may be insufficient, especially for smaller loans or higher-risk borrowers. In addition, one GSE indicated that an increase in loans without upfront points and fees could have an impact on prepayment speed which could reduce the value of mortgage securities and thereby drive up mortgage prices (interest rates). Some industry commenters also noted that some mortgage programs, particularly those designed for lower income people, do not allow the creditor to vary origination fees, or may cap the interest rate on the loan such as it would be difficult for the creditor to recoup the entire origination costs through a higher interest rate. Many industry commenters also raised concerns that the loans without points and fees and higher interest rates might trigger APR thresholds for high-cost loans under § 1026.32 and/or similar state laws, and state that creditors typically are not willing to make these types of high-cost loans.

In addition, some industry commenters also raised concerns about managing prepayment risk for portfolio lending if they were limited in their ability to impose upfront points and fees (especially because they will be limited in imposing prepayment penalties under the 2013 ATR Final Rule and the 2013 HOEPA Final Rule). One industry trade group noted that financial institution prudential regulators have previously warned institutions about offering zero-zero loans, as they tend to have significantly higher prepayment speeds.

One industry trade group commenter also stated that if the statutory ban on upfront points and fees were to go into effect, it would require creditors in the vast majority of transactions in today's market to restructure their current pricing practices or compensation. This trade group indicated that some community bankers have informed it that those community banks will discontinue their mortgage lines. The trade group indicated that the short-term effects would be very damaging, as mortgage sources would shrink, and rates would rise since originators that cannot receive upfront points or fees from the consumer would be forced to recoup their origination costs through higher rates. Several credit union commenters also were concerned about the cost of complying with the proposal requiring a zero-zero alternative and a bona fide trade-off, indicating that implementation, training and system changes would be expensive and resource intensive. These credit union commenters indicated that some smaller institutions like credit unions and community banks may deem the cost too high and exit the mortgage business, leaving the largest mortgage loan operators with more market share and consumers with fewer choices.

Nearly all of the industry commenters also stated that the zero-zero alternative as proposed was unworkable or undesirable. Industry commenters raised a number of compliance and operational issues, such as the difficulty in determining pre-application whether a consumer is likely to qualify for the zero-zero alternative.

Some industry commenters also questioned whether the zero-zero alternative, as proposed, would be beneficial to consumers. Several commenters raised concerns that consumers when they are given information about the zero-zero alternative might be confused about why they are receiving such information and might believe that the zero-zero loan was always the best option for them even when it is not. Some commenters expressed concern that consumers may be confused by receiving information about a zero-zero alternative that they did not request. Some commenters also indicated that including information about the zero-zero alternative in advertisements might not in fact enable consumers properly to determine the lowest cost loan, especially if affiliates' fees were treated as upfront points and fees, but non-affiliates, third-party fees were not. Some of these commenters also urged the Bureau to conduct consumer testing on the zero-zero alternative, similar to what it has done to prepare to integrate the existing mortgage loan disclosures under TILA and RESPA.

Many industry commenters suggested that the Bureau should provide a complete exemption. These commenters generally believed that the Bureau should continue to study the impact of regulating points and fees instead of finalizing an approach in January 2013. Some of these commenters stated that the Bureau should study the impacts of the other Title XIV rulemakings on the mortgage market before adopting any new regulation on upfront points and fees, while other commenters stated that the Bureau should address the issue as part of finalizing the 2012 TILA-RESPA Proposal. Other industry commenters did not advocate for a complete exemption, but instead advocated for various different approaches than the zero-zero alternative as proposed. Suggested alternatives included requiring creditors to provide a generic disclosure stating that additional options for rates, fees, and payments are available, to make the zero-zero alternative available only upon request of the consumer, or to disclose the loan with the fewest points and fees for which the consumer is likely to qualify. Finally, other industry commenters stated that the zero-zero alternative approach was unworkable but did not suggest alternative approaches.

State bank supervisor commenters. A group submitting comments on behalf of State bank supervisors supported the zero-zero alternative without suggesting any revisions.

The Final Rule

Use of the Bureau's exemption authority. As discussed in more detail below, the Bureau adopts in this final rule a complete exemption to the statutory ban on upfront points and fees set forth in TILA section 129B(c)(2)(B)(ii). Specifically, this final rule revises proposed § 1026.36(d)(2)(ii) to provide that a payment to a loan originator that is otherwise prohibited by section 129B(c)(2)(A) of the Truth in Lending Act is nevertheless permitted pursuant to section 129B(c)(2)(B) of the Act, regardless of whether the consumer makes any upfront payment of discount points, origination points, or fees, as described in section 129B(c)(2)(B)(ii) of the Act, as long as the loan originator does not receive any compensation directly from the consumer as described in section 129B(c)(2)(B)(i) of the Act.

The Bureau is including § 1026.36(d)(2)(ii) in the final rule under its authority in TILA section 129B(c)(2)(B), as amended by section 1100A of the Dodd-Frank Act, to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points or origination fees where the Bureau determines that doing so is in the interest of consumers and in the public interest.[152] The Bureau has determined that it is in the interest of consumers and in the public interest to exercise its exemption authority in this way, to avoid the detrimental effect of the statutory ban on consumers paying upfront points and fees. The Bureau's exercise of the exemption authority will preserve access to credit and consumer choice. The complete exemption also will allow the Bureau to continue to conduct consumer testing and market research to improve its ability to regulate upfront points and fees in a way that maximizes consumer protection while preserving access to credit and empowering consumer choice. The Bureau is concerned that the alternative it proposed might not serve consumers or the public. Accordingly, the proposed exemption from the statutory prohibition as described above, and contained in proposed § 1026.36(d)(2)(ii), is not adopted

As explained above, eliminating upfront points and fees would result in an increase in interest rates and thus in monthly payments. The Bureau is concerned that, at the margins, some consumers would not qualify for the loans at the higher interest rate because of debt-to-income ratio underwriting requirements. If the statutory ban were allowed to go into effect, these consumers would not have the opportunity to pay upfront points and fees to lower the interest rate so that they could qualify for the loan.

In addition, the Bureau is concerned that it may not always be feasible for a creditor to offer loans without upfront points and fees to all consumers and various types of loan products.

[152] The Bureau's inclusion of § 1026.36(d)(2)(ii) of the final rule is also an exercise of its exemption authority under TILA section 105(a). This exemption will effectuate the purpose stated in TILA section 129B of ensuring that responsible, affordable mortgage credit remains available to consumers by preserving access to credit and consumer choice in credit as explained in this supplementary information.

In some cases, increasing the interest rate on a loan will not generate sufficient incremental premium to allow creditors to cover their costs, especially for smaller loans or higher-risk borrowers. For example, one commenter indicated that historical data shows that premiums paid by the secondary market for 30-year fixed-rate mortgages have, at times, made it difficult for creditors to recover foregone upfront charges by increasing the interest rate. The commenter noted, for example, that prior to 2009, when the Board was not generally a purchaser of mortgage-backed securities, creditors had difficulty offering zero-zero alternatives for 30-year fixed-rate mortgages. While it is possible that if the statutory ban were to go into effect the secondary market might adjust so as to enable creditors to recoup origination costs by interest rate increases that generate sufficient increases in the premium paid by the secondary market, the Bureau remains concerned that this may not happen for all segments of the market, and as a result access to credit for some consumers may be impaired.

The Bureau also is concerned that creditors may curtail certain types of portfolio lending if the statutory ban were to go into effect. Community banks and some credit unions, in particular, tend to make loans to their customers or members, which cannot be sold into the secondary market because of, for example, unique features of the property or the consumer's finances. These creditors may not be able to afford to wait to recoup their origination costs over the life of the loan and, even if they can, they may have difficulty managing prepayment risk, especially because creditors will be limited in imposing prepayment penalties under the Dodd-Frank Act, the 2013 ATR Final Rule and the 2013 HOEPA Final Rule. For example, one credit union indicated that it currently makes many short-term (10- to 12-year) fixed-rate loans held in portfolio where it charges a relatively small ($250-$500) flat origination fee to offset its direct costs. The credit union does not offer a zero-zero alternative in these instances because it does not sell the loan into the secondary market or generate any upfront revenue. The credit union indicated that it would reconsider originating this type of loan if it was not allowed to charge upfront fees on these loans.

The Bureau also notes that some Federal and State mortgage programs, particularly those designed for lower-income people, do not allow the creditor to vary origination fees, or may cap the interest rate on the loan such that it would be difficult for the creditor to recoup the entire origination costs through a higher interest rate. While it may be possible in some cases for these Federal and State mortgage programs to be restructured to accommodate zero-zero alternatives, the Bureau remains concerned that it might not always be feasible to do so, which could impair access to credit for lower income consumers that these programs are designed to help.

In sum, the Bureau believes that allowing the statutory ban in TILA section 129B(c)(2)(B)(ii) to go into effect has the potential to curtail access to credit for consumers, which would be particularly detrimental to consumers given the current fragile state of the mortgage market. Given the current tight underwriting standards and limited supply of credit, driving up interest rates and thus monthly payments, and constricting the number of creditors in the market, could be particularly damaging to consumers who are already having difficulty qualifying for credit.

The Bureau also believes that allowing the statutory ban on upfront points and fees in TILA section 129B(c)(2)(B)(ii) to go into effect would significantly limit consumer choice for financial products to the detriment of consumers. Some mortgage consumers may want the lowest rate possible on their loans. For example, given today's low interest rate environment, a consumer who has purchased a house in which the consumer plans to live for many years may be best served by paying upfront origination charges in order to get the full benefit of the current low interest rates or even paying discount points to buy down that rate. In addition, some mortgage consumers may prefer to lower the future monthly payment on the loan below some threshold amount, and paying discount points, origination points or origination fees would allow consumers to achieve this lower monthly payment by reducing the interest rate.[153] This is possible today as creditors typically offer a variety of pricing options on mortgages, such as the ability of a consumer to pay less in upfront points and fees in exchange for a higher interest rate or to pay more in upfront points and fees in exchange for a lower interest rate. Creditors also may offer loans without upfront points and fees to some, but not all, consumers.

Finally, the Bureau believes that preserving the ability of consumers to pay upfront points and fees enhances the efficiency of the mortgage market. Investors in mortgage securities face the risk that in declining interest rate environments consumers will prepay their mortgages. Investors factor in this prepayment risk in determining how much they will pay for a mortgage backed security. Consumers who pay discount points and secure a lower rate "signal" to investors their reduced likelihood to prepay. This signaling, in turn, facilitates a more efficient market in which creditors are able to provide such consumers with a better deal.

The Bureau has carefully considered the countervailing considerations noted by some, although by no means all, consumer groups. The Bureau recognizes that some consumers – particularly less sophisticated consumers – may be harmed because they do not fully understand the complexity of the financial trade-offs when they pay upfront points and fees and thus do not get fair value for them. Additionally, other consumers may misperceive their likelihood of

[153] Consumers can also reduce monthly payments by making a bigger down payment, in order to reduce the loan amount. Nonetheless, it may take a significant increase in the down payment to achieve the desired reduction in the monthly payment. In other words, if the consumer applied the same funds that he or she would otherwise pay in discount points, origination points, or origination fees and applied it to a larger down payment to reduce the loan amount, the consumer may not gain as large a reduction in the monthly payment as if the consumer used that money to pay discount points, origination points or origination fees to reduce the interest rate. Some consumers may also obtain a tax benefit by paying discount points that applying such funds to a down payment would not achieve.

prepaying their mortgage (either as the result of a refinance or a home sale) and, as a result, may make decisions that prove not to be in their long-term economic self-interest. The Bureau also recognizes that there is some evidence that consumers pay lower, all-in costs when they do not pay any upfront costs although the Bureau notes that the leading study of this phenomenon was based on a period of time when the compensation paid to originators could vary with the terms of the transaction.

Nevertheless, the Bureau also believes, for the reasons discussed above, that, most consumers generally benefit from having a mix of pricing options available, so that consumers can select financial products that best fit their needs. Allowing the statutory ban to go into effect would prohibit the payment of points and fees irrespective of the circumstances of their payment, which the Bureau believes would significantly restrict consumers' choices in mortgage products and, in aggregate, acts to the detriment of consumers and the public interest. While the Bureau believes that additional study may show that additional restrictions on upfront points and fees are needed beyond the restrictions that are contained in the Title XIV Rulemakings, the Bureau believes that it would be imprudent at this time to restrict consumers' choices of mortgage products to only one type – those without upfront points and fees – especially because this limitation may impair consumers' access to credit, as discussed above. Thus, the Bureau has determined that it is in the interest of consumers and the public interest to provide a complete exemption at this time, to avoid the detrimental effects of the statutory ban on consumers.

As part of the Bureau's ongoing monitoring of the mortgage market and for the purposes of the Dodd-Frank Act section 1022(d) five-year review, the Bureau will assess how the complete exemption of the prohibition on points and fees is affecting consumers, and the impact of the other Title XIV Rulemakings and the final rule to be adopted under the 2102 TILA-

RESPA Proposal on consumers' understanding of points and fees. If the Bureau were to determine over this time that eliminating or narrowing the exemption is in the interest of consumers and in the public interest, the Bureau would issue a new proposal for public notice and comment. The Bureau notes, however, that although it is providing a complete exemption to the statutory ban on upfront points and fees in TILA section 129B(c)(2)(B)(ii) at this time, the Bureau will continue to ensure that creditors are complying with all existing restrictions on upfront points and fees. In the event that problems develop in the marketplace, the Bureau may use its enforcement authority, such as authority to prevent unfair, deceptive, or abusive acts or practices (UDAAP) under section 1031 of the Dodd-Frank Act, as well as considering further action under section 1031 or other authority.

Zero-zero alternative. The Bureau also does not believe it is prudent at this time to adopt the proposal regarding the zero-zero alternative. As discussed above, the Bureau proposed to structure the use of its exemption authority to enable consumers to receive the benefits of obtaining loans that do not include discount points, origination points or origination fees, but also to preserve consumers' ability to choose a loan with such points and fees. Based on comments received on the zero-zero alternative and its own further analysis, the Bureau has concerns whether the zero-zero alternative as proposed would accomplish what the Bureau believes to be the objectives of the statute, which is to facilitate consumer shopping and enhance consumer decision-making.

The Bureau is concerned that some consumers might find the zero-zero alternative confusing, and it believes that testing would be needed to determine whether a variant of the zero-zero alternative can be fashioned to provide information and protections to consumers that outweigh possible disadvantages. Several commenters raised concerns that when consumers are given information about the zero-zero alternative, they might be confused about why they are receiving such information and might believe that a zero-zero alternative was always the best option for them even when it is not. For example, one consumer group commenter stated that while the zero-zero alternative offered by a particular creditor may be less complicated than other options that creditor offers, it may not be the best deal for the consumer.

The Bureau also solicited comment on adopting rules that would require creditors to advertise the zero-zero alternative when advertising loans with upfront points and fees. Through the proposal, the Bureau had intended to facilitate consumer shopping by enhancing the ability of consumers to make comparisons using loans that do not include discount point, origination points or origination fees made available by different creditors as a basis for comparison. As discussed above, for transactions that do not involve a loan originator organization, under the proposal a creditor would be deemed to be making the zero-zero alternative available if, in providing a consumer with an interest rate quote specific to the consumer for a loan which included points or fees, the creditor also provided a quote for a comparable, alternative loan that did not include points and fees (unless the consumer is unlikely to qualify for the loan). In putting this proposal forward, the Bureau recognized that by the time a consumer receives a quote from a particular creditor for an interest rate specific to that consumer the consumer may have already completed his or her shopping in comparing rates from different creditors. Thus, the Bureau suggested, without a specific proposal, that revising the advertising rules in § 1026.24(d) might be a critical building block to enable consumers to make comparisons using loans that does not include discount points, origination points or origination fees made available by different creditors as a basis for comparison.

Some industry commenters argued that requiring information about the zero-zero alternative in advertisements would present the serious risk of providing too much information for consumers to digest and may only confuse consumers. Some industry commenters also indicated that including information about the zero-zero alternative in advertisements might not in fact enable consumers properly to determine the lowest cost loan, especially if affiliates' fees were treated as upfront points and fees, but non-affiliate, third-party fees were not. To address this further issue and facilitate shopping on zero-zero alternatives made available by multiple creditors, the proposal also had solicited comment on which fees to include in the definition of upfront points and fees, including whether to include fees irrespective of affiliate status or fees based on the type of service provided. Comments on the proposal, however, did not point to a clear way to resolve these interlinked issues. Moreover, the Bureau has not conducted consumer testing on how advertising rules could be structured and the definition of points and fees adjusted to facilitate shopping and reduce consumer confusion or whether requiring a zero-zero price quote without modifying the advertising rules would facilitate consumer shopping.

Finally, based on comments received, the Bureau has concerns whether a zero-zero alternative can be crafted that is not easily evaded by creditors. In developing its proposal, the Bureau recognized that because a loan with no upfront points and fees will carry a higher interest rate, not every consumer can qualify for both a loan with upfront costs and a loan with none. Under the Bureau's proposal, therefore, the creditor was not required to make available the zero-zero alternative to consumers that were unlikely to qualify for it. In including this provision, the Bureau was concerned that creditors that do not wish to make available loans without upfront points and fees to certain consumers could possibly manipulate their underwriting standards so that those consumers would not qualify for such loans or could set the interest rates on their purported alternatives without upfront points and fees high enough for certain consumers that those consumers could not satisfy the creditor's underwriting standards. Thus, the Bureau solicited comment on another alternative, whereby a creditor would be permitted to make available a loan that includes discount points, origination points or origination fees only when the consumer also qualifies for the zero-zero alternative. The Bureau was concerned, however, that adoption of such an alternative could impair access to credit to the extent there were consumers who could only qualify for a loan with upfront points or fees. The Bureau solicited comment on this issue.

Industry commenters indicated that the alternative approach would limit access to credit to some consumers, similar to the types of risks to consumers' access to credit that would result if the statutory provision was implemented unaltered, as discussed above. In addition, several consumer group commenters argued that the "unlikely to qualify" standard would be difficult to enforce and very easy to manipulate. These commenters expressed concern that creditors may be dishonest about how they decide who is unlikely to qualify for the zero-zero alternative, may manipulate underwriting standards, or may set interest rates high for certain consumers to avoid being required to offer the zero-zero alternative, which they additionally argued could pose risks for violations of fair lending laws. The Bureau is concerned that the zero-zero alternative as proposed may not provide the intended benefits if the requirement can be easily evaded by creditors.

The Bureau has gained substantial knowledge from these discussions about the zero-zero alternative and believes that there is some potential in the future to adopt some variant of the zero-zero alternative that sufficiently mitigates the concerns discussed above and that strikes the appropriate balance between these competing considerations. The Bureau believes, however, that finalizing now any particular variant of the zero-zero alternative absent further study on a variety of unsettled issues and further notice and comment on a refined proposal would risk harm to consumer interests and the public interest in a period of market fragility and concurrent fundamental changes in the regulatory framework.

There remain unresolved many crucial issues relating to the design, operation, and likely effects of adopting the zero-zero alternative, including whether disclosing the zero-zero alternative to consumers either pre- or post-application or both is in fact beneficial to consumers in shopping for a mortgage and consumer understanding of trade-offs; how best to structure advertising rules, post-application disclosures, and the bona fide requirement if they are determined to be valuable to consumers; and the assessment of the effects on consumer and market behaviors of the other Title XIV Rulemakings and the final rule to be adopted under the 2102 TILA-RESPA Proposal. The Bureau, while mindful of its goal to help consumers make better informed decisions, is not currently able to judge whether and how to structure the zero-zero alternative or whether a different approach to the regulation of upfront points or fees would be more effective to advance Congress's purposes in enacting the points and fees provision.

Additional study needed. The Bureau considers the issues presented in this rulemaking related to the payment of points and fees to be a crucial unresolved piece of its Title XIV Rulemaking efforts to reform the mortgage market after the consumer abuses that contributed to the mortgage crisis and its negative impact on the U.S. economy. The Bureau is committed to determining what additional steps, if any, are warranted to advance the interests of consumers and the public. The mortgage market has undergone significant shifts in the past few years, and the Bureau believes it will continue to do so as the Title XIV protections are implemented and the new disclosure-regime in the 2012 TILA-RESPA Proposal is finalized and implemented.

For example, the Board's 2010 Loan Originator Final Rule reshaped how loan originators may be compensated, and this rulemaking, while continuing the basic approach of that earlier rulemaking, makes significant adjustments to remove loan originators' incentives to steer consumers to particular loans to their detriment. In addition, as noted above, the 2013 ATR Final Rule imposes limits on the points and fees for a qualified mortgage, the 2013 HOEPA Final Rule lowers the points and fees threshold for high-cost loans, and both rules include loan originator compensation in the calculation of points and fees. Moreover, the Bureau also is in the process of finalizing its 2012 TILA-RESPA Proposal to revise loan disclosures for closed-end mortgages, including the Loan Estimate, which would be given within three days after application and is designed to enhance consumers' understanding of points and fees charged on the loan and to facilitate consumer shopping. The Bureau also is in the process of receiving comments on its 2013 ATR Concurrent Proposal which will address the issue of how loan originator compensation should be factored in to the calculation of points and fees which determines whether a loan can be a qualified mortgage or whether a loan is covered by HOEPA.

Without experience under the new regulatory regime and without consumer testing and market research, the Bureau is uncertain whether finalizing a version of the zero-zero alternative or some other alternative would benefit consumers. Once the new rules take effect, the Bureau intends to direct its testing and research to identify the impact of the rules on the prevalence and size of upfront points and fees, consumers' understanding of those charges and the alternatives to them, and the choices consumers make, including whether consumers understand and make informed choices based on the trade-off between the payment of upfront points and fees and the interest rate. Based on the results of that research and analysis, the Bureau will consider whether some additional actions, such as proposing a different version of the zero-zero alternative, are appropriate to enhance consumer decision making and consumer choice and, if so, how to best effectuate those goals.

The Bureau is required by section 1022(d) of the Dodd-Frank Act to conduct an assessment of the effectiveness of each significant rule the Board issues and to publish a report of that assessment within five years of the effective date of each such rule. To prepare for such an assessment, the Bureau intends to conduct baseline research to understand consumers' current understanding and decision making with respect to the tradeoffs between upfront charges and interest rates. The Bureau will undertake further research once this rule, and the related rules discussed above, take effect. Through this research, the Bureau will assess how the complete exemption of the prohibition on points and fees is affecting consumers and how best to further consumer protection in this area.

36(e) Prohibition on Steering

36(e)(3) Loan Options Presented

Existing § 1026.36(e)(1) provides that a loan originator may not direct or "steer" a consumer to consummate a transaction based on the fact that the originator will receive greater compensation from the creditor in that transaction than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer's interest. Section 1026.36(e)(2) provides a safe harbor that loan originators may use to comply with the prohibition set forth in § 1026.36(e)(1). Specifically, § 1026.36(e)(2) provides that a transaction does not violate § 1026.36(e)(1) if the consumer is presented with loan options that meet certain conditions set forth in § 1026.36(e)(3) for each type of transaction in which the consumer expressed an interest. The term "type of transaction" refers to whether: (1) a loan has an annual percentage rate that cannot increase after consummation; (2) a loan has an annual percentage rate that may increase after consummation; or (3) a loan is a reverse mortgage.

As set forth in § 1026.36(e)(3), to qualify for the safe harbor in § 1026.36(e)(2), a loan originator must obtain loan options from a significant number of the creditors with which the originator regularly does business and must present the consumer with the following loan options for each type of transaction in which the consumer expressed an interest: (1) the loan with the lowest interest rate; (2) the loan with the lowest total dollar amount for origination points or fees and discount points; and (3) the loan with the lowest interest rate without negative amortization, a prepayment penalty, a balloon payment in the first seven years of the loan term, shared equity, or shared appreciation, or, in the case of a reverse mortgage, a loan without a prepayment penalty, shared equity, or shared appreciation. Under § 1026.36(e)(3)(ii), the loan originator must have a good faith belief that the options presented to the consumer as discussed above are loans for which the consumer likely qualifies.

Discount Points, Origination Points and Origination Fees

As discussed above, to qualify for the safe harbor in § 1026.36(e)(2), a loan originator must present to a consumer particular loan options, one of which is the loan with the lowest total dollar amount for "origination points or fees and discount points" for which the loan originator has a good faith belief that the consumer likely qualifies. *See* § 1026.36(e)(3)(i)(C) and (e)(3)(ii). For consistency, the Bureau proposed to revise § 1026.36(e)(3)(i)(C) to use the terminology "discount points and origination points or fees," a defined term in proposed § 1026.36(d)(2)(ii)(B).

In addition, the Bureau proposed to amend § 1026.36(e)(3)(i)(C) to address the situation where two or more loans have the same total dollar amount of discount points, origination points or origination fees. This situation would have been more likely to occur in transactions subject to proposed § 1026.36(d)(2)(ii). As discussed above, proposed § 1026.36(d)(2)(ii)(A) would have required, as a prerequisite to a creditor, loan originator organization, or affiliate of either imposing any discount points, origination points or origination fees on a consumer in a transaction, that the creditor also make available to the consumer a comparable, alternative loan that does not include discount points, origination points or origination fees, unless the consumer is unlikely to qualify for such a loan. Under the proposal, for transactions that involve a loan originator organization, a creditor would make available to the consumer a comparable, alternative loan that does not include discount points, origination points or origination fees if the creditor communicates to the loan originator organization the pricing for all loans that do not include discount points, origination points or origination fees, unless the consumer is unlikely to qualify for such a loan. Thus, under the proposal, each creditor with whom a loan originator organization regularly does business generally would have been communicating pricing to the loan originator organization for all loans that do not include discount points, origination points or origination fees.

Proposed § 1026.36(e)(3)(i)(C), read in conjunction with §1026.36(e)(3)(ii), provided that, with respect to the loan with the lowest total dollar amount of discount points and origination points or fees, if two or more loans have the same total dollar amount of discount points, origination points or origination fees, the loan originator must present the loan from among those alternatives that has the lowest interest rate for which the loan originator has a good faith belief that the consumer likely qualifies.

The Bureau did not receive any comments on this aspect of the proposal. This final rule adopts proposed § 1026.36(e)(3)(i)(C) with one revision. As discussed above, this final rule does not adopt the proposed requirement that, as a prerequisite to a creditor, loan originator organization, or affiliate of either imposing any discount points, origination points or origination fees on a consumer in a transaction, that the creditor also make available to the consumer a comparable, alternative loan that does not include discount points, origination points or origination fees, unless the consumer is unlikely to qualify for such a loan. In addition, this final rule does not adopt the definition of “discount points and origination points or fees” as proposed in § 1026.36(d)(2)(ii)(B). Accordingly, § 1026.36(e)(3)(i)(C), as adopted in this final rule, does not use the term “discount points and origination points or fees” as proposed in § 1026.36(e)(3)(i)(C). As adopted, § 1026.36(e)(3)(i)(C) is revised to use the phrase “discount points, origination points or origination fees” to make more clear which points and fees are included for purposes of this provision. Even though the provision in § 1026.36(d)(2)(ii) regarding the comparable, alternative loan is not adopted in this final rule, the Bureau believes that the additional clarification added to § 1026.36(e)(3)(i)(C) is still useful. The Bureau believes that there still may be cases where two or more loans available to be presented to a consumer by a loan originator for purposes of the safe harbor in § 1026.36(e)(2) have the same total dollar amount of discount points, origination points or origination fees. In these cases, § 1026.36(e)(i)(3)(C) as adopted in this final rule, and read in conjunction with §1026.36(e)(ii), would provide that the loan originator must present the loan with the lowest interest rate that has the lowest total dollar amount of discount points, origination points or origination fees for which the loan originator has a good faith belief that the consumer likely qualifies.

The Loan with the Lowest Interest Rate

As discussed above, to qualify for the safe harbor in § 1026.36(e)(2), a loan originator must present to a consumer particular loan options, one of which is the loan with the lowest interest rate for which the loan originator has a good faith belief that the consumer likely qualifies. *See* § 1026.36(e)(3)(i)(A) and (e)(3)(ii). Mortgage creditors and other industry representatives have asked for additional guidance on how to identify the loan with the lowest interest rate, as set forth in § 1026.36(e)(3)(i)(A), given that a consumer generally can obtain a lower rate by paying discount points. To provide additional clarification, the Bureau proposed to amend comment 36(e)(3)-3 to clarify that the loan with the lowest interest rate for which the consumer likely qualifies is the loan with the lowest rate the consumer can likely obtain, regardless of how many discount points the consumer must pay to obtain it.

The Bureau did not receive any comments on this aspect of the proposal. The final rule adopts comment 36(e)(3)-3 as proposed in substance, with several revisions to clarify the intent of the comment. Comment 36(e)(3)-3 is revised to clarify that the loan with the lowest interest rate for which the consumer likely qualifies is the loan with the lowest rate the consumer can likely obtain, regardless of how many discount points, origination points or origination fees the consumer must pay to obtain it. As adopted in this final rule, comment 36(e)(3)-3 uses the phrase "discount points, origination points or origination fees," consistent with § 1026.36(e)(3)(i)(C), as discussed above. In addition, the first sentence of the comment is revised to reference the requirement in § 1026.36(e)(3)(ii) that the loan originator must have a good faith belief that the options presented to the consumer under § 1026.36(e)(3)(i) are loans for which the consumer likely qualifies.

36(f) Loan Originator Qualification Requirements

Section 1402(a)(2) of the Dodd-Frank Act added TILA section 129B(a) and (b)(1), which imposes new requirements for mortgage originators, including requirements for them to be licensed, registered, and qualified, and to include their identification numbers on loan documents. 15 U.S.C. 1639b. It also added TILA section 129B(b)(2), which, as amended by section 1100A of the Dodd-Frank Act, requires the Bureau to prescribe regulations requiring depository institutions to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions, the subsidiaries of such institutions, and the employees of such institutions or subsidiaries with the requirements of TILA section 129B and the registration procedures established under section 1507 of the SAFE Act, 12 U.S.C. 5101, *et seq*.

TILA section 129B(b)(1)(A) authorizes the Bureau to issue regulations requiring mortgage originators to be registered and licensed in compliance with State and Federal law, including the SAFE Act. TILA section 129B(b)(1)(A) also authorizes the Bureau's regulations to require mortgage originators to be "qualified." As discussed in the section-by-section analysis of § 1026.36(a)(1) above, for purposes of TILA section 129B(b) the term "mortgage originator" includes natural persons and organizations. Moreover, for purposes of TILA section 129B(b), the term includes creditors, notwithstanding that the definition of mortgage originator in TILA section 103(cc)(2) excludes creditors for certain other purposes.

The SAFE Act imposes licensing and registration requirements on individuals. Under the SAFE Act, loan originators who are employees of a depository institution or a Federally regulated subsidiary of a depository institution are subject to registration, and other loan originators are generally required to obtain a State license and also comply with registration. Regulation H, 12 CFR part 1008, which implements SAFE Act standards applicable to State licensing, provides that a State is not required to impose licensing and registration requirements on loan originators who are employees of a bona fide nonprofit organization. 12 CFR 1008.103(e)(7). The SAFE Act requires individuals who are subject to SAFE Act registration or State licensing to obtain a unique identification number from the NMLSR, which is a system and database for registering, licensing, and tracking loan originators.

SAFE Act licensing is implemented by States. To grant an individual a SAFE Act-compliant loan originator license, section 1505 of the SAFE Act, 12 U.S.C. 5104, requires the State to determine that the individual has never had a loan originator license revoked; has not been convicted of enumerated felonies within specified timeframes; has demonstrated financial responsibility, character, and fitness; has completed 20 hours of pre-licensing classes that have been approved by the NMLSR; has passed a written test approved by the NMLSR; and has met net worth or surety bond requirements. Licensed loan originators must take eight hours of continuing education classes approved by the NMLSR and must renew their licenses annually. Some States impose additional or higher minimum standards for licensing of individual loan originators under their SAFE Act-compliant licensing regimes. Separately from their SAFE Act-compliant licensing regimes, most States also require licensing or registration of loan originator organizations.

Section 1507 of the SAFE Act, 12 U.S.C. 5106, generally requires individual loan originators who are employees of depository institutions to register with the NMLSR by submitting identifying information and information about their employment history and certain criminal convictions, civil judicial actions and findings, and adverse regulatory actions. The employee must also submit fingerprints to the NMLSR and authorize the NMLSR and the employing depository institution to obtain a criminal background check and information related to certain findings and sanctions against the employee by a court or government agency. Regulation G, 12 CFR part 1007, which implements SAFE Act registration requirements, imposes an obligation on the employing depository institution to have and follow policies to ensure compliance with the SAFE Act. The policies must also provide for the depository institution to review employee criminal background reports and to take appropriate action consistent with Federal law, including the criminal background standards for depository employees in section 19 of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. 1829, section 206 of the Federal Credit Union Act, 12 U.S.C. 1786(i), and section 5.65(d) of the Farm Credit Act of 1971, as amended, 12 U.S.C. 2277a-14(a). 12 CFR 1007.104(h).

Proposed § 1026.36(f) would have implemented, as applicable, TILA section 129B(b)(1)(A)'s mortgage originator licensing, registration, and qualification requirements by requiring a loan originator for a consumer credit transaction to meet the requirements described above. Proposed § 1026.36(f) tracked the TILA requirement that mortgage originators comply with State and Federal licensing and registration requirements, including those of the SAFE Act, where applicable. Proposed comment 36(f)-1 noted that the definition of loan originator includes individuals and organizations and, for purposes of § 1026.36(f), includes creditors. Proposed comment 36(f)-2 clarified that § 1026.36(f) does not affect the scope of individuals and organizations that are subject to State and Federal licensing and registration requirements. The remainder of proposed § 1026.36(f) set forth standards that loan originator organizations would have to meet to comply with the TILA requirement that they and their employees be qualified, as discussed below.

Proposed § 1026.36(f) also would have provided that its requirements do not apply to government agencies and State housing finance agencies, employees of which are not required to be licensed or registered under the SAFE Act. The Bureau proposed this differentiation pursuant to TILA section 105(a) to effectuate the purposes of TILA, which, as provided in TILA section 129B(a)(2), include ensuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive. The Bureau stated in the proposal that it does not believe that it is necessary to apply the proposed qualification requirements to employees of government agencies and State housing finance agencies because the agencies directly regulate and control the manner of their employees' loan origination activities, thereby providing consumers adequate protection from these types of harm.

One nonprofit loan originator organization that has been designated a bona fide nonprofit organization by several States objected to the proposal's lack of an exemption for nonprofit loan originator organizations from the requirements of proposed § 1026.36(f). The commenter's objection was based on the concern that the effect of applying the proposed TILA qualification standards to it and other nonprofit loan originator organizations would be to alter and add to the standards that State regulators must apply in opting not to require an employee of a bona fide nonprofit loan originator organization to be licensed under the SAFE Act and Regulation H. In addition, the commenter expressed concern that the qualification standard would call into question the commenter's individual loan originators' exemption from State licensing requirements in States that have granted exemptions. The commenter noted that nonprofit loan originators and State regulators had worked together extensively to implement the processes for nonprofit organizations to apply for exemption under, and demonstrate compliance with, the Regulation H standards for bona fide nonprofits, as well as processes for State examination procedures to ensure that bona fide nonprofit organizations continue to meet the standards. The commenter was concerned that the proposal would require those processes to be developed all over again. The commenter suggested that, to reduce possible uncertainty, the Bureau should at least revise § 1026.36(f) to require that, to be qualified, a loan originator must be registered or licensed "when required by," rather than "in accordance with" the SAFE Act.

An association of State bank regulators also urged that bona fide nonprofit organizations should be fully exempt from the qualification standards, just as government agencies and State housing finance agencies would be exempted under the proposal. The commenter recommended that an organization that has been determined to meet the Regulation H standards for bona fide nonprofit organizations has been determined to have a public or charitable purpose, to offer loan products that are favorable to borrowers, and to meet other standards, such that the nonprofit should not have to apply further standards to determine whether its individual loan originator employees meet the proposed qualification standards.

The Bureau does not believe that a complete exemption of bona fide nonprofit organizations from the TILA qualification standards is warranted, for the reasons discussed further below. However, in response to the concerns of the bona fide nonprofit organization, the Bureau emphasizes that the TILA qualification standards do not change existing law regarding which entities or individuals must be licensed under Federal or State law. Accordingly, for instance, the standards for States to determine whether a particular organization is a bona fide nonprofit and whether to require such a nonprofit's employees to be licensed under the SAFE Act and Regulation H are not affected by the final rule. As proposed comment 36(f)-2 stated that § 1026.36(f) does not affect the scope of individuals and organizations that are subject to State and Federal licensing and registration requirements. To emphasize and explain further how this principle applies in the context of bona fide nonprofit organizations, the final rule removes the statement from comment 36(f)-2 and adds it to a new comment 36(f)-3. Comment 36(f)-3 goes on to explain that, if an individual is an employee of an organization that a State has determined to be a bona fide nonprofit organization and the State has not subjected the employee to that State's SAFE Act loan originator licensing, the State may continue not to subject the employee to that State's SAFE Act licensing even if the individual meets the definition of loan originator in § 1026.36(a)(1) and is therefore subject to the requirements of § 1026.36. It states that the qualification requirements imposed under § 1026.36(f) do not add to or affect the criteria that States must consider in determining whether an organization is a bona fide nonprofit organization under the SAFE Act.

The Bureau is also adopting, in part, the commenter's suggestion to revise the regulatory text to provide that a loan originator must be registered or licensed "when required by" State or Federal law, including the SAFE Act, to eliminate any further uncertainty. However, the final rule, like the proposal, specifies that, where State or Federal law requires the loan originator to be registered or licensed, the registration or licensing must be "in accordance with" those laws.

As discussed below, the TILA qualification standards primarily require the loan originator organization to screen its individual loan originators for compliance with criminal, financial responsibility, character, and general fitness standards and to provide periodic training to its individual loan originators commensurate with their loan origination activities. For these reasons, the Bureau disagrees with the comment of the association of State banking regulators that the TILA qualification standards are unnecessary for bona fide nonprofit organizations. The standards that a State must apply in determining whether an organization is a bona fide nonprofit organization all pertain to the mission and activities of the organization, but they do not address the background or knowledge of the organization's individual loan originators. The Bureau believes that the standards will be minimally burdensome for bona fide nonprofit organizations to implement and that consumers who obtain residential mortgage loans from them will benefit from increased screening and training of individual loan originators.

36(f)(1)

Proposed § 1026.36(f)(1) would have required loan originator organizations to comply with applicable State law requirements for legal existence and foreign qualification, meaning the requirements that govern the legal creation of the organization and the authority of the organization to transact business in a State. Proposed comment 36(f)(1)-1 stated, by way of example, that the provision encompassed requirements for incorporation or other type of formation and for maintaining an agent for service of process. The Bureau explained that the requirement would help ensure that consumers are able to seek remedies against loan originator organizations that fail to comply with requirements for legal formation and, when applicable, for operating as foreign businesses.

One commenter asked the Bureau to confirm that the provision does not imply that State law requirements for formation and legal existence apply to Federally chartered lending institutions. The Bureau is adopting § 1026.36(f)(1) and comment 36(f)(1)-1 as proposed. The final rule does not affect the extent to which Federally chartered lending institutions must comply with State law but rather, like the proposal, includes the qualifier "applicable" to acknowledge there are situations where certain State law requirements may not apply.

36(f)(2)

Proposed § 1026.36(f)(2) would have required loan originator organizations to ensure that their individual loan originators are in compliance with SAFE Act licensing and registration requirements. Proposed comment 36(f)(2)-1 noted that the loan originator organization can comply with the requirement by verifying information that is available on the NMLSR consumer access website.

One nondepository institution commenter objected to the proposed requirement that it ensure that its individual loan originators are licensed in compliance with the SAFE Act and applicable State licensing laws. The commenter noted that having to determine that its employee loan originators are properly licensed would be burdensome because licensing requirements vary by State.

The Bureau disagrees. First, the Bureau notes that employers are generally already responsible under State law for ensuring their employees comply with all State licensing requirements that apply to activities within the scope of their employment. The proposed provision imposes the same duty under TILA and simply renders it somewhat more universal. In any case, imposing this duty on loan originator organizations will benefit consumers by giving them recourse if an individual who has failed to obtain a loan originator license nonetheless acts as a loan originator for the benefit of the loan originator organization and causes harm to a consumer in originating the loan. The Bureau believes that it is not an unreasonable burden for a loan originator organization to ensure that the individual loan originators through which it conducts its business are not acting in violation of the law. As proposed, comment 36(f)(2)-1 stated that a loan originator organization can confirm the licensing or registration status of individual loan originators on the NMLSR consumer access website. The Bureau therefore is adopting § 1026.36(f)(2) as proposed, except that it is clarifying that a loan originator organization must ensure its individual loan originator are in compliance with SAFE Act licensing and registration requirements before the individuals act as a loan originator in a consumer credit transaction secured by a dwelling. It also clarifies that the individual loan originators whose licensing or registration status the loan originator organization must verify are those individual loan originators who work for the loan originator organization. Comment 36(f)(2)-1 clarifies that individual loan originators who work for the loan originator organization include employees or independent contractors who operate under a brokerage agreement with the loan originator organization. The Bureau notes that the requirement to ensure that each individual loan originator who works for the loan origination organization is licensed or registered to the extent applicable applies regardless of the date the loan originator began working directly for the loan originator organization.

36(f)(3)

Proposed § 1026.36(f)(3) set forth actions that a loan originator organization must take for its individual loan originators who are not required to be licensed and are not licensed pursuant to the SAFE Act and State SAFE Act implementing laws. Individual loan originators who are not required to be licensed generally include employees of depository institutions under Regulation G and organizations that a State has determined to be bona fide nonprofit organizations, in accordance with criteria in Regulation H, 12 CFR 1008.103(e)(7).

The proposed requirements in § 1026.36(f)(3)(ii) applied to unlicensed individual loan originators two of the core standards from SAFE Act State licensing requirements: the criminal background standards and the financial responsibility, character, and general fitness standards. Proposed § 1026.36(f)(3)(iii) would also have required loan originator organizations to provide periodic training to these individual loan originators, a requirement that is analogous to but, as discussed below, more flexible than the continuing education requirement that applies to individuals who have SAFE Act-compliant State licenses.

As explained in the proposal, the Bureau believes its approach is consistent with both the SAFE Act's application of the less stringent registration standards to employees of depository institutions and Regulation H's provision for States to exempt employees of bona fide nonprofit organizations from State licensing (and registration). The Bureau believes that the decision in both cases not to apply the full SAFE Act licensing, training, and screening requirements was based in part on an assumption that these institutions already carry out basic screening and training of their employee loan originators to comply with prudential regulatory requirements or to ensure a minimum level of protection of and service to consumers (consistent with the charitable or similar purposes of nonprofit organizations). The Bureau explained that the proposed requirements in § 1026.36(f)(3) would help ensure that this assumption is in fact accurate and that all individual loan originators meet core standards of integrity and competence, regardless of the type of loan originator organization for which they work, without imposing undue or duplicative obligations on depository institutions and bona fide nonprofit employers.

The Bureau did not propose to apply to employees of depository institutions and bona fide nonprofit organizations the more stringent requirements that apply to individuals seeking a SAFE Act-compliant State license: to pass a standardized test and to be covered by a surety bond. The Bureau explained that it had not found evidence that consumers who obtain mortgage loans from depository institutions and bona fide nonprofit organizations face risks that are not adequately addressed through existing safeguards and proposed safeguards in the proposal. However, the Bureau stated that it will continue to monitor the market to consider whether additional measures are warranted.

Several bank and credit union commenters objected to the Bureau imposing any qualification standards on their individual loan originators, arguing that doing so is inconsistent with the SAFE Act's statutory exemption of employees of depository institutions from licensing requirements. One commenter stated that a better way to increase standards for loan originators would be for Congress to amend the SAFE Act rather than through a regulation. Several bank commenters objected to qualification standards, which they perceived as requiring their individual loan originator employees to meet all of the standards of loan originators who are subject to State licensing. One commenter stated it is inappropriate to impose any standards that apply under State licensing to depository institution employees because those standards were intended for nondepository creditors and brokers, which the commenter stated use questionable business practices. Several credit union and bank trade associations stated that compliance with SAFE Act registration should constitute "equivalent compliance" with the Dodd-Frank Act requirement for loan originators to be qualified. One commenter stated that the qualification standards should apply only to nondepository institutions that fail to comply with the SAFE Act.

Many bank and credit union commenters stated that the proposed qualification standards were both duplicative of practices that they already routinely undertake and would also be burdensome for them to implement because of the cost of ensuring compliance and demonstrating compliance to examiners. Some bank commenters stated that the Bureau had cited no evidence that their individual loan originators were not qualified or that the proposed standards would benefit consumers. Other commenters encouraged the Bureau to study the issue further. One bank stated that it would be unfair to impose TILA liability on depository institutions for failing to ensure their employees meet the qualification standards, but not on nondepository institutions. The commenter stated that, if SAFE Act licensing standards are burdensome for nondepository institutions, then the solution is for Congress to repeal them.

One State association of banks stated that its member banks do not object to this part of the proposal because they already comply with the proposed screening and training standards. Several commenters supported the proposal as a step toward more equal treatment of depository institutions and nondepository institutions through the establishment of basic loan originator qualification standards and also recognized that depository institutions already provide training to their loan originator employees. A State association of mortgage bankers supported the proposal because it would prevent unsuitable and unscrupulous individuals from seeking employment at institutions with lower standards.

Numerous nondepository institution commenters supported the qualification standards in the proposal but were critical of the proposal for not imposing more rigorous requirements on depository institutions. One commenter stated that the Bureau had committed to fully "leveling the playing field" between depository and nondepository institutions but had failed to do so in the proposal. Commenters stated that, when they have hired former depository institution employees as loan originators, they have found them to be highly unprepared. Several commenters objected that the proposal did not include a requirement for loan originators employed by depository institutions to take the standardized test that applicants for State loan originator licenses must take. One commenter stated that depository institution loan originators are not capable of passing the standardized test, and that those who do take and fail the test simply continue to serve consumers poorly at a bank. Others objected that the proposal did not require depository institutions' individual loan originator employees to take the minimum number of hours of NMLSR-approved classes that State license applicants and licensees must take. One commenter who reported working at both depository and nondepository institutions stated that the training at depository institutions is inferior.

Still other commenters objected that the proposal permitted depository institutions to self-police (*i.e.*, to determine whether their own individual loan originator employees meet the proposed standards); some commenters stated that the rule should impose State licensing on all loan originators to require State regulators to make these determinations. Several commenters stated that any disparity between the standards that apply to depository and nondepository loan originators creates an unfair competitive advantage for depository institutions. One association of mortgage brokers stated that consumers assume that banks provide screening and training to their loan originators but that the assumption is incorrect.

The Bureau disagrees with the assertion that the promulgation of qualification standards is inconsistent with Congressional intent. In enacting the SAFE Act, Congress imposed licensing (and registration) requirements on individual loan originators who are not employees of depository institutions and imposed less stringent registration requirements for individual loan originators who are employees of depository institutions. In enacting the Dodd-Frank Act, Congress then mandated all loan originators "when required" comply with the licensing and registration requirements of other applicable State or Federal law, including the SAFE Act, and also imposed an additional requirement that they be "qualified." Congress left significant discretion to the Bureau to determine what additional standards a loan originator must meet to demonstrate compliance with the new "qualified" requirement, but the Bureau believes that Congress would not have imposed the requirement in the first place if it had not intended to create a meaningful protection for consumers. The Bureau also does not assume that Congress intended to disturb the basic framework of the SAFE Act with regard to licensing and registration, given that it limited the duty to be licensed only to situations "when required" by other law. The Bureau declines to read the latter provision out of the Dodd-Frank Act or to perpetuate uncertainty by leaving the statutory requirement undefined.

As it explained in the proposal, the Bureau sought to define certain minimum qualification standards for all loan originators to allow consumers to be confident that all loan originators meet core standards of integrity and competence, regardless of the type of institution for which they work. The standards also serve to ensure that depository institutions in fact carry out basic screening and provide basic training to their employee loan originators because the assumption that they do so was, in the Bureau's view, a critical component of Congress's decision to exempt them from State licensing requirements of the SAFE Act. Moreover, the standards implement Congress's determination reflected in the Dodd-Frank Act that all loan originators, including depository loan originators who are exempt from SAFE Act licensing, must be qualified. In this sense, one purpose of the proposal was to help equalize the treatment of and compliance burdens on depository and nondepository institutions.

The Bureau emphasizes, however, that the provisions of the final rule are not intended to achieve a perfectly level playing field, such as by imposing requirements on depository institutions for the sake of mechanically equalizing certain burdens and costs faced by depository and nondepository institutions. Nor do the provisions impose on depository institution individual loan originators all of the requirements of full licensing, as some nonbank commenters suggested. Instead, the provisions are intended to ensure that consumers receive certain basic benefits and protections, regardless of the type of institution with which they transact business. For this reason, the Bureau declines to adopt the bank commenter's suggestion that compliance with the SAFE Act be deemed to be adequate to comply with the separate requirement for loan originators to be qualified. Similarly, the Bureau is declining to apply the qualification standards only to nondepository institutions whose individual loan originators act in violation of the SAFE Act and State licensing laws, as suggested by one commenter.

In proposing to define the minimum qualification standards, the Bureau carefully evaluated the benefits of these requirements as well as the burdens to loan originators. The Bureau continues to believe that the proposed standards, as further clarified below, will not impose significant burdens on loan originator organizations and will provide important consumer protections. As many bank and credit union commenters stated, most depository institutions already comply with the criminal background and screening provisions and provide training to their loan originators as a matter of sound business practice and to comply with the requirements and guidance of prudential regulators. The qualification standards build on these requirements and provide greater parity and clarity for criminal background and character standards across types of institution. The Bureau recognizes that the consequences for an individual who is determined not to meet the standards is significant, but it does not believe that many individual loan originators will be affected. The Bureau's view is that there is no reason why a consumer should expect that a loan originator who fails to meet the criminal background and character standards for loan originators at one class of institution should be able to act as a loan originator for that consumer at another class of institution.

The Bureau disagrees with some commenters' assertions that the provisions would result in significantly higher compliance burden compared with existing requirements. For example, as further discussed below, a depository institution will not be required to obtain multiple criminal background reports or undertake multiple reviews of a criminal background report. Instead, the required criminal background report is the same report the institution already obtains under Regulation G after submission of the individual's fingerprints to the NMLSR (12 CFR 1007.103(d)(1)(ix) and 1007.104(h)). In reviewing the criminal background report, the institution will be required to apply somewhat broader criteria for disqualifying crimes. Similarly, the training provisions comport with consumers' legitimate expectations that a loan originator should be knowledgeable of the legal protections and requirements that apply to the types of loans that the individual originates. As further discussed below, the provisions seek to ensure this outcome while avoiding imposition of training requirements that needlessly duplicate training that loan originators already receive.

The Bureau also disagrees with one commenter's assertion that the provisions unfairly impose TILA liability for compliance with the qualifications requirements on depository institutions, but not on nondepository institutions. As discussed above, § 1026.36(f)(2) imposes a TILA obligation on all loan originator organizations—mortgage brokers and both nondepository and depository institution mortgage creditors—to ensure that their individual loan originators are licensed or registered to the extent required under the SAFE Act, its implementing regulations, and State SAFE Act implementing laws.

The Bureau is not adopting a requirement, advocated by several commenters, that all loan originators take and pass the NMLSR-approved standardized test that currently applies only to applicants for State loan originator licenses. The Bureau recognizes that independent testing of loan originators' knowledge provides a valuable consumer protection and that individual loan originators at depository institutions are not currently required to take and pass the test. Imposing such a requirement for all individual loan originators, however, would carry with it significant costs and burdens for depository institutions. In addition, the Bureau does not at this time have evidence to show that combining existing bank practices with the new training requirements contained in this final rule will be inadequate to ensure that the knowledge of depository loan originators is comparable to that of loan originators who pass the standardized test. In light of the short rulemaking timeline imposed by the Dodd-Frank Act, and cognizant of the potential burdens on the NMLSR and its approved testing locations that could result from expansion of the test requirement to bank and credit union employees, the Bureau believes it is prudent to continue studying the issue to determine if further qualification requirements are warranted.

The Bureau is not adopting the suggestion of some commenters to impose State licensing requirements on all loan originators. The commenters suggested that such a measure was needed because it is not appropriate for depository institutions to "self-police" by making the required determinations about their own loan originator employees. The Bureau believes requiring registration and licensing only "when required" already under other State or Federal law, including the SAFE Act, is more faithful to the statutory directive in section 129B(b)(1)(A) of TILA. That statutory language in that section makes clear that Congress intended to require compliance with existing State and Federal licensing requirements but did not intend to create new licensing requirements.

36(f)(3)(i)

Proposed § 1026.36(f)(3)(i) provided that the loan originator organization must obtain for each individual loan originator who is not required to be licensed and is not licensed as a loan originator under the SAFE Act a State and national criminal background check; a credit report from a nationwide consumer reporting agency in compliance, where applicable, with the requirements of section 604(b) of the Fair Credit Reporting Act (FCRA), 15 U.S.C. 1681b; and information about any administrative, civil, or criminal findings by any court or government agency. Proposed comment 36(f)(3)(i)-1 clarified that loan originator organizations that do not have access to this information in the NMLSR (generally, bona fide nonprofit organizations) could satisfy the requirement for a criminal background check by obtaining a criminal background check from a law enforcement agency or commercial service. It also clarified that such a loan originator organization could satisfy the requirement to obtain information about administrative, civil, or criminal determinations by requiring the individual to provide it with this information directly to the loan originator organization. The Bureau noted that the information in the NMLSR about administrative, civil, or criminal determinations about an individual is generally supplied to the NMLSR by the individual, rather than by a third party. The Bureau invited public comment on whether loan originator organizations that do not have access to this information in the NMLSR should be permitted to satisfy the requirement by requiring the individual loan originator to provide it directly to the loan originator organization or if, instead, there are other means of obtaining the information that are more reliable or efficient.

One commenter stated that performing a criminal background check is no longer necessary for loan originators because they can no longer be compensated based on the terms of a residential mortgage loan.

A bank commenter requested that the Bureau clarify the proposed regulatory text requiring a "State and national criminal background check" because it could be read to require a separate State criminal background check for each State in which the loan originator operates. The commenter asked for clarification that the FBI criminal background check obtained from the NMLSR is sufficient.

A bank commented that it was not clear what protection was achieved by requiring a depository institution to review the credit report of a prospective individual loan originator. The commenter speculated that the only reason the SAFE Act requires review of credit reports of prospective individual loan originator licensees may be that mortgage brokers, unlike banks, are often thinly capitalized, such that the financial circumstances of the individual applicant are relevant. The commenter urged that, in a depository institution, the financial circumstances of a loan originator are not relevant to consumer protection.

An association of banks stated that the consumer benefit of requiring review of credit reports of prospective loan originators is outweighed by the expense and burden to the bank. A credit union stated that credit history rarely correlates with operating unfairly or dishonestly and therefore there is no benefit to reviewing it. An association of credit unions stated that all credit unions already use credit reports to evaluate prospective employees.

Finally, commenters requested clarification on how to reconcile the requirement to review credit reports with FCRA provisions and Equal Employment Opportunity Commission (EEOC) guidance on employer credit checks. They also requested clarification of language that could have been read to suggest that credit reports should be obtained from the NMLSR.

The Bureau disagrees with the comment that screening for criminal background is no longer warranted for loan originators merely because loan originator compensation cannot vary based on loan terms. Steering a consumer to a particular loan based on the compensation the loan originator expects to receive is not the only way in which a loan originator could cause harm to a consumer. The Bureau's view is that consumers should not have their financial well-being subject to the influence of a loan originator with a recent history of felony convictions.

The Bureau is adopting § 1026.36(f)(3)(i)(A) as proposed but with the bank commenter's suggested clarification to prevent any misunderstanding that multiple State criminal background checks are required for an individual. The Bureau is revising the regulatory text to refer simply to "a criminal background check from the NMLSR" (or in the case of a loan originator organization without access to the NMLSR, "a criminal background check") and adding an express statement to comment 36(f)(3)(i)-1 that a loan originator organization with access to the NMLSR satisfies the requirement by reviewing the standard criminal background check that the loan originator receives upon submission of the individual loan originator's fingerprints to the NMLSR. The Bureau is also making minor organizational revisions to the comment to prevent any implication that the credit report must be obtained from the NMLSR.

The Bureau disagrees with the commenter's statement that the only reason the SAFE Act requires review of a credit report of an applicant for a State license is the thin capitalization of mortgage brokers and that, therefore, there is no consumer protection achieved by requiring a loan originator organization to review the credit report of an individual employed by a depository institution. Instead, the Bureau believes the credit report is useful for determining whether an individual meets the criteria for financial responsibility, which is a requirement under the SAFE Act and, as further discussed below, this final rule. The Bureau believes the cost of obtaining a credit report is modest and, as a number of commenters stated, many credit unions and depository institutions already obtain credit reports as part of established hiring and screening procedures.

Finally, the Bureau agrees that the credit report must be obtained in compliance with provisions of the FCRA on employer credit checks. The Bureau is not aware of any conflict between its rule and EEOC guidance on obtaining credit reports for employment screening.[154] Accordingly, it is adopting § 1026.36(f)(3)(i)(B) as proposed, requiring that the credit report be obtained in compliance with section 604(b) of the FCRA.

The Bureau is providing in § 1026.36(f)(3)(i) and in comments 36(f)(3)(i)-1 and 36(f)(3)(i)-2 that the requirement to obtain the specified information only applies to an individual whom the loan originator organization hired on or after January 10, 2014 (or whom the loan originator organization hired before this date but for whom there were no applicable statutory or regulatory background standards in effect at the time of hire or before January 10, 2014, used to screen the individual). Since these provisions track similar provisions in §1026.36(f)(3)(ii) and

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[154] *See*, *e.g.*, EEOC, informal discussion letter, http://www.eeoc.gov/eeoc/foia/letters/2010/titlevii-employer-creditck.html

related comments, they are discussed in more detail in the section-by-section analysis of those provisions.

36(f)(3)(ii)

Proposed § 1026.36(f)(3)(ii) specified the standards that a loan originator organization must apply in reviewing the information it is required to obtain. The standards were the same as those that State agencies must apply in determining whether to grant an individual a SAFE Act-compliant loan originator license. Proposed comment 36(f)(3)(ii)-1 clarified that the scope of the required review includes the information required to be obtained under § 1026.36(f)(3)(i) as well as information the loan originator organization has obtained or would obtain as part of its reasonably prudent hiring practices, including information from application forms, candidate interviews, and reference checks.

36(f)(3)(ii)(A)

Under proposed § 1026.36(f)(3)(ii)(A), a loan originator organization would be required to determine that the individual loan originator has not been convicted (or pleaded guilty or *nolo contendere*) to a felony involving fraud, dishonesty, a breach of trust, or money laundering at any time, or any other felony within the preceding seven-year period. Depository institutions already apply similar standards in complying with the SAFE Act registration requirements under 12 CFR 1007.104(h) and other applicable Federal requirements, which generally prohibit employment of individuals convicted of offenses involving dishonesty, money laundering, or breach of trust. For depository institutions, the incremental effect of the proposed standard generally would be to expand the scope of disqualifying crimes to include felonies other than those involving dishonesty, money laundering, or breach of trust if the conviction was in the previous seven years. The Bureau stated that it does not believe that depository institutions or bona fide nonprofit organizations currently employ many individual loan originators who would be disqualified by the proposed provision, but that the proposed provision would give consumers confidence that individual loan originators meet common minimum criminal background standards, regardless of the type of institution or organization for which they work.

The proposed description of potentially disqualifying convictions was the same as that in the SAFE Act provision that applies to applicants for State licenses and includes felony convictions in foreign courts. The Bureau recognized that records of convictions in foreign courts may not be easily obtained and that many foreign jurisdictions do not classify crimes as felonies. The Bureau invited public comment on what, if any, further clarifications the Bureau should provide for this provision.

One commenter observed that criminal background checks, credit reports, and the NMLSR information on disciplinary and enforcement actions could contain errors. Another commenter stated that an individual must be allowed to correct any incorrect information in the report. Several commenters asked for clarification about what information a loan originator organization must or may consider in making the determination and specifically asked the Bureau to clarify that it should be able to rely on information and explanations provided by the individual.

Several bank commenters stated that they already perform criminal background checks pursuant to the FDIA and that the proposed standard would be duplicative and unnecessary. Commenters stated that the provision would be especially burdensome if they were required to apply it to current employees who have already been screened for compliance with the FDIA.

One commenter objected to the provision disqualifying individuals for seven years following the date of conviction for felonies not involving fraud, dishonesty, breach of trust, or money laundering. The commenter stated that the provision was too strict and that the standard should consider all the relevant factors, including whether these types of crimes are relevant to a loan originator's job. Other commenters stated that criminal background standards have a disparate impact on minorities and that EEOC enforcement guidelines state that standards for felonies should only exclude individuals convicted of crimes that relate to their jobs. One commenter requested clarification on how pardoned and expunged convictions would be treated. Depository institutions noted that the look-back periods under the FDIA and Federal Credit Union Act for certain enumerated crimes are ten years.

The Bureau agrees with the commenter's observation that criminal background checks, as well as credit reports and NMLSR information on enforcement actions, could contain errors. For this reason, the loan originator organization can and should permit an individual to provide additional evidence to demonstrate that the individual meets the standard, consistent with the requirement in § 1026.36(f)(3)(ii) that the loan originator organization consider any "other information reasonably available" to it. To clarify this, the Bureau is revising comment 36(f)(3)(ii)-1 to state expressly that this other information includes, in addition to information from candidate interviews, "other reliable information and evidence provided by a candidate."

The Bureau disagrees that the requirement to review a criminal background check to determine compliance with the SAFE Act criminal background standard is duplicative of existing requirements of prudential regulators or of Regulation G. As discussed above, the provision does not require a depository institution to obtain multiple criminal background checks or to conduct multiple reviews. A depository institution could meet the requirement in this final rule by obtaining the same criminal background check required by the prudential regulators and

Regulation G and reviewing it one time for compliance with applicable criminal background standards, including the standard of this final rule.

The Bureau disagrees with the commenters that urged using a shorter cutoff time and narrower list of disqualifying crimes. Congress has judged the standard as directly relevant to the job of being a loan originator. As discussed above, the standard is largely the same standard that the SAFE Act imposes for applicants for State loan originator licenses. The Bureau sees no reason why a loan originator who categorically fails to meet the criminal background and character standards for loan originators at one class of institution should categorically be permitted to act as a loan originator at another class of institution. The Bureau believes a seven-year prohibition period is not too strict of a standard to protect consumers from the risk that such individuals could present to them.

In view of these considerations, the Bureau does not believe it would be appropriate to establish standards in this rule that are materially different from those applicable under the SAFE Act. However, as noted by commenters, other regulators, including the Federal Deposit Insurance Corporation (FDIC), are already empowered to consent to the employment of individuals who would otherwise be barred under the Federal Deposit Insurance Act or other relevant laws because of certain prior convictions. To harmonize the qualification standards with those of other regulators, the Bureau is providing in the final rule that a conviction (or plea of guilty or *nolo contendere*) does not render an individual unqualified under § 1026.36(f) if the FDIC (or the Board of Governors of the Federal Reserve System, as applicable) pursuant to section 19 of the Federal Deposit Insurance Act, 12 U.S.C. 1829, the National Credit Union Administration pursuant to section 205 of the Federal Credit Union Act, 12 U.S.C. 1785(d), or the Farm Credit Administration pursuant to section 5.65(d) of the Farm Credit Act of 1971, 12 U.S.C.

227a-14(d), has granted consent to employ the individual notwithstanding the conviction or plea that would have rendered the individual barred under those laws.

In response to commenter requests, the Bureau is clarifying in § 1026.36(f)(3)(ii)(A)(*2*) that a crime is a felony only if, at the time of conviction, it was classified as such under the law of the jurisdiction under which the individual was convicted, and that expunged and pardoned convictions do not render an individual unqualified. These clarifications are consistent with implementation of the SAFE Act criminal background standards in § 1008.105(b)(2) of Regulation H. However, the Bureau is not adopting the provision in the proposal that would have disqualified an individual from acting as a loan originator because of a felony conviction under the law of a foreign jurisdiction. The Bureau is concerned that loan originator organizations might not be able to determine whether a foreign jurisdiction classifies crimes as felonies, and foreign convictions may be unlikely to be included in a criminal background check.

The Bureau is adopting § 1026.36(f)(3)(ii)(A) with these revisions and clarifications.

36(f)(3)(ii)(B)

Under proposed § 1026.36(f)(3)(ii)(B), a loan originator organization would have been required to determine that the individual loan originator has demonstrated financial responsibility, character, and general fitness to warrant a determination that the individual loan originator will operate honestly, fairly, and efficiently.[155] This standard is identical to the standard that State agencies apply to applicants for SAFE Act-compliant loan originator licenses, except that it does not include the requirement to determine that the individual's financial responsibility, character, and general fitness are "such as to command the confidence of the

[155] While the proposed regulatory text also included the requirement to determine that the individual's financial responsibility, character, and general fitness are "such as to command the confidence of the community," the preamble indicated that this requirement would not be included. 77 FR at 55327. The inclusion of that language in the regulatory text was inadvertent.

community." The Bureau believes that responsible depository institutions and bona fide nonprofit organizations already apply similar standards when hiring or transferring any individual into a loan originator position. The proposed requirement formalized this practice to ensure that the determination considers reasonably available, relevant information to ensure that, as with the case of the proposed criminal background standards, consumers could be confident that all individual loan originators meet common minimum qualification standards for financial responsibility, character, and general fitness. Proposed comment 36(f)(3)(ii)(B)-1 clarified that the review and assessment need not include consideration of an individual's credit score but must include consideration of whether any of the information indicates dishonesty or a pattern of irresponsible use of credit or of disregard for financial obligations. As an example, the comment stated that conduct revealed in a criminal background report may show dishonest conduct, even if the conduct did not result in a disqualifying felony conviction. It also distinguished delinquent debts that arise from extravagant spending from those that arise, for example, from medical expenses. The proposal stated the Bureau's view that an individual with a history of dishonesty or a pattern of irresponsible use of credit or of disregard for financial obligations should not be in a position to interact with or influence consumers in the loan origination process, during which consumers must decide whether to assume a significant financial obligation and determine which of any presented mortgage options is appropriate for them.

The Bureau recognized that, even with the proposed comment, any standards for financial responsibility, character, and general fitness inherently include subjective components. During the Small Business Review Panel, some Small Entity Representatives expressed concern that the proposed standard could lead to uncertainty whether a loan originator organization was meeting it. The proposed standard excluded the phrase "such as to command the confidence of the community” to reduce the potential for such uncertainty. Nonetheless, in light of the civil liability imposed under TILA, the Bureau invited public comment on how to address this concern while also ensuring that the loan originator organization’s review of information is sufficient to protect consumers. For example, the Bureau asked whether a loan originator organization that reviews the required information and documents a rational explanation for why relevant negative information does not show that the standard is violated should be presumed to have complied with the requirement.

Several depository institution commenters stated that the proposed standards for financial responsibility, character, and general fitness were too subjective. One civil rights organization commenter expressed concern that the standards could be used by loan originator organizations as a pretext for discriminating against job applicants. Several bank and credit union commenters stated that subjective or vague standards could lead to litigation by rejected applicants. Many of the same commenters requested that the Bureau include a safe harbor under the standard, such as a minimum credit score. One bank commenter noted it already follows FDIC guidance that calls on depository institutions to establish written procedures for screening applicants. Some depository commenters stated that an individual could have negative information in his or her credit report resulting from divorce or the death of a spouse, and that it is usually not possible to determine from a credit report whether negative information was the result of dishonesty or profligate spending, rather than situations beyond the control of the individual. One commenter agreed with the Bureau’s view that the language from the SAFE Act standard requiring that an individual “command the confidence of the community” is especially vague and should be omitted.

The Bureau appreciates and agrees with the concerns expressed in several of the public comments. The Bureau continues to believe that it is important for covered loan originator organizations to evaluate carefully the financial responsibility, character, and general fitness of individuals before employing them in the capacity of a loan originator, but the Bureau also agrees that loan originator organizations should not face increased litigation risk or uncertainty about whether they are properly implementing a standard that necessarily includes a subjective component. Accordingly, although the Bureau is adopting § 1026.36(f)(3)(ii)(B) as described above, it is revising comment 36(f)(3)(ii)(B)-1 to provide further interpretation concerning factors to consider in making the required determinations. In addition, the Bureau is adding comment 36(f)(3)(ii)(B)-2 to provide a procedural safe harbor so that loan originator organizations can have greater certainty that they are in compliance.

Comment 36(f)(3)(ii)(B)-1 is revised to remove references to factors that may not be readily determined from the information that the loan originator organization is required to obtain under § 1026(f)(3)(i) and to conform the comment more closely to the factors that State regulators use in making the corresponding determinations for loan originator licensing applicants. For example, it is revised to avoid any implication that a loan originator organization is expected to be able to determine from a credit report whether an individual's spending has been extravagant or has acted dishonestly or subjectively decided to disregard financial obligations. The comment enumerates factors that can be objectively identified for purposes of the financial responsibility determination, including the presence or absence of current outstanding judgments, tax liens, other government liens, nonpayment of child support, or a pattern of bankruptcies, foreclosures, or delinquent accounts. Following the practice of many States, the comment specifies that debts arising from medical expenses do not render an individual unqualified. It further specifies that a review and assessment of character and general fitness is sufficient if it considers, as relevant factors, acts of dishonesty or unfairness, including those implicated in any disciplinary actions by a regulatory or professional licensing agency as may be evidenced in the NMLSR. The comment, however, does not mandate how a loan originator organization must weigh any information that is relevant under the specified factors. It clarifies that no single factor necessarily requires a determination that the individual does not meet the standards for financial responsibility, character, or general fitness, provided that the loan originator organization considers all relevant factors and reasonably determines that, on balance, the individual meets the standards.

As the Bureau anticipated in the proposal, even with clarifications about the factors that make a loan originator organization's review and assessment of financial responsibility, character, and fitness sufficient, the provision still requires significant subjective judgment. Accordingly, the Bureau believes that a procedural provision is warranted to ensure that loan originator organizations have reasonable certainty that they are complying with the requirement. Accordingly, comment 36(f)(3)(ii)(B)-2 clarifies that a loan originator organization that establishes written procedures for determining whether individuals meet the financial responsibility, character, and general fitness standards under § 1026.36(f)(3)(ii)(B) and follows those written procedures for an individual is deemed to have complied with the requirement for that individual. The comment specifies that such procedures may provide that bankruptcies and foreclosures are considered under the financial responsibility standard only if they occurred within a timeframe established in the procedures. In response to the suggestion in public comments, the comment provides that, although review of a credit report is required, such procedures are not required to include a review of a credit score.

The Bureau declines to provide the safe harbor suggested by the commenter that further review and assessment of financial responsibility is not required for an individual with a credit score exceeding a high threshold. The Bureau is concerned that credit scores are typically developed for the purpose of predicting the likelihood of a consumer to repay an obligation and for similar purposes. A credit score may not correlate to the criteria for financial responsibility in this final rule. It is the Bureau's understanding that, for this reason, the major consumer reporting agencies do not provide credit scores on credit reports obtained for the purpose of employment screening.

The procedural safe harbor provides a mechanism for a loan originator organization to specify how it will weigh information under the factors identified in comment 36(f)(3)(ii)(B)-1, including instances identified by the commenters, such as financial difficulties arising from divorce or the death of a spouse or outstanding debts or judgments that the individual is in the process of satisfying.

The Bureau notes that, as further discussed below, the final rule requires in § 1026.36(j) that depository institutions must establish and maintain procedures for complying with § 1026.36(d), (e), (f), and (g), including the requirements to make the determinations of financial responsibility, character, and general fitness. The Bureau expects that a depository institution could have a single set of procedures to comply with these two provisions, as well as, for example, those under § 1007.104 of Regulation G and those in the regulations and guidance of prudential regulators, such as the FDIC guidance on screening candidates identified by the commenter.

The proposal would not have required employers of unlicensed individual loan originators to obtain the covered information and make the required determinations on a periodic basis. Instead, it contemplated that these employers would obtain the information and make the determinations under the criminal, financial responsibility, character, and general fitness standards before an individual acts as a loan originator in a closed-end consumer credit transaction secured by a dwelling. However, the Bureau invited public comment on whether such determinations should be required on a periodic basis or whether the employer of an unlicensed loan originator should be required to make subsequent determinations only when it obtains information that indicates the individual may no longer meet the applicable standards.

Commenters urged the Bureau to clarify that a loan originator organization is required to make the determinations only once, rather than periodically, or a second time only if the loan originator organization learns the individual loan originator has been convicted of a felony after the initial determination. Several commenters asked the Bureau to clarify that loan originator organizations are not required to make the determinations for individual loan originators who are already employed and have already been screened by the loan originator organization. Large bank commenters stated that having to make the determinations for current loan originator employees would be extremely burdensome.

The Bureau agrees that it would be burdensome and somewhat duplicative for a loan originator organization to have to obtain a credit report, a new criminal background check, and information about enforcement actions and apply retroactively the criminal background, financial responsibility, character, and general fitness standards of this final rule to individual loan originators that it had already hired and screened prior to the effective date of this final rule under the then-applicable standards, and is now supervising on an ongoing basis. As explained in the proposal, the Bureau believes that most loan originator organizations were already screening their individual loan originators under applicable background standards, and the

Bureau does not seek to impose duplicative compliance burdens on loan originator organizations with respect to individual loan originators that they hired and in fact screened under standards in effect at the time of hire. Accordingly, this final rule clarifies in § 1026.36(f)(3)(i) and (ii) and in new comment 36(f)(3)(ii)-2 that the requirements apply for an individual that the loan originator organization hires on or after January 10, 2014, the effective date of these provisions, as well as for individuals hired prior to this date but for whom there were no applicable statutory or regulatory background standards in effect at the time of hire or before January 10, 2014, used to screen the individual.[156]

Additional revisions to § 1026.36(f)(3)(i) and (ii) and new comment 36(f)(3)(ii)-3 respond to the commenter's concerns about when a loan originator organization is required to make subsequent determinations. They specify that such determinations are required only if the loan originator organization has knowledge of reliable information indicating that the individual loan originator likely no longer meets the required standards, regardless of when the individual loan originator was previously hired and screened. As an example, comment 36(f)(3)(ii)-3 states that if the loan originator organization has knowledge of criminal conduct of its individual loan originator from a newspaper article, a previously obtained criminal background report, or the NMLSR, the loan originator organization must determine whether any resulting conviction, or any other information, causes the individual to fail to meet the standards in § 1026.36(f)(3)(ii), regardless of when the loan originator was hired or previously screened.

The Bureau believes that comments 36(f)(3)(ii)-2 and 36(f)(3)(ii)-3, taken together, provide an appropriate balance for determining when a loan originator organization is required to

[156] The Bureau's decision not to apply certain qualification requirements otherwise imposed by this rule to loan originators hired before January 10, 2014, is also an exercise of the Bureau's authority under TILA section 105(a). This rule differentiates loan originators based on their date of hire to facilitate compliance.

screen an individual loan originator hired prior to January 10, 2014, under the standards in § 1026.36(f)(3)(i) and (ii). The approach recognizes that, as the Bureau stated in the proposal, many loan originator organizations already screened their employees under applicable statutory or regulatory standards for criminal background, character, fitness, and financial responsibility that are similar to those in this final rule, prior to the this rule's effective date. To the extent that an individual was determined to meet such standards in effect at the time the individual was hired, but does not meet the standards of this final rule, the Bureau believes the loan originator organization is likely to have knowledge of reliable information indicating that may be the case. For example, the criminal background check that the loan originator organization previously obtained or an entry in the NMLSR may have indicate a felony conviction covered by this rule. Likewise, the loan originator organization is highly likely to have knowledge of the individual loan originator's character and fitness as a result of monitoring the individual's performance over the course of the individual's employment.

The Bureau does not agree that the subsequent review should apply only if the loan originator organization learns that the individual has committed a felony because such a rule would categorically exclude information that seriously implicates the financial responsibility, character, and general fitness standards. However, the Bureau notes that the procedural safe harbor discussed above provides a mechanism for loan originator organizations to adopt specific procedures for when and how such information is considered in subsequent determinations.

36(f)(3)(iii)

In addition to the screening requirements discussed above, proposed § 1026.36(f)(3)(iii) would have required loan originator organizations to provide periodic training to their individual loan originators who are not licensed under the SAFE Act and thus not covered by that Act's training requirements. The proposal provided that the training must cover the Federal and State law requirements that apply to the individual loan originator's loan origination activities. The proposed requirement was analogous to, but more flexible than, the continuing education requirement that applies to loan originators who are subject to SAFE Act licensing. Whereas the SAFE Act requires 20 hours of pre-licensing education and eight hours of preapproved classes every year, the proposed requirement is intended to be flexible to accommodate the wide range of loan origination activities in which loan originator organizations engage and for which covered individuals are responsible. For example, the proposed training provision would have applied to a large depository institution providing complex mortgage loan products as well as a nonprofit organization providing only basic home purchase assistance loans secured by a subordinate lien on a dwelling. The proposed provision also recognized that covered individuals may already possess a wide range of knowledge and skill levels. Accordingly, it required loan originator organizations to provide training to close any gap in the individual loan originator's knowledge of Federal and State law requirements that apply to the individual's loan origination activities.

The proposed requirement also differed from the analogous SAFE Act requirement by not including a requirement to provide training on ethical standards beyond those that amount to State or Federal legal requirements. In light of the civil liability imposed under TILA, the Bureau solicited public comment on whether there exist ethical standards for loan originators that are sufficiently concrete and widely applicable to allow loan originator organizations to determine what subject matter must be included in the required training, if the Bureau were to include ethical standards in the training requirement.

Proposed comment 36(f)(3)(iii)-1 included explanations of the training requirement and also described the flexibility available under § 1026.36(f)(3)(iii) regarding how the required training is delivered. It clarified that training may be delivered by the loan originator organization or any other party through online or other technologies. In addition, it stated that training that a Federal, State, or other government agency or housing finance agency has approved or deemed sufficient for an individual to originate loans under a program sponsored or regulated by that agency is sufficient to meet the proposed requirement, to the extent that the training covers the types of loans the individual loan originator originates and applicable Federal and State laws and regulations. It further stated that training approved by the NMLSR to meet the continuing education requirement applicable to licensed loan originators is sufficient to meet the proposed requirement to the extent that the training covers the types of loans the individual loan originator originates and applicable Federal and State laws and regulations. The proposed comment recognized that many loan originator organizations already provide training to their individual loan originators to comply with requirements of prudential regulators, funding agencies, or their own operating procedures. Thus, the proposed comment clarified that § 1026.36(f)(3)(iii) did not require training that is duplicative of training that loan originator organizations are already providing if that training meets the standard in § 1026.36(f)(3)(iii). These clarifications were intended to respond to questions that Small Entity Representatives raised during the Small Business Review Panel discussed above.

Several bank and credit union commenters stated that they already provide the training required under the proposal to comply with the requirements of prudential regulators. One commenter stated that more specific requirements are needed so that loan originator organizations can be certain they are in compliance. One commenter stated that the standard should cover training in legal requirements only and not in ethics. One credit union association expressed concern that regardless of what the rule provided, agency examiners would ultimately require credit union loan originators to take eight hours of NMLSR classes annually. A provider of NMLSR-approved training urged the Bureau to require loan originators to take 20 hours of NMLSR-approved classes initially and five hours annually thereafter, including classes in ethics. The commenter stated that depository institution employees should have to take NMLSR-approved training because many of the worst loan originators who contributed to the subprime lending crisis were employed by depository institutions. One bank commenter stated that a loan originator who opts to take and passes the national component of the NMLSR standardized test should be exempt from periodic training requirements, and that a loan originator who does receive training should be able to do so before or after obtaining a unique identifier issued by the NMLSR (also referred to as an NMLSR ID). The same commenter asked for clarification that a national bank-employed loan originator need not be trained in state legal requirements, and that a bank-employed loan originator should be presumed to be well trained and qualified.

As stated in the proposal, the Bureau agrees that the training that many depository institutions already provide to comply with prudential regulator requirements will be sufficient to meet the proposed requirement in § 1026.36(f)(3)(iii), which the Bureau is adopting without change. The Bureau did not propose to require covered individual loan originators to take a fixed number of NMLSR-approved classes initially or each year precisely out of the concern that such training could be largely duplicative of training that individual loan originators already receive. Accordingly, the Bureau is not adopting the commenter's suggestion that it require NMLSR-approved training. The Bureau notes that comment 36(f)(3)(iii)-1 clarifies that a loan originator organization may satisfy the training requirement by taking the NMLSR-approved continuing education class. The Bureau is not in a position to address the commenter's concern that prudential regulators would require individual loan originators to take NMLSR-approved classes notwithstanding the flexibility of Bureau's training requirement.

The Bureau also declines to adopt a provision that any individual loan originator employed by a bank, or an individual loan originator who opts to take and passes the NMLSR standardized test, should be deemed trained and qualified and therefore exempt from periodic training. The requirement that training be provided on a periodic basis addresses the fact that legal requirements change over time and that an individual's memory and knowledge of applicable requirements may fade over time. Taking and passing a test one time would therefore not be an adequate substitute for periodic training. Finally, the Bureau notes that the provision does not specify that training must be provided after a loan originator receives an NMLSR ID. It also does not provide for training to be reported to or tracked through the NMLSR.

The Bureau did not receive substantive comments indicating that there exists a definable body of ethical standards specific for loan originators and is not expanding the training requirement to mandate training in ethical standards in addition to the proposed training in legal requirements. Finally, the Bureau does not believe it is necessary or practical to specify in a generally applicable rule which laws apply to the wide range of loans originated by loan originators at various loan originator organizations, and therefore what subject matter must be included in an individual loan originator's training. The Bureau believes each loan originator organization should know the types of loans that each of its individual loan originators originates and which substantive legal requirements (including provisions of State law, to the extent applicable) apply to those loans. The Bureau notes that the training requirements under § 1026.36(f)(3)(iii) apply individual loan originators regardless of when they were hired.

36(g) Name and NMLSR Identification Number on Loan Documents

TILA section 129B(b)(1)(B), which was added by Dodd-Frank Act section 1402(a), provides that "subject to regulations" issued by the Bureau, a mortgage originator shall include on "all loan documents any unique identifier of the mortgage originator" issued by the NMLSR. Individuals who are subject to SAFE Act registration or State licensing are required to obtain an NMLSR ID, and many organizations also obtain NMLSR IDs pursuant to State or other requirements. Proposed § 1026.36(g), as described further below, would have implemented the statutory requirement that mortgage originators must include their NMLSR ID on loan documents and would have provided several clarifications. The Bureau stated its belief that the purpose of the statutory requirement is not only to permit consumers to look up the loan originator's record on the consumer access website of the NMLSR (www.nmlsconsumeraccess.org) before proceeding further with a mortgage transaction, but also to help ensure accountability of loan originators both before and after a transaction has been originated.

36(g)(1)

Proposed § 1026.36(g)(1) provided that loan originators must include both their NMLSR IDs and their names on loan documents because, without the associated names, a consumer may not understand whom or what the NMLSR ID number serves to identify. The proposal explained that having the loan originator's name may help consumers understand that they have the opportunity to assess the risks associated with a particular loan originator in connection with the transaction, which in turn promotes the informed use of credit. The Bureau explained that it believed that this was consistent with TILA section 105(a)'s provision for additional requirements that are necessary or proper to effectuate the purposes of TILA or to facilitate compliance with TILA. These provisions also clarified, consistent with the statutory requirement that mortgage originators include "any" NMLSR ID, that the requirement applies if the organization or individual loan originator has ever been issued an NMLSR ID. For example, an individual loan originator who works for a bona fide nonprofit organization is not required to obtain an NMLSR ID, but if the individual was issued an NMLSR ID for purposes of a previous job, that NMLSR ID must be included. Proposed § 1026.36(g)(1) also provided that the name and NMLSR IDs must be included each time any of these documents is provided to a consumer or presented to a consumer for signature.

Proposed comment 36(g)(1)-1 clarified that for purposes of § 1026.36(g), creditors would not be excluded from the definition of "loan originator." Proposed comment 36(g)(1)-2 clarified that the proposed requirement applied regardless of whether the organization or individual loan originator is required to obtain an NMLSR ID under the SAFE Act or otherwise. Proposed § 1026.36(g)(1)(ii), recognizing that there may be transactions in which more than one individual meets the definition of a loan originator, provided that the individual loan originator whose NMLSR ID must be included is the individual with primary responsibility for the transaction at the time the loan document is issued.

In its 2012 TILA-RESPA Proposal, the Bureau proposed to integrate TILA and RESPA mortgage disclosure documents as mandated by sections 1032(f), 1098, and 1100A of the Dodd-Frank Act. 12 U.S.C. 5532(f); 12 U.S.C. 2603(a); 15 U.S.C. 1604(b). As discussed below, the loan documents that would be required to include the name and NMLSR IDs include these mortgage disclosure documents. That separate rulemaking also addresses inclusion of the name and NMLSR IDs on the proposed integrated disclosures, as well as the possibility that in some circumstances more than one individual may meet the criteria that require inclusion of the

NMLSR ID. To ensure harmonization between the two rules, proposed comment 36(g)(1)(ii)-1 stated that, if more than one individual acts as a loan originator for the transaction, the requirement in § 1026.36(g)(1)(ii) may be met by complying with the applicable provision governing disclosure of NMLSR IDs in rules issued by the Bureau pursuant to Dodd-Frank Act sections 1032(f), 1098, and 1100A.

Commenters generally supported the proposed provision as a way to increase accountability. One commenter urged the Bureau to change the format of NMLSR IDs to allow consumers to determine whether the loan originator is licensed or registered because the commenter was concerned that a consumer might incorrectly assume that all loan originators are licensed. Several commenters asked for more clarity on how to determine which loan originator has primary responsibility for a transaction and has to include his or her name and NMLSR ID on a document. Commenters stated that the loan originator with primary responsibility should be, variously, the person who took a consumer’s application, the person whose name appears on the loan application under Federal Housing Finance Agency requirements, the person who is the consumer’s point of contact, or the person reasonably determined by the loan originator organization. One commenter asked for clarification that the names and NMLSR IDs must appear only once on each loan document rather than on every page of the loan document. Another commenter urged the Bureau to standardize exactly where on each loan document the names and NMLSR IDs must appear. Another commenter asked the Bureau to confirm that if the loan originator with primary responsibility for a transaction changes during the course of the transaction, issued loan documents do not have to be reissued merely to change the name and NMLSR on those documents.

In response to commenters' requests for more specificity on how to determine which individual loan originator has primary responsibility, the Bureau is clarifying in comment 36(g)(1)(ii)-1 that a loan originator organization that establishes and follows a reasonable, written policy for determining which individual loan originator has primary responsibility for the transaction at the time the document is issued complies with the requirement. The Bureau notes that, as further discussed below, the final rule requires in § 1026.36(j) that depository institutions must establish and maintain procedures for complying with § 1026.36(d), (e), (f), and (g) of this section, including the requirement to include names and NMLSR IDs on loan documents. The Bureau is also clarifying in comment 36(g)(1)-2 that, even if the loan originator does not have an NMLSR ID, the loan originator must still include his or her name on the covered loan documents.

The Bureau agrees with the comment urging that the names and NMLSR IDs should be required to appear only once on each loan document rather than on each page of a loan document. New comment 36(g)(1)(i)-3 includes this clarification. The Bureau does not agree that it should mandate exactly where the names and NMLSR IDs must appear on the credit application, note, and security instrument. Doing so would be impractical because State and local law may specify placement of items on documents that are to be recorded, such as the note and security instrument, and revising the format of the most commonly used credit application forms would implicate other rules beyond the scope of this rulemaking.

Finally, the Bureau agrees that, if the loan originator with primary responsibility for a transaction changes during the course of the transaction, previously issued loan documents do not have to be reissued merely to change the names and NMLSR IDs on those documents. This clarification is included in comment 36(g)(1)(ii)-1.

36(g)(2)

Proposed § 1026.36(g)(2) identified the documents that must include loan originators' names and NMLSR IDs as the credit application, the disclosure provided under section 5(c) of RESPA, the disclosure provided under TILA section 128, the note or loan contract, the security instrument, and the disclosure provided to comply with section 4 of RESPA. Proposed comment 36(g)(2)-1 clarified that the name and NMLSR ID must be included on any amendment, rider, or addendum to the note or loan contract or security instrument. These clarifications were provided in response to concerns that Small Entity Representatives expressed in the Small Business Review Panel that the statutory reference to "all loan documents" would lead to uncertainty as to what is or is not considered a "loan document." The proposed scope of the requirement's coverage was intended to ensure that loan originators' names and NMLSR IDs are included on documents that include the terms or prospective terms of the transaction or borrower information that the loan originator may use to identify loan terms that are potentially available or appropriate for the consumer. To the extent that any document not listed in § 1026.36(g)(2) is arguably a "loan document," the Bureau stated that it was specifying an exhaustive list of loan documents that must include loan originators' names and NMLSR IDs using its authority under TILA section 105(a), which allows the Bureau to make exceptions that are necessary or proper to effectuate the purposes of TILA or to facilitate compliance with TILA.

The proposal explained that this final rule implementing the proposed requirements to include names and NMLSR IDs on loan documents might be issued, and might generally become effective, prior to the effective date of a final rule implementing the Bureau's 2012 TILA-RESPA Integration Proposal. As a result, the requirement to include the name and NMLSR ID would apply to the current RESPA GFE and settlement statement and TILA disclosure until the issuance of the integrated disclosures. The Bureau recognized that such a sequence of events might cause loan originator organizations to have to incur the cost of adjusting their systems and procedures to accommodate the name and NMLSR IDs on the current disclosures even though those disclosures will be replaced in the future by the integrated disclosures. Accordingly, the Bureau solicited public comment on whether the effective date of the provisions regarding inclusion of the NMLSR IDs on the RESPA and TILA disclosures should be delayed until the date that the integrated disclosures are issued.

One commenter opposed what it perceived as a requirement to include the NMLSR ID in the RESPA settlement costs information booklet provided to consumers. Another commenter stated that the NMLSR should be required only on the application, note, and security instrument. One commenter stated that the names and NMLSR IDs should not be required on amendments, riders, or addenda to the note or security instruments because the note and security instrument will already have the names and NMLSR IDs on them. Several commenters urged the Bureau not to require the names and NMLSR IDs on the current RESPA GFE and settlement statement because those forms do not currently have space for the information and will be discontinued soon. For the same reason, several commenters urged the Bureau to delay the effective date of the provision until after the integrated forms and regulations are issued and effective.

The Bureau agrees that the loan originator names and NMLSR IDs should not be required to be included on the current RESPA GFE and HUD-1 (or HUD-1A) forms. The current RESPA GFE form has a designated space for the originator's name but not for the NMLSR ID. The current HUD-1 form (and HUD-1A form) has a designated space for the lender's name, but not for the originator's name and NMLSR ID. While the Bureau has no objection to loan originator names and NMLSR IDs being included on the current forms where not required, the Bureau believes it would be duplicative and unnecessarily expensive for the issuers of these forms to have to revise their systems only to have to revise them again once the Bureau implements its 2012 TILA-RESPA Integration Proposal. For this reason, the Bureau is generally implementing all Title XIV disclosure requirements to take effect at the same time.

Accordingly, the Bureau expects to adopt the requirement to include loan originator names and NMLSR IDs on the integrated disclosures at the same time that the rules implementing the 2012 TILA-RESPA Integration Proposal are adopted. The Bureau is adopting § 1026.36(g)(2) with § 1026.36(g)(2)(ii), and (v) reserved in this final rule. The Bureau expects to adopt references to the integrated disclosures in § 1026.36(g)(2)(ii), and (v) in the final rule implementing the 2012 TILA-RESPA Integration Proposal. In response to the commenter's concern that the loan originator names and NMLSR IDs should not be required to be included on preprinted booklets, the final rule, like the proposal, does not require inclusion on the booklets. The revisions to § 1026.36(g)(2) described above are expected to prevent any such misinterpretation.

The Bureau disagrees that the loan originator names and NMLSR IDs should be required only on the application, note, and security instrument. To promote accountability of loan originators throughout the course of the transaction, it is important for the names and NMLSR IDs to appear on the integrated loan estimate and closing disclosure as well, because these loan documents include the loan terms offered or negotiated by loan originators. However, as clarified above, the names and NMLSR IDs will not be required to be included on these additional loan documents until the use of those documents becomes mandatory under the Bureau's upcoming final rule on TILA-RESPA Integration.

The Bureau agrees with the commenter that the loan originator names and NMLSR IDs should not be required on amendments, riders, or addenda to the note or security instruments, as such documents will be attached the note or security instrument, which themselves are required to include the names and NMLSR IDs. Accordingly, the Bureau is not adopting proposed comment 36(g)(2)-1. Removal of this requirement is consistent with the Bureau's clarification in comment 36(g)(1)-3 that for any loan document, the names and NMLSR IDs are required to be included only one time, and not on each page.

36(g)(3)

Proposed § 1026.36(g)(3) defined "NMLSR identification number" as a number assigned by the NMLSR to facilitate electronic tracking of loan originators and uniform identification of, and public access to, the employment history of, and the publicly adjudicated disciplinary and enforcement actions against, loan originators. The definition is consistent with the definition of "unique identifier" in section 1503(12) of the SAFE Act, 12 U.S.C. 5102(12). The Bureau did not receive any public comments on this definition and is adopting it as proposed.

36(h) Prohibition on Mandatory Arbitration Clauses and Waivers of Certain Consumer Rights

Section 1414 of the Dodd-Frank Act added TILA section 129C(e)(1), which prohibits a closed-end consumer credit transaction secured by a dwelling or an extension of open-end consumer credit secured by the consumer's principal dwelling from containing terms that require arbitration or any other non-judicial procedure as the method for resolving disputes arising out of the transaction. TILA section 129C(e)(2) provides that, subject to TILA section 129C(e)(3) a consumer and creditor or any assignee may nonetheless agree, after a dispute arises, to use arbitration or other non-judicial procedure to resolve the dispute. The statute further provides in section 129C(e)(3) that no covered transaction secured by a dwelling, and no related agreement between the consumer and creditor, may be applied or interpreted to bar a consumer from bringing a claim in court in connection with any alleged violation of Federal law.

The Bureau proposed § 1026.36(h) to implement these statutory provisions, pursuant to TILA section 105(a) and section 1022(b) of the Dodd-Frank Act. Proposed § 1026.36(h)(2) would have clarified the interaction between TILA sections 129C(e)(2) and (e)(3), and the section-by-section analysis noted that TILA section 129C(e)(3) and § 1026.36(h)(2) do not address State law causes of action.

Commenters generally supported the proposal. Although some commenters addressed details of the substance of the proposal, many commenters addressed the timing of the provisions' implementation. For example, several consumer groups stated that the proposal did not make any substantive changes to the statutory provisions and should be withdrawn because there was no reason to delay the effective date of the statutory provisions. One commenter acknowledged that the provisions were mandated by the Dodd-Frank Act but urged the Bureau to encourage mandatory arbitration anyway. SBA Advocacy stated that some Small Entity Representatives did not understand why the provisions were being included in this rule and asked the Bureau to consider adopting it at a later date. A bank association commenter urged the Bureau to delay the provisions until after it completed its required general study of arbitration clauses in consumer transactions, pursuant to section 1028 of the Dodd-Frank Act.

One commenter requested clarification on whether the provisions apply to waivers of rights to a jury trial. Other commenters questioned variously whether the proposal altered the statutory provisions: by applying the provision on waivers of causes of action to post-dispute agreements; by applying that provision to loans other than residential mortgage loans and open-end consumer credit plans secured by a principal dwelling; by limiting it to Federal causes of action; or by prohibiting mandatory arbitration clauses in contracts and agreements other than the note and agreements related to the note. One commenter stated that the applicability of the proposed rule provisions was confusing because the provisions refer to consumer transactions secured by a dwelling but their scope is also addressed separately in proposed § 1026.36(j). (Proposed § 1026.36(j) is finalized as § 1026.36(b) of the rule.) Finally, one commenter suggested that the statute and the rule would prohibit nonjudicial foreclosures and prevent a servicer from settling a dispute with a consumer through a settlement agreement.

The provisions on mandatory arbitration and waiver are contained in the Dodd-Frank Act. Absent action by the Bureau, they would take effect on January 21, 2013. The Bureau believes that it is necessary and appropriate to provide implementing language to facilitate compliance with the statute. At the same time, the Bureau recognizes the point made by several commenters regarding the importance of these consumer protections. The fact that the Bureau is implementing the provisions by regulation does not require the Bureau to delay the provisions' effective date for an extended period, as the commenters may have assumed. Instead, the Bureau is providing an effective date of June 1, 2013. The Bureau believes this effective date will give consumers the benefit of these statutory protections within a short timeframe, while also providing industry time to adjust its systems and practices. The Bureau does not believe that industry needs a longer period because the prohibitions on mandatory arbitration agreements and waivers of Federal claims have been known since the Dodd-Frank Act was enacted, and this final rule will not require extensive changes to origination systems. Furthermore, Fannie Mae and Freddie Mac do not accept loans that require arbitration or other nonjudicial procedures to resolve disputes, so the Bureau believes this aspect of the statute and final rule will not necessitate significant changes to current practices in most circumstances. The Bureau is not providing that the provision become effective immediately, however, in order to provide industry a short period to make any needed adjustments.

In response to the comments, the Bureau does not interpret TILA section 129C(e)(3) to limit waivers of rights to a jury trial because bench trials are judicial procedures, not nonjudicial procedures. The Bureau does not interpret TILA section 129C(e)(1) to limit deeds of trust providing for nonjudicial foreclosure because such instruments are not agreements to use nonjudicial procedures to resolve controversies or settle claims arising out of the transaction, in contrast with agreements to use arbitration, mediation, and other forms of alternative dispute resolution. Nor does the Bureau interpret TILA section 129C(e)(3) to limit nonjudicial foreclosures because nonjudicial foreclosures still allow consumers to bring actions in court alleging violations of Federal law.

Similarly, the Bureau does not interpret the statute to bar settlement agreements. Such a result would be a highly unusual—perhaps unprecedented—prohibition, and the Bureau believes that Congress would have spoken expressly about settlement agreements if that was the result it intended.[157] Instead, the Bureau reads the statute to mean that if a consumer and creditor or assignee agree, after a dispute or claim arises, to settle the dispute or claim, the settlement agreement may be applied or interpreted to waive the consumer's right to bring that dispute or claim in court, even if it is a Federal law claim. Accordingly, the Bureau is revising the regulatory text to clarify that § 1026.36(h) does not limit a consumer and creditor or any assignee from agreeing, after a dispute or claim under the transaction arises, to settle that dispute or claim. Under TILA section 129C(e)(3) and § 1026.36(h)(2), however, no settlement agreement may be

[157] *See, e.g.*, *Robinson v. Shelby Cnty. Bd. of Educ.*, 566 F.3d 642, 648 (6th Cir. 2009) ("[I]t is also well-established that '[p]ublic policy strongly favors settlement of disputes without litigation.... Settlement agreements should therefore be upheld whenever equitable and policy considerations so permit.'").

applied or interpreted to bar the consumer from bringing an action in court for any other alleged violation of Federal law.

The Bureau is further revising the regulatory text to address the belief of some commenters that the Bureau had altered the scope of the statutory provision. As discussed above, TILA section 129C(e)(2) provides that the exception for post-dispute agreements from the prohibition on mandatory arbitration agreements is itself subject to the prohibition on waivers of rights to bring Federal causes of action in court. The proposal specified that a post-dispute agreement to use arbitration or other nonjudicial procedure could not limit the ability of the consumer to bring a covered claim through the agreed-upon procedure. This final rule clarifies that, consistent with the discussion of waivers of causes of action in settlement agreements above, the Bureau interprets the statute to mean that if a consumer and creditor or assignee agree, after a dispute or claim arises, to use arbitration or other nonjudicial procedure to resolve that dispute or claim, the agreement may be applied or interpreted to waive the consumer's right to bring *that* dispute or claim in court, even if it is a Federal law claim. The Bureau believes that, in such an instance, the consumer is aware of the specific dispute or claim at issue and is therefore in a better position to make a knowing decision whether to resolve the dispute or claim without bringing an action in court. But no post-dispute agreement to use arbitration or other nonjudicial procedure may be applied or interpreted to bar the consumer from bringing an action in court for any other alleged violation of Federal law.

The Bureau disagrees with commenters who stated it had expanded the scope of TILA section 129C(e) to cover open-end consumer credit plans other than those secured by the principal dwelling of the consumer. Proposed § 1026.36(j) (implemented in this final rule as § 1026.36(b)) clarifies the scope of each of the other substantive paragraphs in § 1026.36 and provides that the only open-end consumer credit plans to which § 1026.36(h) applies are those secured by the principal dwelling of the consumer. However, to reduce uncertainty, the Bureau is including a statement in § 1026.36(h) that it is applicable to "a home equity line of credit secured by the consumer's principal dwelling."

The Bureau also disagrees that the proposed language changed the scope of the prohibition on waivers of causes of action by including the word "Federal" in the paragraph (h)(2) heading, "No waivers of Federal statutory causes of action." The contents of paragraph (h)(2) and the corresponding statutory paragraph (e)(3) both provide that the prohibition applies to alleged violations of Section 129C of TILA, any other provision of TILA, or any other Federal law. Thus, the scope of the statutory prohibition is limited to Federal law, and the implementing regulation is properly so limited.

Finally, the Bureau disagrees that the prohibition on agreements to use mandatory arbitration applies only to the note itself. TILA section 129C(e)(1) provides that it applies to the terms of a residential mortgage loan and to an extension of credit under an open-end consumer credit plan secured by the principal dwelling of the consumer. The terms of such transactions are frequently memorialized in multiple documents. Plainly, the prohibition cannot be evaded simply by including a provision for mandatory arbitration in a document other than the note if that document is executed as part of the transaction. The prohibition applies to the terms of the whole transaction, regardless of which particular document contains those terms. However, to prevent any misunderstanding that the prohibition applies to agreements that are not part of the credit transaction, the Bureau is replacing the phrase "contract or agreement in connection with a" consumer credit transaction with the phrase "contract or other agreement for" a consumer credit transaction.

36(i) Prohibition on Financing Single-Premium Credit Insurance

Dodd-Frank Act section 1414 added TILA section 129C(d), which generally prohibits a creditor from financing any premiums or fees for credit insurance in connection with a closed-end consumer credit transaction secured by a dwelling or an extension of open-end consumer credit secured by the consumer's principal dwelling. The prohibition applies to credit life, credit disability, credit unemployment, credit property insurance, and other similar products. The same provision states, however, that the prohibition does not apply to credit insurance for which premiums or fees are calculated and paid in full on a monthly basis or to credit unemployment insurance for which the premiums are reasonable, the creditor receives no compensation, and the premiums are paid pursuant to a separate insurance contract and are not paid to the creditor's affiliate.

Proposed § 1026.36(i) would have implemented these statutory provisions. The authority to implement these statutory provisions by rule is TILA section 105(a) and section 1022(b) of the Dodd-Frank Act. Rather than repeating Dodd-Frank Act section 1414's list of covered credit insurance products, the proposed language cross-referenced the existing description of insurance products in § 1026.4(d)(1) and (3). The Bureau explained that the proposal was not intended to make any substantive change to the statutory provision's scope of coverage. The proposal stated the Bureau's belief that these provisions are sufficiently straightforward that they require no further clarification. The Bureau requested comment, however, on whether any issues raised by the provision require clarification and, if so, how they should be clarified. The Bureau also solicited comment on when the provision should become effective, for example, 30 days following publication of the final rule, or at a later time.

Commenters generally supported the proposed provision. Two commenters asked the Bureau to permit financing of credit insurance when doing so would be beneficial to a consumer. SBA Advocacy stated that some Small Entity Representatives did not understand why the provision was being included and asked the Bureau to consider adopting it at a later date.

Several consumer groups stated that the proposal did not make any substantive changes to the statutory provision and stated that there is no reason to delay the effective date of the statutory provision. The same commenters asked the Bureau to clarify that a creditor cannot evade the prohibition by charging a fixed monthly payment that does not decrease as the principal is paid off or by adding the monthly charge to the loan balance. The commenters stated that the cross-reference to credit insurance products described elsewhere in Regulation Z could be read to narrow the scope of the prohibition and asked the Bureau to clarify what a "reasonable" credit unemployment insurance premium is.

A credit union sought clarification that the prohibition does not apply to mortgage insurance premiums. Finally, one commenter requested that the effective date of the prohibition be delayed for six months so that software programmers could program appropriate warnings and blockages in their loan originating systems.

The prohibition of financing of credit insurance is required by the Dodd-Frank Act. Absent action by the Bureau, they would take effect on January 21, 2013. The Bureau agrees with the commenters who stated that the provision is an important consumer protection that should not be delayed without good reason. The fact that the Bureau is implementing the provision by regulation does not require it to delay the provision's effective date for a long period, as the commenters may have assumed. Instead, the Bureau is providing an effective date of June 1, 2013. The Bureau believes this effective date will give consumers the benefit of this important protection within a short timeframe, while also providing industry time to adjust its systems and practices. The Bureau does not believe that industry needs a longer period of time because the prohibition, which is not substantially changed by this final rule, has been known since the Dodd-Frank Act was enacted and the codified regulation will not require extensive calibration of origination systems. Furthermore, Freddie Mac and Fannie Mae have prohibited the same practice for years.[158] The Bureau is not providing that the provision become effective immediately, however, because industry may need to make some adjustments based on the clarifications made in this final rule.

The Bureau is adopting the consumer groups' suggestion to incorporate the full list of covered insurance products from TILA section 129C(d) to prevent any perception that the Bureau did not intend for the regulatory provision to cover all of those insurance products. As revised, the final rule provides that the listed types of insurance are what insurance "means," not just what it "includes," because the list provided in the statute seems to be exclusive. The Bureau declines to define at this time what insurance premiums are "reasonable" for purposes of the exception for certain credit unemployment insurance products because the Bureau does not currently have sufficient data and other information to make this judgment for a rule of general applicability.

With regard to the requests for clarification that a creditor cannot evade the prohibition by charging a fixed monthly payment that does not decrease as the principal is paid off or by adding the monthly charge to the loan balance, the Bureau believes that the two practices identified would directly violate the prohibition. Adding a monthly charge for the insurance to the loan balance would amount to financing the premiums for credit insurance rather than paying

[158] *See, e.g.*, 2000 Freddie Mac policy, at http://www.freddiemac.com/sell/guide/bulletins/pdf/421indltr.pdf and 2004 Fannie Mae policy, https://www.fanniemae.com/content/announcement/04-05.pdf.

them in full on a monthly basis. Similarly, charging a fixed monthly charge for the credit insurance that does not decline as the loan balance declines would fail to meet the requirement for the premium to be "calculated…on a monthly basis." As a result, this practice would fail to satisfy the conditions for the exclusion from what constitutes "financ[ing], directly or indirectly" credit insurance premiums.

The Bureau agrees with the commenter that the provision does not apply to mortgage insurance. Mortgage insurance is not listed in TILA section 129C(d). Credit insurance generally insures a consumer in the event of a specified event, and the benefit provided is to make the consumer's periodic payments while the consumer is unable to make them. Mortgage insurance is distinguishable in that it insures a creditor (or its assignee) against loss in the event of default by the consumer or in other specified events.

36(j) Depository Institution Compliance Procedures

Dodd-Frank Act section 1402(a)(2) added TILA section 129B(b)(2), which provides that the Bureau "shall prescribe regulations requiring depository institutions to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions, and subsidiaries of such institutions, and the employees of such institutions or subsidiaries with the requirements of this section and the registration procedures established under section 1507 of the [SAFE Act]." 15 U.S.C. 1639b(b)(2). The Bureau notes that one week after the Dodd-Frank Act was signed into law, the Federal prudential regulatory agencies for banks, thrifts, and credit unions jointly issued a final rule requiring the institutions they regulate, among other things, to adopt and follow written policies and procedures designed to assure compliance with the registration requirements of the SAFE Act. That final rule was inherited by the Bureau and is designated as Regulation G. The Bureau believes that Regulation

G largely satisfies the provision under TILA section 129B(b)(2) for regulations requiring compliance policies and procedures, with regard to mortgage originator qualification requirements. TILA section 129B(b)(2) also requires the Bureau to prescribe regulations requiring depository institutions to establish and maintain procedures reasonable designed to assure and monitor compliance with all of TILA section 129B.

The proposal did not contain specific regulatory language to implement TILA section 129B(b)(2), but the Bureau stated that it might adopt such language in this final rule. Accordingly, it described the language it was considering in detail and solicited comment on the described text.

Specifically, the proposal stated the Bureau's expectation that such a rule would require depository institutions to establish and maintain procedures reasonably designed to ensure and monitor the compliance of themselves, their subsidiaries, and the employees of both with the requirements of § 1026.36(d), (e), (f), and (g). The Bureau stated that the rule would provide further that the required procedures must be appropriate to the nature, size, complexity, and scope of the mortgage credit activities of the depository institution and its subsidiaries. The Bureau solicited public comment on whether it should define "depository institution" using the FDIA's definition (which does not include credit unions), the SAFE Act's definition (which includes credit unions), or some other definition.

The Bureau further noted that under Regulation G only certain subsidiaries (those that are "covered financial institutions") are required by 12 CFR 1007.104 to adopt and follow written policies and procedures designed to assure compliance with Regulation G. Accordingly, the proposal noted that it may be appropriate to apply the duty to ensure and monitor compliance of subsidiaries and their employees under TILA section 129B(b)(2) only to subsidiaries that are covered financial institutions under Regulation G. Exercising TILA section 105(a) authority to make an adjustment or exception in this way may facilitate compliance by aligning the scope of the subsidiaries covered by the TILA and SAFE Act requirements.

Finally, the proposal questioned whether extending the scope of a regulation requiring procedures even further, to apply to other loan originators that are not covered financial institutions under Regulation G (such as independent mortgage companies), would help ensure consistent consumer protections and more equal compliance responsibilities among types of creditor. The Bureau discussed whether exercising TILA section 105(a) authority in this way is necessary or proper to effectuate the purpose stated in TILA section 129B(a)(2) of ensuring that consumers are offered and receive residential mortgage loans that are not unfair, deceptive, or abusive.

The Bureau therefore solicited comment on whether a regulation requiring procedures to comply with TILA section 129B should apply only to depository institutions as defined in section 3 of the FDIA, or also to credit unions, other covered financial institutions subject to Regulation G, or any other loan originators such as independent mortgage companies. Additionally, the Bureau solicited comment on whether it should apply the duty to ensure and monitor compliance of subsidiaries and their employees only with respect to subsidiaries that are covered financial institutions under Regulation G. With respect to all of the foregoing, the Bureau also solicited comment on whether any of the potential exercises of TILA section 105(a) authority should apply with respect to procedures concerning only SAFE Act registration, or with respect to procedures for all the duty of care requirements (*i.e.*, the qualifications and loan document provisions) in TILA section 129B(b)(1), or with respect to procedures for all the requirements of TILA section 129B, including the compensation and steering provisions and those added by section 1402 of the Dodd-Frank Act.

The Bureau also recognized that a depository institution's failure to establish and maintain the required procedures under the implementing regulation would constitute a violation of TILA, thus potentially resulting in significant civil liability risk to depository institutions under TILA section 130. *See* 15 U.S.C. 1640. The Bureau anticipated concerns on the part of depository institutions regarding their ability to avoid such liability risk and therefore sought comment on the appropriateness of establishing a safe harbor that would demonstrate compliance with the rule requiring procedures. It stated that such a safe harbor might provide that a depository institution is presumed to have met the requirement for procedures if it, its subsidiaries, and the employees of it and its subsidiaries do not engage in a pattern or practice of violating § 1026.36(d), (e), (f), or (g).

The Bureau did not receive any public comments on the contemplated provision requiring compliance procedures. The Bureau is adopting the contemplated provision to implement TILA section 129B(b)(2) in § 1026.36(j), which requires compliance policies and procedures corresponding only to the substantive requirements of TILA section 129B implemented through this final rule, namely those in § 1026.36(d), (e), (f), and (g). The adopted provision clarifies that the required procedures must be "written" to promote transparency, consistency, and accountability. The Bureau is adopting, for purposes of § 1026.36(j), the definition of "depository institution" in the SAFE Act, which includes credit unions, because the substantive provisions in § 1026.36(d), (e), (f), and (g) apply to credit unions. The Bureau notes that provisions implicating the contents of the written procedures that a depository institution establishes and maintains pursuant to § 1026.36(j) are included in §1026.36(f)(3)(ii)(B)*(3)* and comment 36(g)(1)(ii)-1.

VI. Effective Date

The amendments to § 1026.36(h) and (i) of this final rule are effective on June 1, 2013. The rule applies to transactions for which the creditor received an application on or after that date. All other provisions of the rule are effective on January 10, 2014. As discussed above in part III.G, the Bureau believes that this approach is consistent with the timeframes established in section 1400(c) of the Dodd-Frank Act and, on balance, will facilitate the implementation of the rules' overlapping provisions, while also affording creditors sufficient time to implement the more complex or resource-intensive new requirements.

In the proposal, the Bureau recognized that this rulemaking addresses issues important for consumer protection and thus should be implemented as soon as practical. The Bureau also recognized, however, that creditors and loan originators will need time to make systems changes, establish appropriate policies and procedures, and retrain their staff to address the Dodd-Frank Act provisions and other requirements implemented through this rulemaking. The Bureau stated that ensuring that industry has sufficient time to properly implement the necessary changes will inure to the benefit of consumer through better industry compliance, and solicited comment on an appropriate implementation period for the final rule in light of these competing considerations.

In response to the proposal, the Bureau received approximately 20 comments from industry participants with respect to the appropriate effective date for the requirements in the proposed rule. The majority of commenters, including large and small banks, credit unions, non-depository creditors, and State and national trade associations, requested that the Bureau provide the industry with ample time to implement the requirements of the final rule, but did not suggest a specific effective date or timeframe. For example, one State trade association representing banks and a mortgage company did not propose a specific effective date, but urged the Bureau to carefully consider the challenges involved with implementing such massive changes and to make every effort to avoid significant adverse impact on consumers, creditor, and the economy as a whole. Two commenters also noted that their software vendors were concerned about their ability to meet potential effective dates. A State trade association representing credit unions expressed concern about the number of changes required by the rule and suggested that the Bureau delay the effective date until all of the related proposals have been finalized. Further, another trade association representing credit unions stated that, if credit unions were not exempt from the new regulations, the Bureau should apply maximum flexibility in determining the implementation and effective dates of the final rule.

For commenters requesting a specific date for implementation, the time periods suggested ranged from 12 to 36 months. One large and one small credit union indicated that the Bureau should establish an implementation period of 18 months, while a leading industry trade association and a large bank advocated for an effective date of 18 to 24 months and 24 months, respectively. Further, one trade association representing manufactured housing providers requested that the Bureau use its authority to extend the effective date to the greatest extent possible and suggested an implementation date of up to 36 or 48 months after issuance of the rule. Each of the commenters generally stated that the requested time was necessary to effectively implement the regulations because of the complexity of the proposed rules, the impact on systems changes and staff training, and the cumulative impact of the proposed loan originator compensation rules when combined with other requirements imposed by the Dodd-

Frank Act or proposed by the Bureau. One major trade association referred to the complexity faced by HUD in implementing the RESPA reform rules from 2009 to 2011 and urged the Bureau to provide industry with an opportunity to review the rule and have uncertainties and ambiguities addressed before the implementation period begins. Similarly, another bank recommended that the Bureau establish an internal group to respond to industry questions and concerns regarding implementation.

The Bureau received three comments specifically regarding the effective date for § 1026.36(g), which requires the loan originator's name and NMLSR ID on all loan documents. One trade association requested that the Bureau delay the effective date for including the NMLSR IDs on forms until the rule implementing the TILA-RESPA integrated disclosure forms takes effect. The commenter urged that a delayed effective date would eliminate unnecessary costs for creditor to update the technology related to disclosures for this rule and then again once the new integrated disclosures are finalized. A large bank stated that the new NMLSR ID requirement, if adopted, should become effective no sooner than January 2014 to provide industry with enough time to make document forms and system changes. The bank commenter also recommended that a 12-month implementation period may not be adequate if banks do not timely receive updated note and security interest forms supplied by the Government Sponsored Enterprises ("GSEs") and federal agencies. One information services company did not propose a timeframe, but sought clarification of the effective date to ensure consistency across the industry.

Additionally, the Bureau received two comments from consumer groups specifically regarding the effective date of the ban on mandatory arbitration clauses in § 1026.36(h) and certain financing practices for single-premium credit insurance in § 1026.36(i). One of the consumer groups stated that the proposed regulation adds little to the statutory requirements and, thus, should take effect no later than January 21, 2013. The other consumer group did not propose a specific implementation date, but stated generally that the ban on mandatory arbitration clauses in section 1414 of the Dodd-Frank Act should be implemented immediately.

For the reasons already discussed above, the Bureau believes that an effective date of January 10, 2014 for most of the other title XIV final rules and all provisions of this final rule except § 1026.36(h) regarding mandatory arbitration and waivers of federal claims and § 1026.36(i) regarding certain financing practices for single-premium credit insurance will ensure that consumers receive the protections in these rules as soon as reasonably practicable. These effective dates take into account the timeframes established by the Dodd-Frank Act, the need for a coordinated approach to facilitate implementation of the rules' overlapping provisions, and the need to afford loan originators, creditors and other affected entities sufficient time to implement the more complex or resource-intensive new requirements. Accordingly, except for § 1026.36(h) and (i), the effective date for implementation of the regulations adopted in this notice is January 10, 2014. This time period is consistent with: (1) the request for the majority of comments for an ample amount of time to implement the requirements: (2) outreach conducted by the Bureau with vendors and systems providers regarding timeframes for updating core systems: and (3) the implementation period for other requirements imposed by the Dodd-Frank Act or regulations issued by the Bureau that may have a cumulative impact on loan originators and creditors. Although some commenters requested a longer time period to come into compliance with this rule, the Bureau believes that the implementation period adopted appropriately balances the need of industry to have a sufficient amount of time to bring their systems and practices into compliance with the goal of providing consumers the benefits of these new protections as soon as practical.

With respect to the Dodd-Frank Act's ban on mandatory arbitration clauses, waivers of Federal claims, and certain financing practices for single-premium credit insurance, the Bureau agrees with commenters that these requirements should be implemented without further delay. Accordingly, the requirements banning mandatory arbitration clauses, waivers of Federal claims, and certain financing practices for single-premium credit insurance in § 1026.36(h) and (i) take effect June 1, 2013. Thus, compliance with these provisions of this final rule will be mandatory nearly eight months earlier than the January 21, 2014 baseline mandatory compliance date that the Bureau is adopting for the other parts of this final rule and most of the Title XIV Rulemakings, as discussed above in part III.G. As that discussion notes, the Bureau is carefully coordinating the implementation of the Title XIV Rulemakings, including their mandatory compliance dates. The Bureau is including § 1026.36(h) and (i) of this final rule, however, among a subset of the new requirements of the Title XIV Rulemakings that will have earlier effective dates because the Bureau believes that they do not present significant implementation burdens for industry.

VII. Dodd-Frank Act Section 1022(b)(2)

In developing the final rule, the Bureau has considered potential benefits, costs, and impacts.[159] The proposed rule set forth a preliminary analysis of these effects, and the Bureau requested and received comments on this analysis. In addition, the Bureau has consulted or offered to consult with the prudential regulators, HUD, the FHFA, and the Federal Trade

[159] Specifically, section 1022(b)(2)(A) of the Dodd-Frank Act calls for the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services; the impact on depository institutions and credit unions with $10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act; and the impact on consumers in rural areas.

Commission, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies.

In this rulemaking, the Bureau amends Regulation Z to implement amendments to TILA made by the Dodd-Frank Act. The amendments to Regulation Z implement certain provisions in Dodd-Frank Act sections 1402 (new duties of mortgage originators concerning proper qualification, registration, and related requirements), 1403 (limitations on loan originator compensation to reduce steering incentives for residential mortgage loans), and 1414(a) (restrictions on the financing of single-premium credit insurance products and mandatory arbitration agreements and waivers of Federal claims in residential mortgage loan transactions). The final rule also provides clarification of certain provisions in the 2010 Loan Originator Final Rule, including the application of those provisions to certain profit-based compensation plans and the appropriate analysis of other payments made to loan originators.

The Board and Congress acted in 2010, as discussed in Part II above, to address concerns that certain methods of compensating loan originators could create potential moral hazard in the residential mortgage market, creating incentives for originators to persuade consumers to agree to loan terms, such as higher interest rates, that are more profitable to originators but detrimental to consumers. The final rule will continue the protections provided in the 2010 Loan Originator Final Rule while implementing additional provisions Congress included in the Dodd-Frank Act that, as discussed previously, improve the transparency of mortgage loan originations, preserve consumer choice and access to credit, and enhance the ability of consumers to accurately interpret and select among the alternative loan terms available to them.

A. Provisions To Be Analyzed

The analysis below considers the benefits, costs, and impacts of the following major provisions:

1. A complete exemption, pursuant to Dodd-Frank Act section 1403 and other authority, from the statutory prohibition in section 1403 on consumers paying upfront points and fees in all loan transactions where a loan originator receives compensation from someone other than a consumer for that particular transaction.

2. Clarification of the applicability of the prohibition on payment and receipt of loan originator compensation based on transaction terms to compensation by creditors or loan originator organizations through designated tax-advantaged plans in which individual loan originators participate and to payment of non-deferred profits-based compensation.

3. New requirements for loan originators, including requirements related to their licensing, registration, and qualifications, and a requirement to include their identification numbers and names on loan documents.

The prohibition of mandatory arbitration clauses and waivers of Federal claims in residential mortgage contracts and restrictions on the financing of single-premium credit insurance are also discussed.

The analysis considers the benefits and costs to consumers and covered persons from each of these provisions. The analysis also addresses comments the Bureau received on the proposed 1022(b)(2) analysis as well as certain other comments on the benefits or costs of provisions of the proposed rule when doing so is helpful to understanding the section 1022(b)(2) analysis. Comments that mention the benefits or costs of a provision of the rule in the context of commenting on the merits of that provision are addressed in the section-by-section analysis for that provision. The analysis also addresses the benefits, costs, and impacts of certain alternative provisions that were considered by the Bureau in the development of the final rule, including in response to comments. Broader and more detailed discussions of these alternative provisions, including the requirement to make available to the consumer an alternative loan that would not include discount points, origination points, or origination fees and the use of a revenue test to determine circumstances under which loan originators may receive certain compensation on the basis of profits from mortgage origination activities, can also be found in the section-by-section analysis above.

As noted, section 1022 of the Dodd-Frank Act requires that the Bureau, in adopting the rule, consider potential benefits and costs to consumers and covered persons resulting from the rule, including the potential reduction of access by consumers to consumer financial products or services resulting from the rule, as noted above; it also requires the Bureau to consider the impact of proposed rules on covered persons and the impact on consumers in rural areas. These potential benefits and costs, and these impacts, however, are not generally susceptible to particularized or definitive calculation in connection with this rule. The incidence and scope of such potential benefits and costs, and such impacts, will be influenced very substantially by economic cycles, market developments, and business and consumer choices that are substantially independent from adoption of the rule. No commenter has advanced data or methodology that it claims would enable precise calculation of these benefits, costs, or impacts. Moreover, the potential benefits of the rule on consumers and covered persons in creating market changes anticipated to address market failures are especially hard to quantify.

In considering the relevant potential benefits, costs, and impacts, the Bureau has utilized the available data discussed in this preamble, where the Bureau has found it informative, and applied its knowledge and expertise concerning consumer financial markets, potential business and consumer choices, and economic analyses that it regards as most reliable and helpful, to consider the relevant potential benefits and costs, and relevant impacts. The data relied upon by the Bureau includes the public comment record established by the proposed rule.[160] However, the Bureau notes that for some aspects of this analysis, there are limited data available with which to quantify the potential costs, benefits, and impacts of the final rule. The absence of public data regarding the specific distribution of loan products offered to consumers, for example, eliminates the ability to estimate precisely any empirical benefits from increased consumer choice.

In light of these data limitations, the analysis below generally provides a qualitative discussion of the benefits, costs, and impacts of the final rule. General economic principles, together with the limited data that are available, provide insight into these benefits, costs, and impacts. Where possible, the Bureau has made quantitative estimates based on these principles and the data that are available. For the reasons stated in this preamble, the Bureau considers that the rule as adopted faithfully implements the purposes and objectives of Congress in the statute.

[160] The Bureau noted in the mortgage proposals issued in summer 2012 that it sought to obtain additional data to supplement its consideration of the rulemakings, including additional data from the National Mortgage License System (NMLS) and the NMLS Mortgage Call Report, loan file extracts from various lenders, and data from the pilot phases of the National Mortgage Database. Each of these data sources was not necessarily relevant to each of the rulemakings. The Bureau used the additional data from NMLS and NMLS Mortgage Call Report data to better corroborate its estimate of the contours of the non-depository segment of the mortgage market. The Bureau has received loan file extracts from three lenders, but at this point, the data from one lender is not usable and the data from the other two is not sufficiently standardized nor representative to inform consideration of the final rules. Additionally, the Bureau has thus far not yet received data from the National Mortgage Database pilot phases. The Bureau also requested that commenters submit relevant data. All probative data submitted by commenters are discussed in this document.

Based on each and all of these considerations, the Bureau has concluded that the rule is appropriate as an implementation of the Act.

B. Baseline for Analysis

The amendments to TILA in sections 1403 and 1414(a) of the Dodd-Frank Act would have taken effect automatically on January 21, 2013, in the absence of these final rules implementing those requirements.[161] Specifically, new TILA section 129B(c)(2), which was added by section 1403 of the Dodd-Frank Act and restricts the ability of a creditor, the mortgage originator, or any affiliate of either to collect from the consumer upfront discount points, origination points, or origination fees in a transaction in which the mortgage originator receives from a person other than the consumer an origination fee or charge, would have taken effect automatically unless the Bureau exercised its authority to waive or create exemptions from this prohibition. New TILA section 129B(b)(1) requires each mortgage originator to be qualified and include unique identification numbers on loan documents. TILA section 129B(c)(1) prohibits mortgage originators in residential mortgage loans from receiving compensation that varies based on loan terms. TILA section 129C(d) creates prohibitions on single-premium credit insurance, and TILA section 129C(e) provides restrictions on mandatory arbitration agreements and waivers of Federal claims. These statutory amendments to TILA also would have taken effect automatically in the absence of the Bureau's instant regulation.

In some instances, this final rule provides exemptions to certain statutory provisions. These exemptions are made to enhance the benefits received by consumers relative to allowing the TILA amendments to take effect automatically. In particular, the Dodd-Frank Act prohibits consumer payment of upfront discount points, origination points, and origination fees in all

[161] Sections 129B(b)(2) and 129B(c)(3) of TILA, as added by sections 1402 and 1403 of the Dodd-Frank Act, however, do not impose requirements on mortgage originators until Bureau implementing regulations take effect.

residential mortgage transactions where someone other than the consumer pays a loan originator compensation tied to the transaction (*e.g.*, a commission). Pursuant to its authority under section 1403 of the Dodd-Frank Act to create exemptions from this prohibition when doing so would be in the interest of consumers and in the public interest, and other authority, the Bureau's final rule does not prohibit the use of upfront points and fees. In exercising its exemption authority, the Bureau maintains the current degree of choice available to consumers and the current methods by which creditors can hedge prepayment risk inherent in mortgage loans.

Thus, many costs and benefits of the provisions of the final rule arise largely or entirely from the statute, and not from the final rule. The final rule would provide substantial benefits compared to allowing these provisions to take effect by clarifying parts of the statute that are ambiguous. Greater clarity on these issues should reduce the compliance burdens on covered persons by reducing costs for attorneys and compliance officers as well as potential costs of over-compliance and unnecessary litigation. In addition, the final rule would provide substantial benefits by granting the exemptions to the statute described above that will benefit consumers and avoid disruption to the mortgage industry. Section 1022 of the Dodd-Frank Act permits the Bureau to consider the benefits and costs of the rule solely compared to the state of the world in which the statute takes effect without an implementing regulation. To provide the public better information about the benefits and costs of the statute, however, the Bureau has nonetheless chosen to evaluate the benefits, costs, and impacts of the major provisions of the final rule against a pre-statutory baseline. That is, the Bureau's analysis below considers the benefits, costs, and impacts of the relevant provisions of the Dodd-Frank Act combined with the final rule implementing those provisions relative to the regulatory regime that pre-dates the Act and remains in effect until the final rule takes effect. The one exception is the analysis of the

Bureau's adoption in the final rule of a complete exemption to the statutory ban on upfront points and fees. Evaluating this provision relative to a pre-statutory baseline would be an empty exercise, as the exemption preserves the pre-statute status-quo.

C. Coverage of the Final Rule

The final rule applies to loan originators, as that term is defined in § 1036.36(a)(1)(i). The new qualification and document identification requirements also apply to creditors that finance transactions from their own resources and meet the definition of a loan originator. The required compliance procedures only apply to depository institutions. Like existing § 1026.36(d) and (e), the new qualification, document identification, and compliance procedure requirements apply to closed-end consumer credit transactions secured by a dwelling (as opposed to the consumer's principal dwelling). The new arbitration, waiver, and single-premium credit insurance provisions apply to both closed-end consumer credit transactions secured by a dwelling and HELOCs subject to § 1026.40 and secured by the consumer's principal dwelling.

D. Potential Benefits and Costs of the Final Rule to Consumers and Covered Persons

1. *Full exemption of discount points and origination points or fees*

The Dodd-Frank Act prohibits consumer payment of upfront points and fees in all residential mortgage loan transactions, except those where a loan originator does not receive compensation that is tied to the specific transaction (*e.g.*, a commission) from someone other than a consumer.

Pursuant to its authority under section 1403 of the Dodd-Frank Act to create exemptions from this prohibition when doing so would be in the interest of consumers and in the public interest, the Bureau earlier proposed to provide that a creditor or loan originator organization may charge a consumer discount points or fees when someone other than the consumer pays a loan originator transaction-specific compensation, but only if the creditor also makes available to the consumer a comparable, alternative loan that excludes discount points, origination points, or origination fees. The proposal to require the creditor to satisfy this prerequisite was termed the "zero-zero alternative."

The Bureau chooses, at this time, to adopt a complete exemption to the statutory ban on upfront points and fees in the final rule, rather than the proposed zero-zero alternative. The Bureau believes that providing a complete exemption at this time, while preserving its ability to revisit the scope of the exemption in the future, will benefit consumers and the public interest by maintaining access to credit and the range of alternative mortgage products available to consumers at this time, and by avoiding any unanticipated effects on the nascent recovery of domestic mortgage and housing markets.

The Bureau strongly believes, however, that while an exemption from the statutory restrictions on points and fees is, at this time and under the current state of knowledge of the mortgage market, in the consumer and the public interests, future research could indicate that amending the existing regulations regarding points and fees would benefit consumers and the public. The Bureau intends to conduct research into this issue over the next five years. This five-year timeframe corresponds to the Bureau's responsibility to conduct a five-year review of the rule as required by the Dodd-Frank Act. Based on its research findings, the Bureau would, as part of this review, assess consumer and public welfare under a complete exemption of the statutory prohibition on points and fees. This five-year review period will allow the Bureau, as part of its research on points and fees, to assess effects on the mortgage market arising from the new disclosures to be issued by the Bureau when the 2012 TILA-RESPA Integration Proposal is finalized, the 2013 ATR Final Rule, the 2013 HOEPA Final Rule, and other relevant Title XIV rulemakings. The Bureau notes that these Title XIV rulemakings are likely to have a significant impact on how points and fees are structured in the mortgage market. If the Bureau determines over this period that additional requirements are needed, the Bureau would issue a new proposal for public notice and comment.

Potential Benefits and Costs to Consumers

In any mortgage transaction, the consumer has the option to prepay the loan and exit the existing contract. This option to repay has some inherent value to the consumer and imposes a cost on the creditor.[162] In particular, consumers usually pay for part of this option through one of three alternative means: (1) "discount points," which are the current payment of the value of future interest; (2) a "prepayment penalty," which is a payment of the same market value deferred until the time at which the loan balance is actually repaid; or (3) a higher coupon rate on the loan.

In many instances, creditors or loan originators will charge consumers an origination point or fee. When many loan originator organizations serve a mortgage market, competition between them drives these upfront payments to a level just sufficient to cover the cover the labor and material costs the organization incurs from processing the loan and these payments do not represent a source of economic profit for that loan originator organization. Here too, the loan originator could offer the consumer a loan with a higher interest rate in order to recover the creditor's costs. In this sense, discount points and origination points or fees are similar; from the

[162] Consumers who expect to pay the balance of their loan prior to maturity can purchase from creditors the sole right to choose the date of this payoff. This right is valuable and its price is the market value such a sale creates for creditors in regard to the date of this potential payoff. Creditors exchange rights with consumers but in the opposite direction with "callable" bonds. This type of bond exhibits an exactly opposite trade, in which the borrower cedes to the creditor the choice of time at which the creditor can require, if it chooses, the borrower to remit the remaining value of the bond.

consumer's perspective, they are various upfront charges the consumer may pay where the possibility may exist to trade some or all of this payment in exchange for a higher interest rate.

By permitting discount points under certain circumstances, the Bureau's final rule offers consumers greater choice over the terms of the coupon payments on their loans and a choice between paying discount points or a higher rate for the purchase of the prepayment option embedded in their loans.[163] In theory consumers make this choice, at least in part, based on how long they will stay in the particular loan. This, in turn, will depend primarily on how long they expect to stay in the property and their beliefs about future conditions in the mortgage market. At the time of origination, however, consumers necessarily have some uncertainty about future events; the actual outcome of such events could induce these consumers to pay off their loan after a shorter period than planned. Consequently, the benefits the consumer actually obtains at the termination of the loan may be less than those the consumer expected at the time of origination and could even result in the consumer suffering a realized loss.[164]

Greater choice over the terms of transactions and greater choice over how to pay for the prepayment option should, under all but rare circumstances, increase the ex ante welfare of

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[163] The two options are not mutually exclusive. In some transactions, consumers may pay for the embedded option through more than one of the methods outlined. *See, e.g.*, Donald Keenan & James J Kau, *An Overview of the Option-Theoretic Pricing of Mortgages*, 6 Journal of Housing Research 217 (1995) (providing an overview of options embedded in residential mortgages); James J Kau, Donald Keenan, Walter Muller & James Epperson, *A Generalized Valuation Model for Fixed-Rate Mortgages with Default and Prepayment*, 11 Journal of Real Estate Finance & Economics 5 (1995) (providing a traditional method to value these options numerically); Robert R. Jones and David Nickerson, *Mortgage Contracts, Strategic Options and Stochastic Collateral*, 24 Journal of Real Estate Finance & Economics 35 (2002) (generating numerical values, in current dollars, for option-embedded mortgages in a continuous-time environment).

[164] Similarly, consumers who expect to pay their loans over a period sufficiently short as to make the purchase of discount loans unattractive may find it better at the end of this expected period to continue to pay their mortgage and, consequently, suffer an unanticipated loss from refraining from the purchase of points. *See* Yan Chang & Abdullah Yavas, *Do Borrowers Make Rational Choices on Points and Refinancing?*, 37 Real Estate Economics 635 (2009) (offering empirical evidence that consumers in their sample data remain in their current fixed-rate mortgages for too short a time to recover their initial investment in discount points). Other empirical evidence, however, conflicts with these results in regard to both the frequency and magnitude of losses. Simple numerical calculations that take into account taxes, local volatility in property values, and returns on alternative assets highlight the difficulty in drawing conclusions from much of the empirical data.

consumers.[165] The degree to which individual consumers ultimately benefit after origination will depend on their individual circumstances and their relative degree of financial acuity.[166]

Relative to permitting the statutory provision to go into effect unaltered, the Bureau's exemption also provides the potential for an additional benefit to consumers when adverse selection in the mortgage market compounds the costs of uncertainty over early repayment. Consumers' purchase of discount points signals to creditors that the expected maturity of their loans is longer than those loans taken out by consumers who do not purchase discount points. This results in the consumer being offered a rate below the rate that would be offered if the rate-point trade-off did not incorporate the signal about the likely length of time that consumers paying points will hold the loan. Creditors respond by offering a lower average rate on each class of mortgages over which creditors have discretion in pricing.[167]

Potential Benefits and Costs to Covered Persons

Relative to implementation of the general statutory prohibition on points and fees without exercise of Bureau's exception authority, the ability to trade a lower loan rate to consumers in exchange for the upfront payment of discount points and origination points or fees is of

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[165] Such a circumstance includes, for example, the case in which the need to understand and decide among loans with different points and fees combinations imposes a burden on some consumers. The existence of increased choice made available by this provision would, in this case, be itself a cost to the consumer. Based on standard economic reasoning, the Bureau believes, however, that the circumstances in which the exercise of its exemption authority has the potential to reduce consumer welfare, relative to the statutory prohibition, are, for the most part, quite rare.

[166] The choice over the means by which consumers compensate creditors for the prepayment option is of particular potential benefit to consumers who currently enjoy high liquidity but who either face prospects of diminished liquidity in the future or are more sensitive to the risk posed by a high variance in their future income or wealth. Examples of such consumers include retiring or older individuals wishing to secure their future housing, individuals who are otherwise predisposed to use their wealth for a one-time payment, consumers with relocation funds available, and consumers offered certain rebates by developers or other sellers. In situations where consumers are unaware of their own circumstance or their own relative financial acuity, some creditors may be able to benefit. For example, an unethical creditor may persuade those consumers unaware of their lower relative financial ability to make incorrect decisions regarding purchasing points. The outcome of this type of adverse selection will be reversed when consumers have a more accurate knowledge of their financial abilities than does the creditor.

[167] Conversely, the elimination of the option to pay upfront points and fees could, depending on the extant risk in creditors' portfolios and their perceptions of differential risk between neighborhoods, seriously reduce the access to mortgage credit for some consumers.

significant benefit to all creditors participating in loan origination. When purchasing a mortgage, consumers also receive an option to prepay their mortgage balance at a time only they choose. While this "prepayment" option is valuable to consumers, it is also a source of risk to creditors, which lose future interest rate payments should the consumer prepay the consumer's loan prior to the loan's maturity. The potential for a mutually beneficial exchange of lower rates for current payment of points and fees allows a creditor to recoup a portion of the (market) value of this option, which is equivalent to the creditor's cost of bearing prepayment risk. This is a primary means by which a creditor can hedge the risk posed by fixed-rate mortgages, whether held or sold, to its portfolio and the value of its business.[168]

A related benefit for creditors arises from the presence of adverse selection among consumers in the mortgage market, which compounds the risks borne from early repayment. Allowing consumers to purchase discount points allows them to signal to creditors that they expect to make payments on their loans for a longer period than other consumers who choose not to purchase such points. Creditors gain from that information and will respond to such differences in behavior.[169] Increasing a creditor's ability to measure more precisely the prepayment risk and credit risk posed by an individual consumer allows it to more precisely adjust the prices or loans to correspond to the particular risk presented by each individual

[168] In contrast, the prohibition on payment of upfront points and fees in the Dodd-Frank Act under most circumstances would ensure that the value of the option to share risk through discount points is lost to both the creditor and the consumer in those circumstances. Absent other means of hedging prepayment risk, creditors would either need to reduce the volume of loans they originate or incur greater costs of raising capital to fund such loans, owing to the increased risk to their business and, consequently, to their solvency.

[169] Credible signaling in such a situation, from the creditor's perspective, distinguishes two groups of consumers—one with low prepayment risk who purchase discount points, and the second a group not purchasing discount points and, consequently, expect to prepay their loan more rapidly than average—in what would otherwise be a pool of consumers who are perceived by the creditor to exhibit an equivalent measure of prepayment risk.

consumer. By charging different loan rates to consumers who pose different degrees of risk, creditors will earn a greater overall return from funding mortgage loans.[170]

Both creditors and consumers, consequently, benefit from the role of discount points as a credible signal. This enhances the economic efficiency of the mortgage markets. The Bureau believes that this private means for reducing the risk that the mortgage loan (a liability for the consumer) can pose to the assets of the creditor is a significant source of efficiency in the mortgage market.

In addition, the final rule benefits covered persons by avoiding the imposition of transition costs, including such things as internal accounting procedures and origination software systems, which would have been imposed had the full statutory prohibition taken effect.

Finally, mindful of the state of the United States housing and mortgage markets, the final rule also reduces the chance that potential disruptions to the mortgage market might arise from the significant changes to the regulations under which loan originators, creditors, and consumers operate. This final rule should help promote the recovery and stability of those markets.

2. *Compensation Based on Transaction Terms*

Restricting the means by which a loan originator receives compensation is a way to mitigate potential harm to consumers arising from moral hazard on the part of loan originators.[171] Similar to the existing rule, the Dodd-Frank Act includes such restrictions to mitigate the potential harm to consumers arising from such moral hazard.

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[170] In this situation where the efficiency of the market is only impaired by adverse selection, this increase in creditor returns is independent of whether the creditor sells loans in the secondary market or chooses to engage in hedging to hold these mortgages in portfolio.

[171] Moral hazard, in the current context of mortgage origination, depends fundamentally on the advantage the loan originator has in knowing the least expensive transaction terms acceptable to creditors and greater overall knowledge of the functioning of mortgage markets. *See* Holden Lewis, *"Moral Hazard" Helps Shape Mortgage Mess*, Bankrate (Apr. 18, 2007), *available at*

The Dodd-Frank Act generally follows the existing rule's prohibition on compensating an individual loan originator based on the terms of a transaction. Although the statute and the existing rule are clear that an individual loan originator cannot be compensated differently based on the terms of the individual loan originator's transactions, they do not expressly address whether the individual loan originator may be compensated based on the terms of multiple transactions, taken in the aggregate, of multiple individual loan originators employed by the same creditor or loan originator organization.

The Bureau is aware that loan originator organizations may be unsure of how the restrictions on compensation in the current rule apply to compensation based on the profits of the organization.[172] The final rule and commentary address this uncertainty by clarifying the scope of the compensation restrictions in existing § 1026.36(d)(1)(i).[173] The final rule treats different methods of compensation differently based on an analysis of the incentives for originators to engage in moral hazard, as created for originators by each such method. The final rule permits a creditor or loan originator organization to make contributions to designated tax-advantaged plans (which include defined benefit and contribution plans that satisfy the qualification requirements of Internal Revenue Code section 401(a) or certain other Internal Revenue Code sections), even if the contributions are made out of mortgage-related business profits. The final rule also permits compensation under non-deferred profits-based compensation plans even if the amounts paid are funded through mortgage-related business profits, if: (1) the percentage of a loan originator's

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http://www.bankrate.com/brm/news/mortgages/20070418_subprime_mortgage_morality_a1.asp (providing a practitioner description of the costs of such moral hazard on the current mortgage and housing industries).

[172] Such compensation includes bonuses paid under profit-sharing plans, and contributions by creditors and loan originator organizations to designated and non-designated benefit and contribution plans.

[173] As noted in the section-by-section analysis, the Bureau issued CFPB Bulletin 2012-2 in response to the questions it received regarding the applicability of the current regulation to designated plans and non-designated plans, and this regulation is intended in part to provide further clarity on such issues. Until the final rule goes into effect, the clarifications in CFPB Bulletin 2012-2 will remain in effect.

compensation attributable to such compensation is equal to or less than 10 percent of total compensation; or (2) the individual loan originator has been a loan originator for ten or fewer transactions during the preceding 12-month period, *i.e.*, a de minimis test for individuals who originate a very small number of transactions per year. The final rule, however, generally reaffirms the existing rule insofar as it does not permit, under non-deferred profit-based compensation plans and designated defined contribution plans, that individual loan originators be compensated based on the terms of their individual transactions.

Potential Benefits and Costs to Consumers

The final rule benefits consumers by clarifying the existing rule to address and mitigate the moral hazard inherent in the nature of profits-based compensation and other types of compensation that are directly or indirectly based on the terms of multiple transactions of an individual loan originator (these are referred to in this section and the next section as "profits-based compensation"). Limiting such profits-based compensation for many firms limits the incentives to steer consumers into more expensive loans. To the extent that the existing rule already prohibits a type of compensation plan for loan originators, the final rule's prohibition of such a plan will not result in any new benefits to consumers. The Bureau's approach permits compensation under non-deferred profits-based compensation plans and compensation through designated tax-advantaged plans[174] only in cases in which the relationship between transaction terms and such forms of compensation are sufficiently weak to render insignificant any potential for steering incentives.

These forms of compensation are designed to provide individual loan originators and other individuals working for the creditor or loan originator organization with greater

[174] Payments to designated retirement plans include, for example, employer contributions to employee 401(k) plans.

performance incentives and to align their interests with those of the owners of the entity they work for.[175] When moral hazard exists, however, such compensation determined with reference to profits could lead to misaligned incentives on the part of individual loan originators with respect to consumers. The magnitude of adverse incentives arising from profits-based compensation, however, depends on several variables.[176] These include the number of individual loan originators working for the creditor or loan originator organization that contributes to the funds available for profits-based compensation, the means by which shares of the profits are distributed to the individual loan originators working for the same firm, and the ability of owners to monitor the current value of a loan on an ongoing basis.

The Bureau received a number of comments from industry disagreeing with the premise that profits-based compensation could create incentives for individual loan originators to persuade consumers to accept transactions terms that are costly for the consumer but more profitable for the loan originator. Some industry commenters admitted that such incentives existed but believed that, with regard to profits-based compensation, the incentives were insignificant. Commenters from consumer groups generally asserted that profits-based compensation creates incentives for individual loan originators to steer consumers into loans that are more costly to the consumer.

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[175] Bengt Holmstrom, *Moral Hazard and Observability*, Bell Journal of Economics 74 (1979), provides the first careful analysis of the effects such compensation methods have on employee incentives.

[176] When multiple originators are working for a given loan originator organization or creditor, the compensation to each individual loan originator will depend upon on the aggregate efforts of all the loan originators working for this entity, rather than directly on the individual loan originator's own performance. Consequently, if we compare the efforts of an individual loan originator working for a smaller entity with those of another individual at a larger entity, the effort by the individual at the larger entity will be less than the effort of the individual at the smaller entity, owing to the smaller influence any individual at the larger entity has on the amount of compensation awarded to the individual. This relationship between individual effort and the total number of peers in a given entity is termed "free-riding." Free riding behavior has been extensively analyzed: Surveys of these analyses appear in Martin L. Weitzman, *Incentive Effects of Profit Sharing, in Trends in Business Organization: Do Participation and Cooperation Increase Competitiveness?* (Kiel Inst. of World Econs.1995), *available at* http://ws1.ad.economics.harvard.edu/faculty/weitzman/files/IncentiveEffectsProfitSharing.pdf.

The Bureau recognizes that the potential that profits-based compensation has to create adverse incentives for individual loan originators depends, in general, on both how the efforts of individual loan originators affect profits and how those profits affect the compensation distributed to individual loan originators. The Bureau also recognizes that, depending on the particular environment in which a particular individual loan originator conducts business, these adverse incentives could decline as the number of individual loan originators involved in the specified profit-sharing plan increases.

The Bureau, however, notes that the current state of academic research has not provided an unequivocal answer to the question of whether any given profit-based compensation arrangement will produce incentives sufficiently strong for individual loan originators to engage in consumer steering. The Bureau also notes that this research, whether based on theoretical or empirical methods, shows that the potential for any profit-sharing plan to create adverse incentives are acutely sensitive to the specific features of the working environment and the means by which such profits are distributed to the relevant individual loan originators.[177]

[177] Economic research has established the general principle that the amount of work individuals put into a given task, in response to remuneration based on the sharing of profits, declines as the number of their peers increases ("free-riding."). No principle with such generality has been shown, however, in regard to the rate of this decline and the amount of individual work effort for any particular group of employees. Features of the means by which profits are distributed to individuals and the individual's environment within a given firm, such as the individual's ability to observe the performance of his peers and the frequency of managerial monitoring of individual performance, strongly affect these variables, as shown in a number of recent studies, including empirical and experimental research papers: Susan Helper, et al., *Analyzing Compensation Methods in Manufacturing: Piece Rates, Time Rates, or Gain-Sharing?*, (NBER Working Paper No. 16540, 2010); R. Mark Isaac & James M. Walker, *Group Size Effects in Public Goods Provision: The Voluntary Contributions Mechanism*, Quarterly Journal of Economics, 1988, 103 (1), 179–199; Xavier Gine & Dean Karlan *Peer Monitoring and Enforcement: Long Term Evidence from Microcredit Lending Groups with and without Group Liability*, (2008); and in a vast number of theoretical research papers, such as that of Bengt Holmström and Paul Milgrom, 1991, Multitask Principal Agent Analyses: Incentive Contracts, Asset Ownership and Job Design, Journal of Law, Economics and Organizations. Several surveys of this research have been published, including that of Candice Prendergast, *The Provision of Incentives in Firms*, J Econ. Literature, 7, 37 (1999), among others.

Finally, the Bureau notes that any potential reduction in the strength of these incentives is almost surely insufficient, under all realistic circumstances, to eliminate them entirely.[178]

Despite the uncertainties the remain in the economic literature, the Bureau believes that the approach taken in the final rule will benefit consumers by mitigating the moral hazard inherent in compensation systems that are based, directly or indirectly, on the terms of mortgage loan transactions, including those based on multiple transactions.

Potential Benefits and Costs to Covered Persons

As described above, considering the benefits, costs, and impacts of this provision requires the understanding of current industry practice against which to measure any changes. As discussed, the Bureau is aware, based in part on outreach to and inquiries received from industry, that originator organizations may be unclear about the application of the existing rule to profits-based compensation plans, including non-deferred profits-based compensation and employer compensation through designated plans. In light of this lack of clarity, the Bureau believes that industry practice likely varies and therefore any determination of the costs and benefit of the final rule depend critically on assumptions about current firm practices.

Firms that currently offer profits-based compensation for individual loan originators that would continue to be allowed under the final rule should incur no costs from the final rule. They could, however, benefit from the presence of a regulation and accompanying official commentary that clarifies which methods of loan originator compensation are permissible. Notably, the final rule explicitly states that employer contributions to designated defined

[178]Examples of empirical evidence of the persistence of moral hazard among employees in commercial and retail lending, include originators of residential mortgages, appears in Sumit Agarwal & Itzhak Ben-David, *Do Loan Officers' Incentives Lead to Lax Lending Standards?*, (Federal Reserve Bank of Chicago, Working Paper, 2012); Aritje Berndt, et al., *The Role of Mortgage Brokers in the Subprime Crisis*, (Carnegie Mellon University, Working Paper, 2010). Shawn Coleet, et al., *Rewarding Calculated Risk-Taking: Evidence from a Series of Experiments with Commercial Bank Loan Officers*, (Harvard Business School, Working Paper, 2010).

contribution plans in which individual loan originators participate are permitted, provided that the contributions are not based on the terms of the individual loan originator's transactions. Such firms can continue to benefit from these arrangements, which have the potential to motivate individual productivity, to reduce potential intra-firm moral hazard by aligning the interests of individual originators with those of creditor or loan originator organization for whom they work and to reduce the potential for increased costs arising from adverse selection in the retention of more productive individual loan originators. Firms that do not offer such plans would benefit, with the increased clarity of the final rule, from the opportunity to do so should they so choose.[179]

Similarly, some firms may currently compensate their individual loan originators through methods, such as designated defined benefit plans, the legality of which may have been unclear, with different originator organizations interpreting the existing rule differently. The final rule benefits these firms by clarifying the legality of various compensation practices.

As discussed above, the final rule permits compensation under non-deferred profits-based compensation plans, including bonuses, to be paid from mortgage-related profits if such compensation for an individual loan originator does not, in the aggregate, exceed 10 percent of the individual loan originator's total compensation. This will benefit firms that would prefer to pay these types of bonuses or make these types of contributions out of mortgage-related profits, but do not because of uncertainty about the application of the existing rule. Firms that currently compensate individual loan originators through non-deferred profits-based compensation plans in excess of 10 percent of individual loan originators' total compensation might have to adjust

[179] Some firms may choose not to offer such compensation. In certain circumstances, an originating institution (perhaps unable to invest in sufficient management expertise) will see reduced profitability from adopting profits-based compensation plans.

their non-deferred profits-based compensation to comply with the 10-percent total compensation test under the final rule. This may impose some adjustment costs or may make it more costly to attract or retain qualified loan originators.

The final rule also contains a de minimis provision exempting individuals who originate ten or fewer loans per year from limitations on non-deferred profits-based compensation. This provision is intended to avoid penalizing those individuals whose compensation from the origination of a small number of loans is insufficient to give them incentives inimical to the welfare of consumers. Industry commenters generally favored the de minimis exception, although a few commenters preferred a higher value for the de minimis threshold (*e.g.*, one trade association representing banks requested a threshold of 15). The Bureau's survey of recent research into the relation of the total number of employees in a given firm, the value of total compensation to any individual employee, and the effects on the behavior of individual employees of compensation that is based on the profits arising from the collective effort of all employees of that firm corroborates the judgment that any adverse incentives from profits-based compensation to an individual under the final rule's de minimis threshold are insignificant and do not affect the welfare of consumers.[180]

3. *Qualification Requirements for Loan Originators*

Section 1402 of the Dodd-Frank Act amends TILA to impose a duty on loan originators to be "qualified" and, where applicable, registered or licensed as a loan originator under State law and the Federal SAFE Act. Employees of depositories, certain of their subsidiaries, and bona fide nonprofit organizations currently do not have to meet the SAFE Act standards that apply to licensing, such as taking pre-licensure classes, passing a test, meeting character and

[180] See footnotes 100 and 101 for a number of examples of research in this area.

fitness standards, having no felony convictions within the previous seven years, or taking annual continuing education classes. To implement the Dodd-Frank-Act's requirement that entities employing or retaining the services of individual loan originators be "qualified," the final rule requires entities whose individual loan originators are not subject to SAFE Act licensing, including depositories and bona fide nonprofit loan originator entities, to: (1) ensure that their individual loan originators meet character and fitness and criminal background standards similar to the licensing standards that the SAFE Act applies to employees of non-bank loan originators; and (2) provide appropriate training to their individual loan originators commensurate with the mortgage origination activities of the individual. The final rule mandates training appropriate for the actual lending activities of the individual loan originator and does not impose a minimum number of training hours.

Industry commenters to the proposal disagreed that there is a need for individual loan officers to meet qualification standards because loan originators already must comply with the requirements of prudential regulations. The Bureau also received a number of requests from industry representatives to refrain from adopting mandatory testing and education requirements in favor of instead requiring taking courses and passing examinations approved by the NMLSR. Finally, an association of mortgage bankers requested that the Bureau explore imposing a national test for all bank employees or employees of creditors that offer loans.

The Bureau notes that it is not opposed to the idea of future testing for all bank employees or employees of creditors who offer loans. Conditional on the current state of the mortgage market, however, the Bureau believes that the burden imposed by comprehensive testing might, at this time, be sufficiently burdensome to further decrease benefits to consumers, and covered persons as a whole.

Potential Benefits and Costs to Consumers

The primary benefit to consumers of the qualification provisions of the final rule are that tighter qualifications will screen out, on an ongoing basis after implementation of the final rule and with regard to some loan officers currently employed who have not previously been screened, those individual originators with backgrounds suggesting they could pose risks to consumers and will raise the level of loan originator expertise regarding the origination process. Both of these effects will likely decrease the harm that could be borne, unknowingly at the time of origination, by any individual consumer.

Several industry representatives, including national and State industry trade associations and large depository institutions, expressed doubt about whether consumers would receive significant benefits from the change in qualification requirements.

The Bureau believes that its qualification requirement will improve consumer welfare because it will help ensure that any individual loan originator with whom a consumer negotiates a loan will possess levels of expertise and integrity no less than those required in the final rule and assures consumer that they bear relatively little risk of encountering a loan originator who lacks these qualifications. While measuring the magnitude of this benefit is impossible with currently available public data, the Bureau notes that the its qualification requirement will not only convey a direct benefit to consumers, it will, in addition, benefit both consumers and covered persons through the reduction of this source of adverse selection among new originators. This reduction will increase economic efficiency in the market and allow more mutually beneficial loan transactions to occur.

Potential Benefits and Costs to Covered Persons

The increased requirements for institutions that employ individuals not licensed under the SAFE Act would further assure that the individual loan originators in their employ satisfy those levels of expertise and standards of probity as specified in the final rule.[181] This would have a positive effect by tending to reduce any potential liability they incur in future mortgage transactions and to enhance their reputation among consumers. If the requirements, as expected, reduce the likelihood that consumers will encounter loan originators with inadequate expertise or integrity, this may lead to an increase in consumer confidence and may possibly increase the number of consumers willing to engage in these transactions. Some entities could, however, face increased recruitment, training, and related costs in complying with these new requirements.

In addition, relative to current market conditions, the final rule would create a more level "playing field" between non-depository institutions and depository and nonprofit institutions with regard to the enhanced training requirements and background checks that would be required of depository institutions. This may help mitigate possible adverse selection in the market for individual originators, in which individuals who cannot meet the requirements for non-depository institutions might seek employment by depository and nonprofit institutions.

These requirements may also slightly limit the pool of employees from which to hire, relative to the pool from which they can hire under existing requirements. Similarly, the requirement for credit checks for new hires (and those who were not screened under standards in effect at the time of hire) will result in some minimal increased costs. Bona fide nonprofit institutions not currently subject to the SAFE Act will have to incur the costs of both the criminal background check and the credit check.

4. *Mandatory Arbitration and Waivers of Federal Claims*

[181] Under Regulation G, depository institutions must already obtain criminal background checks for their individual loan originator employees and review them for compliance under Section 19 of the FDIA.

Section 1414 of the Dodd-Frank Act added section 129C(e) to TILA. Section 129C(e)(1) prohibits the inclusion of terms in any contract or agreement for a residential mortgage loan (as defined in the Dodd-Frank Act) or extension of open-end credit secured by the principal dwelling of the consumer that require arbitration or any other non-judicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction. Section 129C(e)(2) provides that a consumer and creditor may nonetheless agree, after a dispute arises, to use arbitration or other non-judicial procedure to resolve the dispute. The statute further provides in section 129C(e)(3) that no covered transaction secured by a dwelling, and no related agreement between the consumer and creditor, may bar a consumer's ability to bring a claim in court in connection with any alleged violation of Federal law. Section 1026.36(h) of the final rule implements and clarifies these statutory provisions.

The restrictions on mandatory arbitration and waiver of Federal claims are imposed by the Dodd-Frank Act. The Bureau is implementing these protections by regulation. The Bureau believes that implementing regulations provide benefits to consumers and covered persons by providing clarity and thereby facilitating compliance with the statutory provisions.

The Bureau received one comment from an industry association asserting that the prohibition of mandatory arbitration as a means of resolving disputes between consumer and creditor, and instead allowing the consumer to seek resolution through the court system would increase the cost of credit to consumers. One member of industry also speculated that, by allegedly expanding the statutory prohibition of mandatory arbitration to cover open-end consumer credit plans other than those secured by the principal dwelling of the consumer, the final rule could impose significant costs on those creditors making open-ended and other forms of credit available to consumers. Several consumer groups expressed concern regarding the timing of the implementation of the provision, asserting that, since the proposal made no substantive changes to the statutory provision, the effective date of implementation provided by the statute should also be maintained.

To the extent that contractual terms requiring mandatory arbitration and restricting waiver Federal claims benefit covered persons by reducing litigation and other expenses, the statute and implementing regulation will create costs for covered persons. The Bureau notes, however, that covered persons and consumers will still be permitted to agree, after a dispute has arisen, to submit *that* dispute to arbitration. The Bureau also notes that, to its knowledge, no compelling empirical evidence supports the comments that consumer access to the court system for the resolution of disputes would increase the cost of such mortgages to consumers. In addition, no evidence supporting this prediction was presented by the industry association making this assertion or by any other industry or consumer representative.

The Bureau disagrees with the assertion that the final rule would impose costs on those creditors marketing open-ended loans and other forms of credit not secured by principal dwelling of the consumer. Since proposed § 1026.36(j), implemented in the final rule as § 1026.36(b), clarifies that the only open-end consumer credit plans to which § 1026.36(h) applies are those secured by the principal dwelling of the consumer, no additional litigation cost is imposed on these creditors from this source.[182]

5. *Creditor Financing of "Single Premium" Credit Insurance*

Dodd-Frank Act section 1414 added section 129C(d) to TILA. Section 129C(d) pertains to a creditor financing credit insurance fees for the consumer. Although the provision permits insurance premiums to be calculated and paid in full per month, this provision prohibits a

[182] However, to reduce uncertainty, the Bureau is including a statement in § 1026.36(h) that it is applicable to "a home equity line of credit secured by the consumer's principal dwelling."

creditor from financing any fees, including premiums, for credit insurance in closed- and certain open-end loan transactions secured by a dwelling. The final rule implements the relevant statutory provision of the Dodd-Frank Act. Owing to the lack of transparency consumers may experience in negotiating a mortgage loan with a creditor while simultaneously needing to decide to finance their insurance, such as through an increase in their mortgage payments, with this same creditor, the Bureau believes there is significant potential for such a combined transaction to harm the consumer. The final rule should, on this basis, benefit consumers.

6. *Additional Potential Benefits and Costs*

Covered persons will have to incur some costs in reviewing the final rule and adapting their business practices to any new requirements. The Bureau notes that many of the provisions of the final rule do not require significant changes to current practice, since many of the provisions in this final rule are also in the existing rule, and therefore these costs should be minimal for most covered persons.

The Bureau has considered whether the final rule would lead to a potential reduction in access to consumer financial products and services. Firms will not have to incur substantial operational costs nor any potential loss owing to adverse selection among loan originators. As a result, the Bureau does not anticipate any material impact on existing consumer access to mortgage credit. The Bureau, however, does note that its final rule precludes any reduction in credit access that could otherwise occur without its exemption from the statutory prohibition on points and fees.

E. Potential Specific Impacts of the Final Rule

1. *Depository Institutions and Credit Unions with $10 Billion or Less in Total Assets, As Described in Section 1026*[183]

The Bureau believes that its final rule will provide significant benefits to smaller creditors. Although some creditors could incur potential costs associated with stricter qualification standards for newly hired loan officers, because of the Bureau's use of its exemption authority, smaller creditors will receive a significant benefit from their ability to continue to hedge the prepayment risk inherent in fixed-rate mortgages through the sale of discount points to their consumers. Smaller creditors normally use this method to hedge such risk because the relatively small volume of loans they finance make prohibitive the costs they incur in using other means of hedging, such as the sale of their loans in the secondary market or through transactions in swap and other derivatives markets. Absent the Bureau's use of its exemption authority, the statue's prohibition on the sale of discount points combined with extensive restrictions on prepayment penalties would have resulted in virtually all smaller creditors choosing to either originate a smaller volume of mortgage loans or bearing a higher degree of portfolio risk. This would result in the average smaller creditor being far less competitive with their larger rivals, losing market share, paying higher costs of funds, and bearing a greater risk of insolvency. The consequence of these disadvantages would inevitably be higher frequencies among small creditors of both bankruptcy and absorption by large financial holding companies. This would result in higher interest rates and reduced access to

[183] Approximately 50 banks with under $10 billion in assets are affiliates of large banks with over $10 billion in assets and subject to Bureau supervisory authority under Section 1025. However, these banks are included in this discussion for convenience.

credit to consumers. The final rule saves smaller creditors from these potential costs by exempting them from the ban on points and fees.

2. *Impact on Consumers in Rural Areas*

Consumers in rural areas are unlikely to experience benefits or costs from the final rule that significantly differ from those experienced by consumers in general. To the extent that consumers in rural areas may depend more heavily on small creditors, however, they may be more affected by the effects of the rule on small creditors, as described above.

VIII. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The Bureau is also subject to certain additional procedures under the RFA involving the convening of a panel to consult with small business representatives prior to proposing a rule for which an IRFA is required.[184] The Small Business Administration (SBA) designates an entity as "small" based on the whether the primary products or services it offers are within thresholds for these products and services set by the North American Industry Classification System (NAICS). An entity is considered "small" if it is an insured depository institution or credit union and holds $175 million or less in assets, or, if it is a non-depository mortgage lender, a mortgage brokerage or a mortgage servicer, if it generates $7 million or less in annual receipts.[185]

[184] 5 U.S.C. 609.
[185] The current SBA size standards are found on SBA's website at http://www.sba.gov/content/table-small-business-size-standards.

The Bureau did not certify that the proposed rule would have no significant economic impact on a substantial number of small entities. The Bureau, consequently, convened a Small Business Review Panel to obtain advice and recommendations of representatives of the regulated small entities. The section-by-section analysis in the proposal included detailed information on the Small Business Review Panel.[186] The Panel's advice and recommendations may be found in the Small Business Review Panel Report.[187] The section-by-section analysis in the proposal also included discussion of each Small Business Review Panel Report recommendation, and many of recommendations were included in the proposal.

The proposal contained an Initial Regulatory Flexibility Analysis (IRFA),[188] pursuant to section 603 of the RFA. In the IRFA, the Bureau solicited comment on the impact to small entities that would have resulted from the proposed provisions regarding record retention; the prohibition on the payment of upfront points and fees; the prohibition on compensation based on a transaction's terms; the use of mandatory arbitration in mortgage loan agreements; the prohibition on creditor financing of single premium credit insurance; loan originator qualification requirements; the prohibition of dual compensation of loan originators; restrictions on reducing loan originator compensation to cover the cost of pricing concessions; and the prohibition on compensation of loan originators based on a proxy for a relevant term in the mortgage transaction. Comments addressing the impacts of record retention, the prohibition on the payment of upfront points and fees, the prohibition on compensation based on a mortgage transaction's terms, the use of mandatory arbitration in mortgage loan transactions, and the prohibition on creditor financing of single premium credit insurance are discussed below.

[186] 77 FR 55272, 55341-55343 (Sept. 7, 2012).
[187] Final Panel Report available in the Proposed Rule Docket: Docket ID No. CFPB-2012-0037, *available at*. http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0037-0001.
[188] 77 FR 55272, 55341-55343 (Sept. 7, 2012).

Comments addressing loan originator qualification requirements, the dual compensation of loan originators, the reduction in loan originator compensation to bear the cost of pricing concessions, and the compensation of loan originators based on a proxy for a term in the mortgage transaction are addressed in the section-by-section analysis above. The section-by-section analysis above also notes the exemption granted by the Bureau under Dodd-Frank Act section 1403 and other authority in the final rule of all entities, including small entities, from the statutory ban on upfront points and fees.

Based on the comments received, and for the reasons stated below, the Bureau is not certifying that the final rule will not have a significant economic impact on a substantial number of small entities. Accordingly, the Bureau has prepared the following final regulatory flexibility analysis pursuant to section 604 of the RFA.

A. A Statement of the Need For, and Objectives of, the Rule

During the aftermath of the recent crisis in financial markets, in 2010 the Board issued the 2010 Loan Originator Final Rule. Authority for that rule now resides with the Bureau.[189]

The 2010 Loan Originator Final Rule addressed many concerns regarding the lack of transparency, consumer confusion, and steering incentives created by certain residential loan originator compensation structures. The Dodd-Frank Act included a number of provisions that substantially resembled those in the 2010 Loan Originator Final Rule, but also added further provisions.

The Board noted, in adopting the 2010 Loan Originator Final Rule, that the Dodd-Frank Act would necessitate further rulemaking to implement the additional provisions of the legislation not reflected by the regulation. These provisions are new TILA sections 129B(b)(1)

[189] A prior description of the details of the origin and nature of the 2010 Loan Originator Final Rule may be found in Background, Part II, appearing above.

(requiring each mortgage originator to be qualified and include unique identification numbers on loan documents), (b)(2) (requiring depository institution compliance procedures), (c)(1) and(c)(2) (prohibiting steering incentives including prohibiting mortgage originators from receiving compensation that varies based on loan terms and from receiving origination charges or fees from persons other than the consumer except in certain circumstances), and 129C(d) and (e) (prohibiting financing of single-premium credit insurance and providing restrictions on mandatory arbitration agreements and waivers of Federal claims), as added by sections 1402, 1403, and 1414 of the Dodd-Frank Act.

The Bureau, in undertaking this rulemaking, is also clarifying certain provisions of the 2010 Loan Originator Final Rule to provide additional clarity and reduce uncertainty to both consumers and covered persons.

The Dodd-Frank Act and TILA authorize the Bureau to adopt implementing regulations for the statutory provisions provided by sections 1402, 1403, and 1414 of the Dodd-Frank Act. The Bureau is using this authority to issue regulations to provide creditors and loan originators with clarity about their obligations under these provisions. The Bureau is also adjusting or providing exemptions to the statutory requirements, including the obligations of small entities, in certain circumstances. The Bureau is taking this action in order to ease burden when doing so would not sacrifice adequate protection of consumers.[190]

The objectives of this rulemaking are: (1) to revise current § 1026.36 and commentary to implement substantive requirements in new TILA sections 129B(b), (c)(1), and (c)(2) and 129C(d) and (e), as added by sections 1402, 1403, and 1414 of the Dodd-Frank Act; (2) to clarify ambiguities resulting from differences between current § 1026.36 and the new TILA

[190] The new statutory requirements relating to compensation take effect automatically on January 21, 2013, as written in the statute, unless final rules are issued on or prior to that date that provide for a later effective date.

amendments; (3) to adjust existing rules governing compensation to individual loan originators to account for Dodd-Frank Act amendments to TILA; and (4) to provide greater clarity and flexibility on several issues.

The Bureau adopts, in the final rule, a complete exemption to the Dodd-Frank Act ban on the consumer paying upfront points and fees that would otherwise apply to all covered transactions in which anyone other than the consumer pays compensation to a loan originator. Specifically, the final rule amends § 1026.36(d)(2)(ii) to provide that a payment to a loan originator that is otherwise prohibited by section 129B(c)(2)(A) of the Truth in Lending Act is nevertheless permitted pursuant to section 129B(c)(2)(B) of the Act, regardless of whether the consumer makes any upfront payment of discount points, origination points, or fees, as described in section 129B(c)(2)(B)(ii) of the Act, as long as the mortgage originator does not receive any compensation directly from the consumer as described in section 129B(c)(2)(B)(i) of the Act. Accordingly, the Bureau does not adopt the portion of the proposal that would have required creditors or loan originator organizations to generally make available an alternative loan without discount points or origination points or fees where they offer a loan with discount points or origination points or fees. This complete exemption is being implemented by the Bureau under Dodd-Frank Act section 1403 because, as explained in the section-by-section analysis, it is in the interest of consumers and the public interest, as well as under other authority.

The final rule also implements certain other Dodd-Frank Act requirements applicable to closed-end consumer credit transactions secured by a dwelling and open-end extensions of consumer credit secured by a consumer’s principal dwelling. Specifically, the rule codifies TILA section 129C(d), which creates prohibitions on financing of premiums for single-premium credit insurance. The provisions of this rule also implement TILA section 129C(e), which restricts agreements requiring consumers to submit any disputes to arbitration and limits waivers of Federal claims, thereby preserving consumers' ability to seek redress through the court system after a dispute arises. The final rule also implements TILA section 129B(b)(2), which requires the Bureau to prescribe regulations requiring depository institutions to establish and monitor compliance of such depository institutions, the subsidiaries of such institutions, and the employees of both with the requirements of TILA section 129B and the registration procedures established under section 1507 of the SAFE Act.

In addition, the Dodd-Frank Act extended previous efforts by lawmakers and regulators to strengthen loan originator qualifications and regulate industry compensation practices. New TILA section 129B(b) imposes a duty on loan originators to be "qualified" and, where applicable, registered or licensed as a loan originator under State law and the Federal SAFE Act and to include unique identification numbers on loan documents. The final rule implements this section and expands consumer protections by requiring entities whose individual loan originators are not subject to SAFE Act licensing requirements, including depositories and bona fide nonprofit loan originator entities, to: (1) ensure that their individual loan originators, hired on or after the rule's effective date (or otherwise not screened according to procedures in place when they were hired), meet character and fitness and criminal background standards similar to the licensing standards that the SAFE Act applies to employees of non-bank loan originators; and (2) provide appropriate training to their individual loan originators commensurate with the mortgage origination activities of the individual.

Furthermore, the final rule adjusts existing rules governing compensation to individual loan originators in connection with closed-end mortgage transactions to account for Dodd-Frank Act amendments to TILA and provide greater clarity and flexibility. Specifically, the final rule preserves, with some refinements, the prohibition on the payment or receipt of commissions or other loan originator compensation based on the terms of the transaction (other than loan amount) and on loan originators being compensated simultaneously by both consumers and other persons in the same transaction. To further reduce potential steering incentives for loan originators created by certain compensation arrangements, the final rule also clarifies and revises restrictions on profits-based compensation for loan originators, depending on the potential for incentives to steer consumers to different transaction terms.

Finally, the final rule makes two changes to the current record retention provisions of § 1026.25 of TILA. The revised provisions: (1) require a creditor to maintain records of the compensation paid to a loan originator, and the governing compensation agreement, for three years after the date of payment; and (2) require a loan originator organization to maintain records of the compensation it receives from a creditor, a consumer, or another person and that it pays to its individual loan originators, as well as the compensation agreement that governs those receipts or payments, for three years after the date of the receipts or payments. By ensuring that records associated with loan originator compensation are retained for a time period commensurate with the statute of limitations for causes of action under TILA section 130 and are readily available for examination, these modifications to the existing recordkeeping provisions will prevent circumvention or evasion of TILA and facilitate compliance.

The legal basis for the final rule is discussed in detail in the legal authority analysis in the section-by-section analysis above.

B. Summary of Issues Raised by Comments in Response To the Initial Regulatory Flexibility Analysis.

In accordance with section 3(a) of the RFA, the Bureau prepared an IRFA. In the IFRA, the Bureau estimated the possible compliance costs for small entities from each major component of the rule against a pre-statute baseline. The Bureau requested comments on the IRFA but did not receive any such comments. The Bureau did receive some comments describing in general terms the impact of the proposed rule on small creditors and loan originator organizations and the need for exemptions for small entities from various provisions of the proposed rule. These comments, and the responses, are discussed in the section-by-section analysis.

C. Response to the Comment from the Small Business Administration Office of Advocacy

SBA Advocacy provided a formal comment letter to the Bureau in response to the proposal. Among other things, the letter expressed concern about the following issues: record retention; the prohibition of consumer payment of upfront points and fees; the restrictions on compensation based on transaction terms; and the mandatory arbitration, waiver of Federal claims, and credit insurance provisions.

1. *Record Retention*

SBA Advocacy noted that the Small Entity Representatives had expressed concern that the proposed requirements for a loan originator organization or creditor to retain for three years documents evidencing the amount of compensation paid to a loan originator were unclear and overbroad, especially given the broad definition of “compensation” in the proposed rule. The Bureau disagrees that the record retention requirements are either unclear or overbroad, and the Bureau provides examples in the commentary to § 1026.25(c)(2) of the types of records that could be sufficient to satisfy the record-retention requirements, depending on the type of compensation.

2. *Upfront Points and Fees*

SBA Advocacy relayed the Small Entity Representatives' strong support of the Bureau's proposed use of its exemption authority under the Dodd-Frank Act to allow consumers to pay upfront discount and origination points and fees. SBA Advocacy noted that the Small Entity Representatives were concerned, however, that the proposal's requirement for creditors or loan originator organizations to offer an alternative loan without discount points or origination points or fees (the "zero-zero alternative") would have been unrealistic for small entities. For reasons discussed in the section-by-section analysis, the Bureau is not implementing the zero-zero alternative and is instead exercising its authority under the points and fees provision to effect a complete exemption to the prohibition on consumer payment of upfront points and fees.

3. *Compensation Based on Transaction Terms*

SBA Advocacy expressed concern with the portion of the proposal that would have permitted bonuses and contributions to non-designated plans from mortgage-related profits only if the mortgage-business revenue component of total revenues is below a certain threshold.[191] For reasons discussed in the section-by-section analysis, the final rule does not include this provision. Instead, the Bureau is implementing a final rule that permits compensation under non-deferred profits-based compensation plans, in which the compensation is determined with reference to profits from mortgage-related business, provided that the compensation is not directly or indirectly based on the terms of the individual's residential mortgage loan transactions

[191] The Bureau previously used the term "qualified," not "designated."

and the compensation is equal to or less than 10 percent of the loan originator's total compensation.

SBA Advocacy also expressed concern that any mistake in compensation structure might result in loans being returned from the secondary market and a massive buyback. To the extent that violations of the rule could lead to this result, it is possible that such an event could occur today because Regulation Z already contains provisions that prohibit the payment of compensation based on transaction terms as well as payment of loan originator compensation by both a consumer and a person other than the consumer on the same transaction. The final rule provides clarifications and grants relief under certain circumstances with respect to these existing restrictions.

The Bureau believes that the application of the 10-percent total compensation test will be less likely to result in the scenarios described by SBA Advocacy than the proposed revenue test. The Bureau acknowledges that several industry commenters expressed concern about potential TILA liability where an error is made under the revenue test calculation; SBA Advocacy's concern about buyback is related to these concerns. As a threshold matter, creditors and loan originator organizations can choose whether or not to pay this type of compensation, and a payer of compensation has full knowledge and control over the numerical and other information used to determine the compensation. That said, the Bureau is sensitive to SBA Advocacy's concerns but believes they are not warranted to nearly the same degree with the 10-percent total compensation test. Under the revenue test, an error in determining the amount of total revenues or mortgage-related revenues could have potentially impacted all awards of profits-based compensation to individual loan originators for a particular time period. Because the 10-percent total compensation test focuses on compensation at the individual loan originator level, however, the potential liability implications of a calculation error largely would be limited to the effect of that error alone. In other words, in contrast to the revenue test, an error under the 10-percent total compensation test would not likely have downstream liability implications as to other compensation payments across the company or business unit and, therefore, would be extremely unlikely to result in the "massive buyback" described by SBA Advocacy. The Bureau also believes that creditors and loan originator organizations will develop policies and procedures to minimize the possibility of such errors.

4. *Mandatory Arbitration, Waivers of Federal Claims, and Credit Insurance*

SBA Advocacy commented that it was uncertain why the mandatory arbitration and credit insurance provisions were addressed in the loan originator compensation rule. The provisions in the final rule are intended to clarify the prohibitions on mandatory arbitration, waivers of Federal claims, and creditor financing of single premium credit insurance in the Dodd-Frank Act.

D. Description and, Where Feasible, Provision of an Estimate of the Number of Small Entities to Which the Final Rule Will Apply

As discussed in the Small Business Review Panel Report, for purposes of assessing the impacts of the regulations being implemented on small entities, "small entities" are defined in the RFA to include small businesses, small nonprofit organizations, and small government jurisdictions. 5 U.S.C. 601(6). A "small business" is determined by application of SBA regulations and reference to the North American Industry Classification System ("NAICS") classifications and size standards.[192] 5 U.S.C. 601(3). A "small organization" is any "not-for-profit enterprise which is independently owned and operated and is not dominant in its field." 5

[192] The current SBA size standards are available on the SBA's website at http://www.sba.gov/content/table-small-business-size-standards.

U.S.C. 601(4). A “small governmental jurisdiction” is the government of a city, county, town, township, village, school district, or special district with a population of less than 50,000. 5 U.S.C. 601(5).

During the Small Business Review Panel process, the Bureau identified six categories of small entities that may be subject to the proposed rule for purposes of the RFA:

- commercial banks (NAICS 522110);
- savings institutions (NAICS 522120);[193]
- credit unions (NAICS 522130);
- firms providing real estate credit (NAICS 522292);
- mortgage brokers (NAICS 522310); and
- small nonprofit organizations.

Commercial banks, savings institutions, and credit unions are small businesses if they have $175 million or less in assets. Firms providing real estate credit and mortgage brokers are small businesses if their average annual receipts do not exceed $7 million.

A small nonprofit organization is any not-for-profit enterprise that is independently owned and operated and is not dominant in its field. Small nonprofit organizations engaged in loan origination typically perform a number of activities directed at increasing the supply of affordable housing in their communities. Some small nonprofit organizations originate mortgage loans for low and moderate-income individuals while others purchase loans originated by local community development lenders.

The Bureau’s estimated number of affected and small entities by NAICS Code and engagement in loan origination appears in the table below. The estimates in this analysis are

[193] Savings institutions include thrifts, savings banks, mutual banks, and similar institutions.

based upon data and statistical analyses performed by the Bureau. To estimate counts and properties of mortgages for entities that do not report under HMDA, the Bureau has matched HMDA data to Call Report data and NMLS and has statistically projected estimated loan counts for those depository institutions that do not report these data either under HMDA or on the NCUA call report. The Bureau has projected originations of higher-priced mortgage loans for depositories that do not report HMDA in a similar fashion. These projections use Poisson regressions that estimate loan volumes as a function of an institution's total assets, employment, mortgage holdings and geographic presence.

Category	NAICS Code	Total Entities	Small Entities	Entities That Originate Any Mortgage Loans [b]	Small Entities that Originate Any Mortgage Loans
Commercial Banking	522110	6,505	3,601	6,307[a]	3,466[a]
Savings Institutions	522120	930	377	922[a]	373[a]
Credit Unions[c]	522130	7,240	6,296	4,178[a]	3,240[a]
Real Estate Credit [d e]	522292	2,787	2,294	2,787	2,294[a]
Mortgage Brokers	522310	8,051	8,049	N/A[f]	N/A[f]
Total[g]		25,513	20,617	14,194	9,373

Source: 2011 HMDA, Dec 31, 2011 Bank and Thrift Call Reports, Dec 31, 2011 NCUA Call Reports, 2010 and 2011 NMLSR

[a] For HMDA reporters, loan counts from HMDA 2011. For institutions that are not HMDA reporters, loan counts projected based on Call Report data fields and counts for HMDA reporters.

[b] Entities are characterized as originating loans if they make one or more loans.

[c] Does not include cooperatives operating in Puerto Rico. The Bureau has limited data about these institutions, which are subject to Regulation Z, or their mortgage activities.

[d] NMLSR Mortgage Call Report ("MCR") for 2011. All MCR reporters that originate at least one loan or that have positive loan amounts are considered to be engaged in real estate credit (instead of purely mortgage brokers). For any institutions with missing revenue values, the probability that the institution was a small entity is estimated based on the count and amount of originations and the count and amount of brokered loans

[e] Data do not distinguish nonprofit from for-profit organizations, but Real Estate Credit presumptively includes nonprofit organizations.

[f] Mortgage brokers do not originate (back as a creditor) loans.

[g] The total may be overstated to the extent that some entities that act as mortgage brokers also appear in other entity categories.

E. Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Final Rule, Including an Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and the Type of Professional Skills Necessary for the Preparation of the Report

1. *Reporting Requirements*

The final rule does not impose new reporting requirements.

2. *Recordkeeping Requirements*

Regulation Z currently requires creditors to create and maintain records to demonstrate their compliance with provisions that apply to the compensation paid to or received by a loan originator. As discussed above in part V, the final rule requires creditors to retain these records for a three-year period, rather than for a two-year period as currently required. The rule applies the same requirement to organizations when they act as a loan originator in a transaction, even if they do not act as a creditor in the transaction. The revised recordkeeping requirements, however, do not apply to individual loan originators.

As discussed in the section-by-section analysis, the Bureau recognizes that increasing the period a creditor must retain records for specific information related to loan originator compensation from two years, as currently provided in Regulation Z, to three years may impose some marginal increase in the creditor's compliance burden in the form of the incremental cost of storage. The Bureau believes, however, that creditors should be able to use existing recordkeeping systems to maintain the records for an additional year at minimal cost. Similarly, although loan originator organizations may incur some costs to establish and maintain recordkeeping systems, loan originator organizations may be able to use existing recordkeeping systems that they maintain for other purposes at minimal cost. During the Small Business Review Panel process, the Small Entity Representatives were asked about their current record retention practices and the potential impact of the proposed enhanced record retention requirements. Of the few Small Entity Representatives who provided feedback on the issue, one creditor stated that it maintained detailed records of compensation paid to all of its employees and that a regulator already reviews its compensation plans regularly, and another creditor reported that it did not believe the proposed record retention requirement would require it to change its current practices. Therefore, the Bureau does not believe that the record retention requirements will create undue burden for small entity creditors and loan originator organizations.

3. *Compliance Requirements*

As discussed in detail in the section-by-section analysis, the final rule imposes new compliance requirements on creditors and loan originator organizations. The possible compliance costs for small entities from each major component of the final rule are presented below. In most cases, the Bureau presents these costs against a pre-statute baseline. As noted above in the section 1022(b)(2) analysis in part VII above, provisions where the Bureau has used its exemption authority are discussed relative to the statutory provisions. The analysis below considers the benefits, costs, and impacts of the following major provisions on small entities: (1) upfront points and fees; (2) compensation based on a term of a transaction; and (3) qualification requirements for loan originations. It also discusses other provisions in less detail.

a. Upfront Points and Fees

The Dodd-Frank Act prohibits consumer payment of upfront points and fees in all residential mortgage loan transactions except those where no one other than the consumer pays a loan originator compensation tied to the transaction (*e.g.*, a commission) and provides the Bureau authority to waive or create exemptions from this prohibition if doing so is in the interest of consumer and in the public interest. As discussed in the Background and section-by-section analysis, the Bureau adopts in the final rule a complete exemption to the statutory ban on upfront points and fees. Specifically, the final rule amends § 1026.36(d)(2) to provide that a payment to a loan originator that is otherwise prohibited by section 129B(c)(2)(A) of TILA is nevertheless permitted pursuant to section 129B(c)(2)(B) of TILA, regardless of whether the consumer makes any upfront payment of discount points, origination points, or fees, as described in section 129B(c)(2)(B)(ii) of TILA, as long as the mortgage originator does not receive any compensation directly from the consumer as described in section 129B(c)(2)(B)(i) of TILA.

Benefits to Small Entities

The final rule's treatment of the payment of upfront points and fees has a number of potential benefits for small entities. First, relative to the complete prohibition on the payment of points and fees that the Dodd-Frank Act would have applied absent the exercise of the Bureau's exemption authority, the final rule maintains the opportunity during origination for the current wide choice consumers have in selecting a specific mortgage product from the current variety of mortgage products available to them. The ability of creditors and loan originator organizations, particularly small ones, to offer consumers this wide variety of choices, relative to that available under the baseline, occurs primarily because under the final rule consumers and particularly small creditors and loan originator organizations retain the opportunity to exchange, at the time of origination, a mutually agreeable share of the financial risk inherent in the future payments required by any given mortgage loan. Consumers, in this exchange, may decide to purchase discount points from the loan originator and in return receive a reduced loan rate which is commensurate with the lower degree of credit and prepayment risk now borne by the creditor holding the loan.

Moreover, the ability of small creditors to charge discount points in exchange for lower interest rates would accommodate those consumers who prefer to pay more at settlement in exchange for lower monthly interest charges and could produce a greater volume of available credit in residential mortgage markets. Preserving this ability would potentially allow a wider access to homeownership, which would benefit consumers, creditors, loan originator organizations, and individual loan originators. The ability to charge origination fees upfront also would allow small creditors to recover fixed costs at the time they are incurred rather than over time through increased interest payments or through the secondary market prices. And similarly, preserving the flexibility for affiliates of creditors and loan originator organizations to charge fees upfront should allow for these firms to charge directly for their services. This means that creditors and loan originator organizations may be less likely to divest such entities than if the Dodd-Frank Act mandate takes effect as written.

Costs to Small Entities

The Bureau's exercise of its statutory authority to create a full exemption from the Dodd-Frank Act prohibition on consumer payment of upfront points and fees maintains the current financial environment in which small creditors operate. Small creditors, and indirectly, loan originator organizations funding their loans through such creditors, have, relative to their larger rivals, limited means of hedging the costs of all the financial (credit and interest rate/prepayment) risk posed to them by the origination of a mortgage. These costs are borne by a creditor retaining such mortgages in its portfolio, but they are also borne by those that sell their mortgages in the secondary market, owing to the lower price investors will pay for mortgage pools with higher credit and prepayment risk.

Small creditors bear relatively high costs of participating in ancillary markets for financial instruments through which their larger rivals can more easily hedge mortgage risk. The primary means by which these small institutions can hedge this type of risk is by allowing consumers to purchase discount points. The sale of discount points to consumers in exchange for lower interest rates on loans can still cost smaller creditors relatively more, per dollar of current loan value, than their larger rivals, but, to the extent it exists, this relative cost posed to small creditors is far lower than that of using alternative means of hedging. If the Bureau had decided to finalize the prohibition on the payment of discount points, it would have, in combination with current regulatory restrictions on prepayment penalties, entirely eliminated the ability of small institutions to hedge risk at a price that allows them to compete with larger financial institutions. This inability to compete could conceivably have resulted in a significant reduction in the number of small creditors, whether through dissolution or through absorption by larger financial firms.

This ability to hedge risk through the continued ability of consumers to purchase discount points, however, could inflict losses to small creditors. These losses, while relatively minor in comparison to those benefits previously described, could nevertheless be of significant concern.

First, limiting the advantage of larger creditors in offering different combinations of points and fees would aid the competitiveness of small creditors.

Second, small creditors most often serve relatively specialized markets that are distinguished by several criteria, including a relatively more stable consumer base. Implementation of the prohibition on consumer payment of upfront points and fees without exercise of exemption authority could have further increased both the stability and size of this base, by enhancing consumer perceptions of the greater degree of transparency exhibited by small creditors in comparison to larger institutions in the provision of all financial services. Larger creditors, for example, would have an incentive to offset any risk to mortgage profits from the statutory ban on points and fees by charging additional service fees to borrowers, depositors, and other clients. Since small creditors engage in these activities to a lesser extent, implementation of the prohibition on consumer payment of upfront points and fees could have enhanced the favorable reputation of small creditors in all lines of their business, allowing them to preserve their relatively larger percentage of long-term consumer relationships while potentially increasing the size of all of the financial markets they serve.

Third, even in periods of significant interest rate volatility, small creditors often exhibit a relatively greater willingness to hold mortgages in portfolio rather than selling them in the secondary market, as do larger institutions. This propensity mitigates the need for small creditors to follow the practices imposed by the secondary market on larger creditors. Mortgage pooling, for example, which is necessary to securitization, requires larger creditors to focus on lending to consumers with relatively standard credit profiles. The comparative advantage of smaller creditors in serving consumers exhibiting a wider array of credit histories could conceivably increase when the variety of mortgage products offered by larger creditors decreases and, consequently, the value of diversity in consumers served increases.

b. Compensation Based on Transaction Terms

The final rule clarifies and revises restrictions on profits-based compensation from mortgage-related business profits for loan originators based on the analysis of the potential incentives that loan originators have to steer consumers to different transaction terms in a variety of contexts. As discussed in the section-by-section analysis, § 1026.3(d)(1)(iii) permits creditors or loan originators organizations to make contributions from mortgage-related profits to "designated tax-advantaged plans" as listed in that paragraph.

As discussed in the section-by-section analysis, § 1026.36(d)(1)(iii) permits creditors or loan originator organizations to make contributions from mortgage-related profits to 401(k) plans, and other "designated tax-advantaged plans," such as Simplified Employee Pensions (SEPs) and savings incentive match plans for employees (SIMPLE plans), provided the contributions are not based on the terms of the individual loan originator's transactions. Section 1026.36(d)(1)(iv) permits creditors or loan originator organizations to pay compensation under non-deferred profits-based compensation plans from mortgage-related business profits if: (1) the individual loan originator is the loan originator for ten or fewer mortgage transactions during the preceding 12 months (a de minimis number of originations); or (2) the percentage of an individual loan originator's compensation under a non-deferred profits-based compensation plan is equal to or less than 10 percent of that individual loan originator's total compensation. While such contributions and bonuses can be funded from general mortgage profits, the amounts paid to individual loan originators cannot be based on the terms of the transactions that the individual had originated.

Benefits to Small Entities

Small entities have, through outreach and inquiries, expressed concern over the potential costs they could incur owing to their difficulty, particularly in contrast to large institutions, in interpreting the restrictions the existing rule imposes on methods of compensation for individual loan originators, such as compensation under non-deferred profits-based compensation plans paid to individual loan originators or compensation by creditors or loan originator organizations through designated tax-advantaged plans. Small entities will benefit, in both absolute and relative terms, from clarification regarding permissible forms of loan originator compensation. Such clarification will reduce legal and related costs of interpreting the existing rule and the risk of unintended violations of that regulation.

Small entities engaging in compensating individual loan originators through contributions to designated tax-advantaged plans in which the individual loan originators participate will also continue to benefit from this practice under the final rule. Those small entities that do not currently offer such plans would benefit, with the increased clarity of the final rule, from the opportunity to do so should they so choose.[194] For small entities that currently do not pay bonuses out of mortgage-related profits because of uncertainty about the application of the existing rule, the final rule will allow these types of compensation up to the 10-percent cap or under the de minimis exception. A final benefit is provided to those small entities that have working for them individual loan originators who are the loan originators for no more than 10 transactions per year, owing to the de minimis provision in the final rule that exempts these employees from limitations on profits-based bonuses. The Bureau believes that small entities are more likely than larger institutions to have producing managers or other employees whose day-to-day responsibilities are diverse and fluid, in which case they are more likely to act as a loan originator on occasion outside of their primary or secondary responsibilities. As a result, small entities for which such individuals work, as well as the individuals themselves, would benefit from the de minimis exception to allow their participation in profits-based compensation from mortgage-related business profits for which they might otherwise not be eligible under the other restrictions in the final rule.

[194] Some firms may choose not to offer such compensation. In certain circumstances an originating institution (perhaps unable to invest in sufficient management expertise) will see reduced profitability from adopting profits-based compensation plans.

Costs to Small Entities

Small entities that currently compensate their individual loan originators through profits-based compensation, such as by compensation under a non-deferred profits-based compensation plan limited by the final rule, will incur compliance costs if they currently pay, or wish to pay in the future, compensation under a non-deferred profits-based compensation plan to individual loan originators outside of the 10-percent cap or the de minimis exception set forth in the final rule. Small entities that currently compensate individual loan originators through non-deferred profits-based compensation in excess of 10 percent of individual loan originators' total compensation might have to adjust their profits-based compensation to comply with the 10-percent total compensation test under the final rule. This cost to comply will likely be minimal to nominal, however, because the final rule allows firms to pay profits-based compensation from non-mortgage related business above the 10-percent limits so long as those profits are determined in accordance with reasonable accounting methods and the compensation is not based on the terms of that individual's residential mortgage transactions. Thus, this would presumably create a compliance cost only for small entities that do not currently utilize reasonable accounting methods for internal accounting or other purposes: for these entities, the costs of compliance with the final rule could include making needed revisions to internal accounting practices, re-negotiating the remuneration terms in the contracts of individual loan originators currently working for the small entity, and updating any other practices essential to these methods of compensation. Owing to their current usage of these compensation programs, these firms may encounter higher retention costs and possibly lower levels of ability on the part of new hires, relative to the average ability displayed by the loan originators they currently employ.

c. Loan Originator Qualification Requirements

The final rule implements a Dodd-Frank Act provision requiring both individual loan originators and loan originator organizations to be "qualified" and to include their license or registration numbers on loan documents. Loan originator organizations are required to ensure that individual loan originators who work for them are licensed or registered under the SAFE Act where applicable. Loan originator organizations and the individual loan originators that are primarily responsible for a particular transaction are required to list their license or registration numbers on key loan documents along with their names. Loan originator organizations are required to ensure that their loan originator employees meet applicable character, fitness, and criminal background check requirements.

Benefits to Small Entities

Benefits from an enhanced reputation among consumers will accrue to those small entities employing originators not currently required to be licensed under the SAFE Act. Increased consumer confidence in such institutions arises from the knowledge that the small entity has ensured that the loan originators it employs have satisfied training requirements commensurate with their responsibilities as originators and they have met the character, fitness, and criminal background check requirements similar to those specified for licensees in the SAFE Act.

Costs to Small Entities

The final rule requires small entities, such as many depositories and bona fide nonprofit organizations, to adopt standards similar to those of the SAFE Act in regard to ongoing training, and the satisfaction of character and fitness standards, including having no felony convictions within the previous seven years. The Bureau estimates the costs of compliance with these standards to include the cost of obtaining a criminal background check and credit reports for new hires and existing employees who were not screened at the time of hire, and the time involved in checking employment and character references of any such individuals and evaluating the information. The additional time and cost required to provide occasional, appropriate training to individual loan originators will vary as a consequence of the skill and experience level of those individuals.

The Bureau believes that virtually all small depositories and nonprofit organizations have already adopted such screening and training requirements as a matter of good business practice and the Bureau anticipates that the training that many individual originators employed by small depositories and nonprofits already receive will be adequate to meet the requirement. The Bureau expects that in no case would the training needed to satisfy the requirement be more comprehensive, time-consuming, or costly than the online training approved by the NMLSR to satisfy the continuing education requirement imposed under the SAFE Act on those individuals who are subject to state licensing.

The requirement to include the names and NMLSR identifiers of originators on loan documents may impose some additional costs relative to current practice. These costs, however, may be mitigated by the existing requirement of the Federal Housing Finance Agency to include the NMLSR numerical identifier of individual loan originators and loan originator organizations on all applications for Fannie Mae and Freddie Mac loans.

d. Other Provisions

The final rule adjusts existing rules governing compensation to loan originators in connection with closed-end mortgage transactions to implement Dodd-Frank Act amendments to TILA, to provide greater clarity on the 2010 Loan Originator Final Rule, and to provide loan originator increased flexibility to engage in certain compensation practices. These provisions prohibit the compensation of loan originators by both consumers and other persons in the same transaction. They also preserve the current prohibition on the payment or receipt of commissions or other compensation based on the “transaction terms” governing the mortgage loan or factors that, for purposes of compensation, serve an equivalent role and may consequently be regarded as “proxies” for any of these transactions terms. The final rule, however, clarifies the existing prohibition by providing a new and explicit definition of a “term of a transaction” and explicitly addresses the criteria that determine whether a factor appearing in the loan is prohibited by its role as a proxy for a loan term and serving as a basis for compensation.

The final rule also clarifies several additional aspects of compensation provided to a loan originator. First, the final rule revises the existing rule to allow ”broker splits” by permitting a loan originator organization receiving compensation directly from a consumer in connection with a given transaction to pay and an individual loan originator to receive compensation in connection with this transaction (*e.g.*, a commission). Second, the final rule clarifies that payments to a loan originator paid on the consumer’s behalf by a person other than a creditor or its affiliates, such as a non-creditor seller, home builder, home improvement contractor, or real estate broker, are considered compensation received directly from the consumer if they are made pursuant to an agreement between the consumer and the person other than the creditor or its affiliates. Third, the final rule allows reductions in loan originator compensation where there are unforeseen circumstances to defray the cost, in whole or part, of an increase in the actual settlement cost above an estimated settlement cost disclosed to the consumer pursuant to section 5(c) of RESPA or omitted from that disclosure.

These provisions will provide greater clarity and flexibility, relative to the statutory provisions of the Dodd-Frank Act, for the purposes of compliance with the final rule. They should lower the costs of compliance for small entities. The final rule's allowance of broker splits, for example, provides small entities a greater degree of flexibility in their choice of compensation practices than under the 2010 Loan Originator Rule. Small entities, by virtue of their size, often have a disadvantage in competing with larger institutions in the market for skilled labor. The final rule will, as a consequence, lower the overall costs incurred by the small entity in retaining the individual loan originators they currently employ as well as the hiring of new originators. Greater clarity provided by the final rule in the definition of a "term of a transaction" and by explicitly addressing factors on which compensation cannot be based because they are "proxies" for a term of a transaction, will significantly reduce the uncertainty faced by small entities in their adoption of compensation procedures and in negotiating compensation with individual loan originators. They also serve, at the same time, to reduce the risk to small entities, particularly in relation to large institutions employing specialized staff, of unintentional violations of prohibited compensation practices. The final rule also bestows a similar benefit to small entities, in regard to the risk and consequent costs of unintentional noncompliance, by clarifying the nature of payments to an individual originator from unaffiliated third parties in a loan transaction which serve as compensation paid by the consumer to that individual.

The final rule also implements the Dodd-Frank Act requirement that prohibits mandatory arbitration clauses in mortgage loan agreements. It also implements the Dodd-Frank Act requirement concerning waivers of Federal claims in court. Finally, the final rule implements the Dodd-Frank Act requirement that prohibit the financing of single-premium credit insurance.

Firms may incur some costs to comply with each of these prohibitions, such as amending standard contract forms.

F. Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and the Type of Professional Skills Necessary for the Preparation of the Report or Record

Section 603(b)(4) of the RFA requires an estimate of the classes of small entities that will be subject to the requirements. The classes of small entities that will be subject to the reporting, recordkeeping, and compliance requirements of the final rule are the same classes of small entities that are identified above in part VIII.

Section 603(b)(4) of the RFA also requires an estimate of the type of professional skills necessary for the preparation of the reports or records. The Bureau anticipates that the professional skills required for compliance with the final rule are the same or similar to those required in the ordinary course of business of the small entities affected by the final rule. Compliance by the small entities that will be affected by the final rule will require continued performance of the basic functions that they perform today.

G. Description of the Steps the Agency Has Taken to Minimize the Significant Economic Impact on Small Entities

1. *Upfront Points and Fees*

The Dodd-Frank Act prohibits consumer payment of upfront points and fees in all residential mortgage loan transactions (as defined in the Dodd-Frank Act) except those where no one other than the consumer pays a loan originator compensation tied to the transaction (*e.g.*, a commission). As discussed in the Background and section-by-section analysis, the Bureau adopts in the final rule a complete exemption to the statutory ban on upfront points and fees under its Dodd-Frank Act authority to create such an exemption in the interest of consumers and in the public interest, and other authority. Specifically, the final rule amends § 1026.36(d)(2)(ii) to provide that a payment to a loan originator that is otherwise prohibited by section 129B(c)(2)(A) of TILA is nevertheless permitted pursuant to section 129B(c)(2)(B) of TILA, regardless of whether the consumer makes any upfront payment of discount points, origination points, or fees, as described in section 129B(c)(2)(B)(ii) of TILA, as long as the mortgage originator does not receive any compensation directly from the consumer as described in section 129B(c)(2)(B)(i) of TILA. The Bureau has attempted to mitigate the burden of the more limited exemption in the proposal that would have required creditors or loan originator organizations to generally make available an alternative loan without discount points or origination points or fees, where they offer a loan with discount points or origination points or fees.

2. *Compensation Based on Transaction Terms*

The final rule clarifies and revises restrictions on profits-based compensation from mortgage-related business profits for loan originators, depending on the potential incentives to steer consumers to different transaction terms. As discussed in the section-by-section analysis, the final rule permits creditors or loan origination organizations to make contributions from profits derived from mortgage-related business to 401(k) plans, and other "designated tax-advantaged plans" as long as the compensation is not based on the terms of that individual loan originator's residential mortgage loan transactions. Because these designated plans include Simplified Employee Pensions (SEPs) and savings incentive match plans for employees (SIMPLE plans) that may particularly benefit small entities who are eligible to set them up, the impact of this provision on small entities is minimized.

The final rule also permits creditors or loan originator organizations to pay non-deferred profits-based compensation from mortgage-related business profits if the compensation is not based on the terms of that individual loan originator's residential mortgage loan transactions and if: (1) the individual loan originator affected has been the loan originator for ten or fewer mortgage transactions during the prior 12 months; or (2) the percentage of an individual loan originator's compensation that may be attributable to the bonuses is equal to or less than 10 percent of that loan originator's total compensation. The Bureau attempted to minimize the burden of these requirements by modifying the final rule from the proposed requirements in two respects.

First, the Bureau is not adopting the proposed revenue test and is instead adopting the 10-percent total compensation test. The Bureau believes that, relative to the revenue test, the 10-percent total compensation test reduces the cost of the compensation restrictions to small entities. As described earlier in the section-by-section analysis, the Bureau received a number of comments asserting that the revenue test would disadvantage creditors and loan originator organizations that are monoline mortgage businesses. The revenue test would have effectively precluded monoline mortgage businesses from paying profits-based bonuses to their individual loan originators or making contributions to those individuals' non-designated plans because these institutions' mortgage-related revenues as a percentage of total revenues would always exceed 25 or 50 percent (the alternative thresholds proposed). A test focused on compensation at the individual loan originator level, rather than company-wide, would be available to all companies regardless of the diversity of their business lines. Further, as the Bureau noted in the Small Business Review Panel Outline (and as stated by at least one commenter), creditors and loan originator organizations that are monoline mortgage businesses disproportionately consist of small entities. Unlike the revenue test, the 10-percent total compensation test will place restrictions on profits-based compensation (such as non-deferred profits-based compensation) that are neutral across entity size. The Bureau also believes that the relative simplicity of the 10-percent total compensation test in comparison to the revenue test—*e.g.*, calculation of total revenues is not required—will also benefit small entities.

Second, the Bureau, as described in the section-by-section analysis above, has increased the threshold of the de minimis origination exception under § 1026.36(d)(1)(iv)(B)(*2*) from five to ten consummated transactions. As noted earlier in this FRFA, the Bureau believes that small entities are more likely than larger institutions to have producing managers or other employees whose day-to-day responsibilities are diverse and fluid, in which case they are more likely to act as loan originators on occasion outside of their primary or secondary responsibilities. As a result, small entities for which such individuals work, as well as the individuals themselves, would benefit from the de minimis exception to allow their participation in non-deferred profits-based compensation from mortgage-related business profits for which they might otherwise not be eligible under the other restrictions in the final rule. The final rule has expanded slightly the scope of this exception to capture potentially more individuals who work for covered persons, including small entities.

3. *Broker Splits*

The final rule revises the existing Loan Originator Rule to provide that if a loan originator organization receives compensation directly from a consumer in connection with a transaction, the loan originator organization may pay compensation in connection with the transaction (*e.g.*, a commission) to individual loan originators and the individual loan originators may receive compensation from the loan originator organization. As discussed in the section-by-section analysis, this mitigates the burden of the existing rule on loan originator organizations.

H. Description of the Steps the Agency has taken to Minimize Any Additional Cost of Credit for Small Entities.

Section 603(d) of the RFA requires the Bureau to consult with small entities regarding the potential impact of the proposed rule on the cost of credit for small entities and related matters. 5 U.S.C. 603(d). To satisfy this statutory requirement, the Bureau notified the Chief Counsel on May 9, 2012, that the Bureau would collect the advice and recommendations of the same Small Entity Representatives identified in consultation with the Chief Counsel during the Small Business Review Panel process concerning any projected impact of the proposed rule on the cost of credit for small entities.[195] The Bureau sought information from the Small Entity Representatives during the Small Business Review Panel Outreach Meeting regarding the potential impact on the cost of business credit, since the Small Entity Representatives, as small providers of financial services, could also provide valuable input on any such impact related to the proposed rule.[196]

The Bureau had no evidence at the time of the Small Business Review Panel Outreach Meeting that the proposals then under consideration would result in an increase in the cost of business credit for small entities under any plausible economic conditions. The proposals under consideration at the time applied to consumer credit transactions secured by a mortgage, deed of trust, or other security interest on a residential dwelling or a residential real property that includes a dwelling, and the proposals would not apply to loans obtained primarily for business purposes.

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[195] *See* 5 U.S.C. 603(d)(2)(A). The Bureau provided this notification as part of the notification and other information provided to the Chief Counsel with respect to the Small Business Review Panel process pursuant to section 609(b)(1) of the RFA.
[196] *See* 5 U.S.C. 603(d)(2)(B).

At the Small Business Review Panel Outreach Meeting, the Bureau asked the Small Entity Representatives a series of questions regarding any potential increase in the cost of business credit. Specifically, the Small Entity Representatives were asked if they believed any of the proposals under consideration would impact the cost of credit for small entities and, if so, in what ways and whether there were any alternatives to the proposals under consideration that could minimize such costs while accomplishing the statutory objectives addressed by the proposal.[197] Although some Small Entity Representatives expressed the concern that any additional Federal regulations, in general, had the potential to increase credit and other costs, all Small Entity Representatives responding to these questions stated that the proposals under consideration in this rulemaking would have little to no impact on the cost of credit to small businesses. After receiving feedback from Small Entity Representatives at the Small Business Review Panel Outreach Meeting, the Bureau had no evidence that the proposed rule would result in an increase in the cost of credit for small business entities.

In the IRFA, the Bureau asked interested parties to provide data and other factual information regarding whether the proposed rule would have any impact on the cost of credit for small entities. The Bureau did not receive any comments on this issue.

In summary, the Bureau believes that the Final Rule will leave the cost of credit paid by small entities unchanged from its current value and, as a consequence, avoid those additional costs to those entities, created by an inability to hedge mortgage risk and other restrictions, that are an inevitable consequence under the baseline.

[197] *See* Final Panel Report available in the Proposed Rule Docket: Docket ID No. CFPB-2012-0037, *available at*.http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0037-0001.

IX. Paperwork Reduction Act

A. Overview

The Bureau's collection of information requirements contained in this rule, and identified as such, were submitted to the Office of Management and Budget (OMB) for review under section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501, *et seq.*) (Paperwork Reduction Act or PRA). Further, the PRA (44 U.S.C 3507(a), (a)(2) and (a)(3)) requires that a Federal agency may not conduct or sponsor a collection of information unless OMB approved the collection under the PRA and the OMB control number obtained is displayed. Notwithstanding any other provision of law, no person is required to comply with, or is subject to any penalty for failure to comply with, a collection of information does not display a currently valid OMB control number (44 U.S.C. 3512).

This Final Rule contains revised information collection requirements that have not been approved by the OMB and, therefore, are not effective until OMB approval is obtained. The information collection requirements contained in this rule are described below. The Bureau will publish a separate notice in the Federal Register announcing the submission of these information collection requirements to OMB as well as OMB's action on these submissions; including, the OMB control number and expiration date.

This rule amends 12 CFR Part 1026 (Regulation Z). Regulation Z currently contains collections of information approved by OMB, and the Bureau's OMB control number is 3170-0015 (Truth in Lending Act (Regulation Z) 12 CFR 1026). As described below, the rule amends certain collections of information currently in Regulation Z.

On September 7, 2012, a notice of proposed rulemaking was published in the Federal Register (77 FR 55271). In the proposed rule, the Bureau invited comment on: (1) whether the proposed collections of information are necessary for the proper performance of the functions of the Bureau, including whether the information will have practical utility; (2) the accuracy of the estimated burden associated with the proposed collections of information; (3) how to enhance the quality, utility, and clarity of the information to be collected; and (4) how to minimize the burden of complying with the proposed collections of information, including the application of automated collection techniques or other forms of information technology. The comment period for the proposed rule expired on November 6, 2012. In conjunction with the notice of proposed rulemaking, the Bureau received one comment addressing the Bureau's PRA analysis. This comment, received from a nonprofit loan originator organization, related to the Bureau's estimated number of respondents and is discussed in section B(2)(b) below.

The title of this information collection is: Loan Originator Compensation. The frequency of response is on-occasion. The information collection required provides benefits for consumers and is mandatory. *See* 15 U.S.C. 1601, *et seq.* Because the Bureau does not collect any information under the rule, no issue of confidentiality arises. The likely respondents are commercial banks, savings institutions, credit unions, mortgage companies (non-bank creditors), mortgage brokers, and nonprofit organizations that make or broker closed-end mortgage loans for consumers.

Under the rule, the Bureau generally accounts for the paperwork burden associated with Regulation Z for the following respondents pursuant to its administrative enforcement authority: insured depository institutions with more than $10 billion in total assets, their depository institution affiliates, and certain non-depository loan originator organizations. The Bureau and the FTC generally both have administrative enforcement authority over non-depository institutions for Regulation Z. Accordingly, the Bureau has allocated to itself half of its estimated burden for non-depository institutions. Other Federal agencies, including the FTC, are responsible for estimating and reporting to OMB the total paperwork burden for the institutions for which they have administrative enforcement authority. They may, but are not required, to use the Bureau's burden estimation methodology.

It should be noted that the Bureau's estimation of burdens arising from those provisions of the final rule regarding loan originator qualifications takes into account the prior screening activities in which, the Bureau believes, most loan originator organizations have previously engaged, including obtaining credit reports, criminal background checks, and information about prior administrative, civil, or criminal findings by any government jurisdiction actions. This estimation of burdens, consequently, avoids including any costs associated with performing criminal background, financial responsibility, character, and general fitness standards for individual loan originators that loan originator organizations had already hired and screened prior to the effective date of this final rule under the then-applicable statutory or regulatory background standards, except for those individual loan originators already employed but about whom the loan originator organization knows of reliable information indicating that the individual loan originator likely no longer meets the required standards, regardless of when that individual was hired and screened.[198]

Using the Bureau's burden estimation methodology, the total estimated burden for the approximately 22,800 institutions subject to the rule, including Bureau respondents,[199] is

[198] The final rule clarifies, in § 1026.36(f)(3)(i) and (ii) and in new comments 36(f)(3)(ii)-2 and 36(f)(3)(ii)-3, that these requirements apply for an individual that the loan originator organization hires on or after January 10, 2014, the effective date of these provisions, as well as for individuals hired prior to this date who were not screened under standards in effect at the time of hire.

[199] There are 153 depository institutions (and their depository affiliates) that are subject to the Bureau's administrative enforcement authority. In addition there are 146 privately insured credit unions that are subject to the Bureau's administrative enforcement authority. For purposes of this PRA analysis, the Bureau's respondents under Regulation Z are 135 depository institutions that originate closed-end mortgages; 77 privately insured credit unions

approximately 64,600 hours annually and 164,700 one-time hours. The aggregate estimates of total burden presented in this part IX are based on estimated costs that are averages across respondents. The Bureau expects that the amount of time required to implement each of the changes for a given institution may vary based on the size, complexity, and practices of the respondent.

B. Information Collection Requirements

1. *Record Retention Requirements*

Regulation Z currently requires creditors to create and maintain records to demonstrate their compliance with Regulation Z provisions regarding compensation paid to or received by a loan originator. As discussed above in part V, the final rule requires creditors to retain these records for a three-year period, rather than for a two-year period as currently required. The rule applies the same requirement to organizations when they act as a loan originator in a transaction, even if they do not act as a creditor in the transaction.

For the requirement extending the record retention requirement for creditors from two years, as currently provided in Regulation Z, to three years, the Bureau assumes that there is no additional marginal cost. For most, if not all firms, the required records are in electronic form. The Bureau believes that, as a consequence, all creditors should be able to use their existing recordkeeping systems to maintain the required documentation for mortgage origination records for one additional year at a negligible cost of investing in new storage facilities.

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that originate closed-end mortgages; an estimated 2,787 non-depository institutions that originate closed-end mortgages and that are subject to the Bureau's administrative enforcement authority, an assumed 230 not-for profit originators (which may overlap with the other non-depository creditors), and 8,051 loan originator organizations. Unless otherwise specified, all references to burden hours and costs for the Bureau respondents for the collection under Regulation Z are based on a calculation that includes one half of burden for all respondents except the depository institutions.

Loan originator organizations, but not creditors, will incur costs from the new requirement to retain records related to compensation. For the requirement that organizations retain records related to compensation on loan transactions, these firms will need to build the requisite reporting regimes. At some firms this may require the integration of information technology systems; for others simple reports can be generated from existing core systems.

For the roughly 8,000 Bureau respondents that are non-depository loan originator organizations but not creditors, the one-time burden is estimated to total approximately 163,400 hours, or approximately 20 hours per organization, to review the regulation and establish the requisite systems to retain compensation information. The Bureau estimates the requirement for these Bureau respondents to retain documentation of compensation arrangements is assumed to require 64,400 ongoing burden hours, or approximately 8 hours per organization, annually. The Bureau has allocated to itself one-half of this burden.

Those record-keeping requirements that would have arisen had the Bureau chosen to retain in its final rule the proposed requirement to make available a zero-zero alternative are now absent. The overall burden to covered persons created by this final rule, however, remains unchanged, since the Bureau found no additional cost or burden was created by that earlier provision.

2. *Requirement to Obtain Criminal Background Checks, Credit Reports, and Other Information for Certain Individual Loan Originators*

To the extent loan originator organizations hire new originators who are not required to be licensed under the SAFE Act, and who are not so licensed, the loan originator organizations are required to obtain a criminal background check and credit report for these individual loan originators. Loan originator organizations are also required to obtain from the NMLSR or individual loan originator information about any findings against such individual loan originator by a government jurisdiction. In general, the loan originator organizations that are subject to this requirement are depository institutions (including credit unions) and bona fide nonprofit organizations whose loan originators are not subject to State licensing because the State has determined to provide an exemption for bona fide nonprofit organizations and determined the organization to be a bona fide nonprofit organization. The burden of obtaining this information may be different for a depository institution than it is for a nonprofit organization because depository institutions already obtain criminal background checks for their loan originators to comply with Regulation G and have access to information about findings against such individual loan originator by a government jurisdiction through the NMLSR.

a. Credit Check

Both depository institutions and nonprofit organizations will incur costs related to obtaining credit reports for all loan originators that are hired or transfer into this function on or after January 10, 2014. For the estimated 370 Bureau respondents, which include depository institutions over $10 billion, their depository affiliates, and nonprofit nondepository organizations, the estimated one time burden is roughly 25 hours and the estimated on going burden is 90 hours. This includes the total burden for the depository institutions and one-half the estimated burdens for the nonprofit nondepository organizations.

b. Criminal Background Check

Nonprofit organizations will incur costs related to obtaining criminal background checks for all loan originators that are hired or transfer into this function on or after January 10, 2014. Depository institutions already obtain criminal background checks for each of their individual loan originators through the NMLSR for purposes of complying with Regulation G. A criminal background check provided by the NMLSR to the depository institution is sufficient to meet the requirement to obtain a criminal background check in this rule. Accordingly, the Bureau believes they will not incur any additional burden.

Non-depository loan originator organizations that do not have access to information about criminal history in the NMLSR, including bona fide nonprofit organizations, could satisfy the latter requirements by obtaining a national criminal background check.[200] For the assumed 200 nonprofit originators,[201] the one-time burden is estimated to be roughly 20 hours.[202] The ongoing cost to perform the check for new hires is estimated to be 10 hours annually. The Bureau has allocated to itself one-half of these burdens.

The Bureau did receive one comment from a nonprofit firm primarily involved in the purchase and rehabilitation of HUD-FHA REO homes, which queried the definition of a nonprofit firm used by the Bureau in its calculations. The Bureau included all affiliates and regional offices of a parent nonprofit firm in its original estimate of 200 such firms that would be covered by the rule. After receiving this comment, however, the Bureau engaged in extensive research in order to create, from information provided by government and private sources, a national census of nonprofit loan originators currently in operation. Such a census is currently unavailable from any public or private source. Based on this research, the Bureau found no

[200] This check, more formally known as an individual's FBI Identification Record, uses the individual's fingerprint submission to collect information about prior arrests and, in some instances, federal employment, naturalization, or military service.

[201] The Bureau has not been able to determine how many loan originators organizations qualify as bona fide nonprofit organizations or how many of their employee loan originators are not subject to SAFE Act licensing. Accordingly, the Bureau has estimated these numbers.

[202] The organizations are also assumed to pay $50 to get a national criminal background check. Several commercial services offer an inclusive fee, ranging between $48.00 and $50.00, for fingerprinting, transmission, and FBI processing. Based on a sample of three FBI-approved services, accessed on 2012-08-02: Accurate Biometrics, available at: http://www.accuratebiometrics.com/index.asp; Daon Trusted Identity Servs., available at: http://daon.com/prints; and Fieldprint, *available at* http://www.fieldprintfbi.com/FBISubPage_FullWidth.aspx?ChannelID=272.

evidence to support a change in its original estimate and continues to treat all affiliates and regional offices of a parent nonprofit firm as one respondent. The Bureau's research on the number of nonprofit firms covered by the rule is, however, ongoing.

c. Information About Findings Against the Individual by Government Jurisdictions

The information for employees of nonprofit organizations is generally not in the NMLSR. Accordingly, under the rule a nonprofit organization will have to obtain this information using individual statements concerning any prior administrative, civil, or criminal findings. For the employees of bona-fide nonprofit organizations, the Bureau estimates that no more than 10 percent have any such findings by a governmental jurisdiction to describe. The one-time burden is estimated to be 20 hours, and the annual burden to obtain the information from new hires is estimated to be two hours. The Bureau has allocated to itself one-half of these burdens.

C. Summary of Burden Hours

For all of the collections herein, the one-time burden for Bureau respondents is approximately 81,800 hours. The on-going burden is approximately 32,300 hours.

The Consumer Financial Protection Bureau has a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to:

The Consumer Financial Protection Bureau (Attention: PRA Office), 1700 G Street NW, Washington, DC, 20552, or by the internet to CFPB_Public_PRA@cfpb.gov.