Summary of the final rule on mortgage loan originator qualification and compensation practices

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 employee 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, the final rule clarifies the application of this prohibition to various kinds of retirement and profit-sharing plans. For example, mortgage-related business profits can be used to make contributions to certain tax-advantaged retirement plans, such as a 401(k) plan, and to make bonuses and contributions to other plans that do not exceed ten 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 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 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 employers whose employees are not required to be licensed, including depository institutions and bona fide non-profits, 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 employees' 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 originator employees 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 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.