

BUREAU OF CONSUMER FINANCIAL PROTECTION

Policy Guidance on Supervisory and Enforcement Considerations Relevant to Mortgage Brokers Transitioning to Mini-Correspondent Lenders

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Policy Guidance.

SUMMARY: The Bureau of Consumer Financial Protection (CFPB or Bureau) is issuing supervisory and enforcement guidance entitled “Policy Guidance on Supervisory and Enforcement Considerations Relevant to Mortgage Brokers Transitioning to Mini-Correspondent Lenders,” (Policy Guidance) which relates to the Bureau’s exercise of its authority to supervise and enforce compliance with RESPA and Regulation X and TILA and Regulation Z in certain transactions involving “mini-correspondent lenders.”

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SUPPLEMENTARY INFORMATION:

I. Introduction

The Bureau has become aware of increased interest among some mortgage brokers to restructure their business to become mini-correspondent lenders (mini-correspondents) in the possible belief that doing so will alter the applicability of important consumer protections that apply to transactions involving mortgage brokers. These protections include provisions in the Real Estate Settlement Procedures Act (RESPA) and Regulation X and the Truth in Lending Act (TILA) and Regulation Z, as amended by title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Bureau has implemented the title XIV

amendments to RESPA and TILA through final rules amending Regulations X and Z, issued beginning in January 2013. These rules generally took effect in January 2014.

The Bureau is issuing this Policy Guidance to identify for mortgage industry stakeholders, consumers, and the public generally questions the Bureau may consider in exercising its supervisory and enforcement authority under RESPA and TILA with respect to transactions involving mini-correspondent lenders.

II. Description of Policy Guidance

The Policy Guidance begins by providing background on the Bureau's concern regarding the shift of some mortgage brokers to the mini-correspondent lender role, the RESPA and TILA consumer protections potentially affected by the transition of a mortgage broker to a mini-correspondent lender, and an overview of correspondent lending. The Policy Guidance follows this with a discussion of the regulatory framework under Regulation X and Regulation Z that determines the role and obligations of the parties in a mortgage transaction. The Policy Guidance then provides a non-exhaustive list of questions the Bureau may consider in the exercise of its supervisory and enforcement authority with respect to transactions involving mini-correspondent lenders. The Policy Guidance makes clear that no single question listed in the Policy Guidance is necessarily determinative of how the Bureau may exercise its supervisory and enforcement authorities. The Policy Guidance also makes clear that the facts and circumstances of the particular mortgage transaction being reviewed would be relevant to how the Bureau exercises these authorities.

The Policy Guidance states that the Bureau will closely monitor the practices of mini-correspondents, including former mortgage brokers that have converted to this form, to ensure that the protections afforded to consumers under federal consumer financial law, including the

Bureau's implementing regulations, are not being evaded. Finally, the Policy Guidance also states that the Bureau will use all appropriate tools to assess whether supervisory, enforcement, or other actions are necessary.

III. Policy Guidance

The text of the Policy Guidance follows:

Policy Guidance on Supervisory and Enforcement Considerations Relevant to Mortgage Brokers Transitioning to Mini-Correspondent Lenders

The Bureau of Consumer Financial Protection (CFPB or Bureau) is issuing this “Policy Guidance on Supervisory and Enforcement Considerations Relevant to Mortgage Brokers Transitioning to Mini-Correspondent Lenders” (Policy Guidance) to identify the questions the Bureau may consider in exercising its supervisory and enforcement authority under the Real Estate Settlement Procedures Act (RESPA) and Regulation X and the Truth in Lending Act (TILA) and Regulation Z with respect to mortgage transactions involving mini-correspondent lenders (mini-correspondents), including transactions involving mortgage brokers that transition to mini-correspondent lender roles.

Background

The Bureau has become aware of increased mortgage industry interest in the transition of mortgage brokers from their traditional roles to mini-correspondent lender roles. The Bureau is concerned that some mortgage brokers may be shifting to the mini-correspondent model in the belief that, by identifying themselves as mini-correspondent lenders, they automatically alter the application of important consumer protections that apply to transactions involving mortgage brokers. These protections include provisions in RESPA and Regulation X¹ and TILA and

¹ 12 U.S.C. 2601 *et seq.*, 12 CFR part 1024.

Regulation Z,² as amended by title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).³ The Bureau has implemented the title XIV amendments to RESPA and TILA through final rules amending Regulations X and Z, issued beginning in January 2013. These rules generally took effect in January 2014.

Regulations X and Z apply certain requirements and prohibitions to compensation paid to a mortgage broker. These provisions include:

- **Disclosure of mortgage broker compensation.** Regulation X requires that the lender’s compensation to the mortgage broker be disclosed on the Good-Faith Estimate and HUD-1 Settlement Statement.⁴ By contrast, payments received by the lender from an investor as compensation for a “bona fide” transfer of the loan in the secondary market need not be disclosed;⁵

- **Inclusion of mortgage broker compensation in “points and fees.”** Under Regulation Z, compensation paid to a mortgage broker by a consumer or creditor is included in points and fees for purposes of the points-and-fees cap for “qualified mortgages” and for the points-and-fees test for determining whether a mortgage is a “high-cost mortgage” under the Home Ownership and Equity Protection Act (HOEPA).⁶ Interest paid to a creditor is not

² 15 U.S.C. 1601 *et seq.*, 12 CFR part 1026.

³ Public Law 111–203, 124 Stat. 1376 (2010).

⁴ See 12 CFR part 1024, appendix A and appendix C. The Bureau’s TILA-RESPA Integrated Disclosure Rule (78 FR 79730 (Dec. 31, 2013)) effective August 1, 2015, requires that the creditor compensation’s to the mortgage broker be on the Closing Disclosure (although not on the Loan Estimate). See 12 CFR 1026.38(f)(1).

⁵ 12 CFR 1024.5(b)(7). Coverage under section 8 of RESPA, implemented at 12 CFR 1024.14, prohibiting the payment of kickbacks for the referral of settlement services, and splits of charges other than for services performed, is also implicated by whether compensation is being paid in a secondary market transaction. For example, compensation for the sale of a mortgage loan is a secondary market transaction rather than a referral fee and is “beyond the scope of section 8.” See 12 CFR part 1024, appendix B, illustration 5.

⁶ 12 CFR 1026.32(b)(1)(ii). This section cross references the definition of “loan originator” in 12 CFR 1026.36(a)(1). 12 CFR 1026.36(a)(2) defines “mortgage broker” for purposes of § 1026.36, as “any loan originator that is not an employee of the creditor.” See also 12 CFR 1026.32(a)(1)(ii) (threshold for points and fees for high-cost mortgages); 12 CFR 1026.43(e)(3) (limit on points and fees for qualified mortgages). See also 15 U.S.C 1602(bb)(1)(A) (definition of high-cost mortgage); 15 U.S.C 1602(bb)(4) (points and fees included for high-cost

included in points and fees; nor is any compensation a creditor (not otherwise defined as a “loan originator” for purposes of the loan originator compensation restrictions discussed further below) receives from a third party that purchases the loan included in points and fees;⁷

- **Restrictions on mortgage broker compensation.** TILA and Regulation Z⁸ prohibit certain compensation arrangements between creditors and loan originators, including mortgage brokers.⁹ Mortgage brokers may not receive compensation from both the consumer and the creditor or any another person;¹⁰ and mortgage brokers may not receive compensation based on loan terms.¹¹ These restrictions do not apply to compensation by a third party, such as an investor, to a creditor that is not also defined as a loan originator for purposes of these compensation restrictions; and

- **Prohibition on steering to increase mortgage broker compensation.** TILA and Regulation Z prohibit loan originators, including mortgage brokers, from “steering” consumers to transactions not in their interest, to increase the mortgage broker’s compensation.¹²

A correspondent lender, as generally understood in the mortgage industry, performs the activities necessary to originate a mortgage loan, i.e., it takes on the tasks usually performed by the originating lender. The correspondent lender takes and processes applications, provides required disclosures, and often, although not always, underwrites loans and makes the final credit

mortgages); 15 U.S.C 1639c(b)(2)(A)(vii) (limit on points and fees for qualified mortgages); and 15 U.S.C 1639c(b)(2)(C) (definition of points and fees for purposes of qualified mortgages).

⁷ 12 CFR 1026.32(b)(1)(i)(A) (excluding interest from points and fees); 12 CFR 1026.32(b)(1)(ii) (generally including compensation paid directly or indirectly by a consumer or creditor to a loan originator).

⁸ See Loan Originator Compensation Requirements under the Truth in Lending Act (Regulation Z) 78 FR 11279 (Feb. 15, 2013); see also Amendments to 2013 Mortgage Rules Under the Equal Credit Opportunity Act (Regulation B), Real Estate Settlement Procedures Act (Regulation X), and the Truth in Lending Act (Regulation Z), 78 FR 60382 (Oct.1, 2013).

⁹ In Regulation Z these prohibitions apply to compensation paid to “loan originators” (including “loan originator organizations”). See 12 CFR 1026.36(a)(1)(i), (iii). However, for clarity this Policy Guidance refers to mortgage brokers which, as noted, are included in the definition of “loan originator.” See 12 CFR 1026.36(a)(2) and footnote 6.

¹⁰ 12 CFR 1026.36(d)(2).

¹¹ 12 CFR 1026.36(d)(1).

¹² 12 CFR 1026.36(e).

approval decision. The correspondent lender closes loans in its name, funds them (often through a warehouse line of credit), and sells them to an investor by prior agreement. A full correspondent lender may have such agreements with multiple investors.

The Bureau understands that some entities may transition from being a mortgage broker to being a correspondent lender and, in so doing, may begin as a small correspondent with agreements with only a few investors. Entities attempting to move to the role of a correspondent lender may start by obtaining a warehouse line of credit, typically from a third-party “warehouse bank.” The warehouse line of credit will provide the funding for the mortgage loans the entities originate and sell to a third-party investor. Over time, the number of third-party investors with which the correspondent lender has agreements may grow.

Since the Bureau issued the title XIV rules, it understands that some mortgage brokers may be setting up arrangements with wholesale lenders in which they purport to act as mini-correspondent lenders. Under such arrangements, the mortgage broker may in form appear to be the lender or creditor in each transaction by engaging in activities such as closing the loan in its own name, funding the loan from what is designated as a warehouse line of credit, and receiving compensation through what may nominally take the form of a premium for the sale of the loan to an investor.

However, in substance, these mortgage brokers may not have transitioned to the mini-correspondent lender role and may be continuing to serve effectively as mortgage brokers. That is, these mortgage brokers may continue to facilitate brokered loan transactions between borrowers and wholesale lenders (i.e., entities which typically provide the funding for loans in transactions involving mortgage brokers). For example, the mortgage broker may enter into an arrangement with a lender designated as an “investor,” but that investor may function as the

mortgage broker's wholesale lender, and not as a purchaser of loans in the secondary market. Such an "investor" may continue to perform the same origination activities it would perform as a traditional wholesale lender for the loans that it now "buys" from the mortgage broker. As well as performing these functions and agreeing to purchase the loans from the mortgage broker designated as a "mini-correspondent, the "investor" may also provide the warehouse line of credit that the "mini-correspondent" uses to fund its loans.

As discussed below, the requirements and restrictions that RESPA and TILA and their implementing regulations impose on compensation paid to mortgage brokers do not depend on the labels that parties use in their transactions. Rather, under Regulation X, whether compensation paid by the "investor" to the "lender" must be disclosed depends on determinations such as whether that compensation is part of a secondary market transaction, as opposed to a "table-funded" transaction. Likewise, under Regulation Z, whether compensation paid by the "investor" to the "creditor" must be included in the points-and-fees calculation and whether the "creditor" is subject to the compensation restrictions as a mortgage broker depends on determinations such as whether the "creditor" finances the transaction out of its own resources as opposed to relying on table-funding by the "investor."

In exercising its supervisory and enforcement authority, the Bureau may consider factors that evidence the true nature of the mortgage transaction, i.e., whether the parties are engaging in good faith in a secondary market transaction between a lender and a third-party investor or, in fact, a typical primary market transaction involving a mortgage broker and a wholesale lender.

Discussion

RESPA and TILA Regulatory Framework: The mortgage broker compensation requirements imposed by RESPA and Regulation X do not apply to

exempt bona fide secondary-market transactions, but those requirements do apply to table-funded transactions. Whether a transaction is deemed to be a bona fide secondary market sale of a loan turns on the “real source of funding” and the “real interest of the funding lender.”

Regulation X defines a mortgage broker as a person, other than an employee of a lender, who renders origination services and serves as an intermediary between a borrower and lender in a federally-related mortgage loan transaction, including such a person that closes the loan in its own name in a “table-funded transaction.”¹³ “Table-funding” occurs when the loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds.¹⁴ In table-funding, the third party who advances the loan funds and takes initial assignment of the loan at or after settlement is the lender for purposes of Regulation X, and the entity which acts as the intermediary in bringing that lender and the borrower together is the mortgage broker (even though that entity closes the loan in its own name).¹⁵ However, a “bona fide transfer of a loan obligation in the secondary-market” is not covered by RESPA under Regulation X (with exceptions not relevant here).¹⁶ Regulation X explains that the Bureau will consider the “real source of funding” for the loan and the “real interest of the funding lender” in determining what constitutes a bona fide

¹³ 12 CFR 1024.2

¹⁴ *Id.*

¹⁵ *Id.* A lender is otherwise generally defined as the secured creditor named on the debt obligation.

¹⁶ 12 CFR 1024.5(b)(7).

transfer.¹⁷ Under Regulation X, a table-funded transaction is *not* a secondary-market transaction.¹⁸

Similarly, the TILA and Regulation Z loan originator compensation requirements discussed above cover compensation paid to mortgage brokers in “table-funded” transactions. Under Regulation Z, a creditor is defined in relevant part as a person who regularly extends credit and to whom the obligation is initially payable on the face of the note.¹⁹ For purposes of the loan originator compensation requirements discussed above, however, a “loan originator” is defined to include such a creditor if it engages in loan origination activity and “does not finance the transaction at consummation out of the creditor’s own resources, including by drawing on a *bona fide* warehouse line of credit.”²⁰ In other words, the term loan originator, for purposes of the loan originator requirements discussed above, includes any creditor that otherwise satisfies the definition of loan originator and makes use of “table funding” by a third party.²¹ A table-funded transaction is consummated with the debt obligation initially payable by its terms to one person, but another person provides the funds for the transaction at consummation and receives an immediate assignment of the note.²²

By defining mortgage brokers to include entities which close loans in their own names in table-funded transactions – and by excluding from RESPA only bona fide secondary-market transactions – Regulation X recognizes that it is possible to structure transactions that take the form of the sale of a loan to an investor but where, in substance, the purchaser functions as the lender and the entity whose name is on the note is a

¹⁷ *Id.* See also 12 CFR part 1024, appendix B, illustration 5.

¹⁸ *Id.*

¹⁹ 12 CFR 1026.2(a)(17).

²⁰ 12 CFR 1026.36(a)(1)(i).

²¹ Comment 36(a)-1.i.C.

²² Comment 36(a) -1.ii.

mortgage broker. Regulation Z recognizes this as well by defining the term loan originator to include creditors in table-funded transactions and differentiating between such transactions and those in which a creditor draws upon a bona fide warehouse line of credit.

Questions the Bureau May Consider in Exercising Its Supervisory and Enforcement Authority under RESPA and TILA in Transactions Involving Mini-Correspondents: As discussed above, the Bureau understands that some mortgage brokers have successfully transitioned to correspondent lenders (small or large) that do not act as mortgage brokers in covered mortgage transactions. Such correspondent lenders often perform a majority of the principal origination activities with the funds provided by a bona fide warehouse line of credit. The correspondent lenders then sell the loans in secondary market transactions to third-party investors. The Bureau also understands that other mortgage brokers may be seeking to adopt the form of a mini-correspondent lender out of a belief that doing so avoids application of various provisions of Regulations X and Z.

In exercising its supervisory and enforcement authority under RESPA and TILA in transactions involving mini-correspondents, the Bureau asks various questions relevant to understanding the true nature of the mortgage transaction.

Among the questions the Bureau asks are the following:

- Beyond the mortgage transaction at issue, does the mini-correspondent still act as a mortgage broker in some transactions, either brokering to the same wholesale lender that supplies the warehouse line of credit or otherwise?

- If so, what distinguishes the mini-correspondent’s “mortgage broker” transactions from its “lender” transactions?
- How many “investors” does the mini-correspondent have available to it to purchase loans?
- Is the mini-correspondent using a bona fide warehouse line of credit as the source to fund the loans that it originates?
 - Is the warehouse line of credit provided by a third-party warehouse bank?
 - How thorough was the process for the mini-correspondent to get approved for the warehouse line of credit?
 - Does the mini-correspondent have more than one warehouse line of credit?
 - Is the warehouse bank providing the line of credit one of, or affiliated with any of, the mini-correspondent’s investors that purchase loans from the mini-correspondent?
 - If the warehouse line of credit is provided by an investor to whom the mini-correspondent will “sell” loans to, is the warehouse line a “captive” line (i.e., the mini-correspondent is required to sell the loans to the investor providing the warehouse line (or affiliates of the investor))?
 - What percentage of the mini-correspondent’s total monthly originated volume is sold by the mini-correspondent to the entity providing the warehouse line of credit to the mini-correspondent,

or to an investor related to the entity providing the warehouse line of credit?

- Does the mini-correspondent's total warehouse line of credit capacity bear a reasonable relationship, consistent with correspondent lenders generally, to its size (i.e., its assets or net worth)?
- What changes has the mini-correspondent made to staff, procedures, and infrastructure to support the transition from mortgage broker to mini-correspondent?
- What training or guidance has the mini-correspondent received to understand the additional compliance risk associated with being the lender or creditor on a residential mortgage transaction?
- Which entity (mini-correspondent, warehouse lender, investor) is performing the majority of the principal mortgage origination activities?
 - Which entity underwrites the mortgage loan before consummation and otherwise makes the final credit decision on the loan?
 - What percentage of the principal mortgage origination activities, such as the taking of loan applications, loan processing, and pre-consummation underwriting, is being performed by the mini-correspondent, or an independent agent of the mini-correspondent?
 - If the majority of the principal mortgage origination activities are being performed by the investor, is there a plan in place to transition these activities to the mini-correspondent?

- What conditions must be met to make this transition (e.g., number of loans, time)?

This document is intended to provide guidance to mortgage industry stakeholders, consumers, and the public related to the considerations that the Bureau may employ in the exercise of its supervisory and enforcement authority with respect to mortgage transactions involving mini-correspondents, including mortgage brokers transitioning into becoming mini-correspondents. The above list of questions is not an exhaustive list of the Bureau's considerations relevant to the exercise of its supervisory and enforcement authorities. In addition, no single question listed above is necessarily determinative of how the Bureau may exercise its supervisory and enforcement authorities. Furthermore the facts and circumstances of the particular mortgage transaction being reviewed are relevant to the exercise of these authorities.

Conclusion

The Bureau will closely monitor the practices of mini-correspondents, including former mortgage brokers that have converted to this form, to ensure that the protections afforded to consumers under federal consumer financial law, including the Bureau's implementing regulations, are not being evaded. In doing so, the Bureau will use all appropriate tools to assess whether supervisory, enforcement or other actions are necessary.

IV. Regulatory Requirements

This Policy Guidance is a non-binding policy guidance articulating considerations relevant to the Bureau's exercise of its supervisory and enforcement authority under Regulation

X and RESPA, and Regulation Z and TILA. It is therefore exempt from the notice and comment rulemaking requirements under the Administrative Procedure Act pursuant to 5 U.S.C. 553(b).

Because no notice of proposed rulemaking is required, the Regulatory Flexibility Act does not require an initial or final regulatory flexibility analysis. 5 U.S.C. 603(a), 604(a).

The Bureau has determined that this Policy Guidance does not impose any new or revise any existing recordkeeping, reporting, or disclosure requirements on covered entities or members of the public that would be collections of information requiring OMB approval under the Paperwork Reduction Act, 44 U.S.C. 3501, *et seq.*

**[THIS SIGNATURE PAGE PERTAINS TO THE POLICY GUIDANCE TITLED
“POLICY GUIDANCE ON SUPERVISORY AND ENFORCEMENT
CONSIDERATIONS RELEVANT TO MORTGAGE BROKERS TRANSITIONING TO
MINI-CORRESPONDENT LENDERS”]**

Dated: July 9, 2014.



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