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Friday, March 11, 2011

NAMB v. FRB: David 2.00 v. Goliath

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Goliath has yet another David to contend with! On March 7, 2011, the [National Association of Independent Housing Professionals](#) (NAIHP) filed a lawsuit against the FRB, and two days later, on March 9, 2011, the [National Association of Mortgage Brokers](#) (NAMB) also brought suit against the FRB. Litigating against the FRB to get a court order staying the implementation of the TILA loan originator compensation requirements is a daunting undertaking. Better than one David fighting Goliath, it surely is significant that now two Davids are taking on this gargantuan agency!

Yesterday, I provided a brief synopsis of NAIHP's lawsuit. Today, let's take a look at NAMB's arguments and strategy.



Lawsuit Arguments - A Salient Selection

This Commentary offers a brief outline of selected arguments against the TILA Loan Originator Compensation rule (Rule). I am leaving out citations, where possible, for ease of reading. This outline is not meant to be comprehensive, authoritative, or relied upon for legal advice. It offers only a brief synopsis of the argumentation. For citations, exhibits, and argumentation, I suggest that you read the lawsuit. (See Below)

Plan of Attack

NAMB has set up an attack on specific aspects of the Loan Originator Compensation rule (Rule), which it calls the "Challenged Section of the Rule" (Challenged Section). This is the area of TILA compensation that prohibits a mortgage broker from paying its loan officers a commission in a specific loan transaction.

This line of attack seems to be taken to show the grievous harm to mortgage brokers that will ensue if the Rule is enforced. It is a smart gambit, since NAMB is seeking a temporary and preliminary injunction enjoining and restraining the FRB from enforcing the Challenged Section, until such time as the Court adjudicates the legality of the Rule; that is, demonstrating a clear and present danger, and imminent and irreparable harm to the industry, are at the basis for seeking immediate relief from the Court.

NAMB's suit also takes the position that the FRB's actions are arbitrary and capricious, because it has acted without a rational basis, ignored the Regulatory Flexibility Act, and exceeded its authority pursuant to TILA in contravention of Dodd-Frank. Accordingly, the Challenged Section, which goes into effect on April 1, 2011, should be declared unlawful and the FRB should be temporarily, preliminarily, and permanently enjoined from implementing and enforcing that section of the Rule.

Loan Officers Leaving

It is alleged that enforcement of the Challenged Section will lead to loan officers leaving mortgage brokers to seek employment from competitors *qua* banks *qua* creditors - due to the fact that their loan officer employees will no longer be able to be compensated on a commission basis or because they know their employer is going out of business as a result of compliance with the Rule. So, the "departure and the unavoidable termination of these loan officers will leave mortgage brokers without the ability to originate the majority of their loans and ultimately the mortgage brokerage industry will become extinct."

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Similar to the objection raised by the NAIHP suit, NAMB claims that the Rule exempts creditors (i.e., banks and lenders) from the prohibitions of the Challenged Section and permits them to continue to compensate their individual loan officers based on the well-established and preferred commission basis.

Bone of Contention

The nub of NAMB's suit is the fact that the Rule carves out a "sweeping and unfair exception to its prohibition on payments to loan originators." In other words, the unfair "creditor exemption" argument, also noted by the NAIHP in its suit, is being used in the NAMB suit.

Specifically, because the definition of "loan originator" does not include "creditors," large banks and other lenders are free to compensate their employees on a commission basis. Thus, when consumers pay loan origination fees to a creditor, that creditor is free to share a portion of that fee with its employees in the form of commissions. Yet, as the Rule requires, loan originators like mortgage brokerages are prohibited from paying compensation to their loan officer employees. The claim, then, is that in carving out this exception, "the FRB provided no rational basis for discriminating between mortgage brokers, on the one hand, and creditors on the other."

Consumer Paid Model - An Economic Quagmire

The suit highlights the so-called "consumer paid model" as contributory toward loan officers leaving mortgage brokers and joining banks and lenders. The Challenged Section prohibits mortgage brokers from paying their loan officer employees a commission in a consumer paid transaction.

The suit declares that this prohibition will cause "catastrophic and far-reaching harm" to the mortgage brokerage industry. It will lead to wholesale lending operations being significantly diminished and less loan choices for the consumer. Smaller mortgage brokers cannot compensate their loan officer employees on an hourly rate or salary basis because loan volume and loan sizes are constantly changing based on a variety of factors in the marketplace. So, as direct result of the Challenged Section, "mortgage brokers will no longer be able to use commissions to compensate their loan originators," and paying loan officers on a salary or hourly basis "is not workable because most mortgage brokers do not have sufficient loan volume to make salaried loan officers an economically viable option."

The suit states that already, before April 1, 2011, many loan officers "are leaving mortgage brokerage companies to join creditors or leaving the industry entirely."

The approach taken in the suit is to make it crystal clear that the effect of the Rule will bring **extinction of the mortgage brokerage industry** - stating that "many will cease operations before the Rule's April 1, 2011 effective date, and many others will be driven out of business after the Rule goes into effect." Furthermore, the loan officers themselves will find obtaining employment with creditors a challenge, because the number of applicants will far exceed the number of available openings. And, of course, the ripple effect will extend to the diminution in employment for the administrative personnel.

The overall effect of implementing the Challenged Section will be the virtual elimination of the mortgage broker, which will bring about, according to the suit, a reduction in competition because consumers will have no choice but to rely on large mortgage providers *qua* **creditors** for their mortgage needs. This will drive up prices and reduce choice and even the availability of mortgages for a large swath of the American public. Importantly, the suit claims, "the closing of these small mortgage broker companies will have a devastating effect on ... wholesale lenders by eliminating the majority of their business."

Arbitrary and Capricious 2.0 - FRB Acts Without Rational Basis

There are three areas that the suit challenges in order to show that the FRB's actions are arbitrary and capricious. Let's break down these areas into a "claim and rebuttal" perspective.

- **FRB Claim:**

If consumers pay loan originators directly and creditors also pay originators through higher rates, consumers may be unwittingly paying originators more in total compensation (directly and through the rate) than consumers believe they agreed to pay.

- **Rebuttal:**

Any concerns regarding a consumer unwittingly paying originators more where they are also receiving compensation from the creditor, even if true, are fully addressed by the Challenged Section which prohibits a creditor and a consumer from paying a loan originator. But prohibiting a mortgage broker from paying its own individual loan officer does nothing to address this concern.

- **FRB Claim:**

The FRB believes that the restriction on loan originator compensation would increase transparency for consumers by requiring that all originator compensation come from the



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creditor or from the consumer but not both.

- Rebuttal:

The FRB's concern over transparency is addressed by the Challenged Section's prohibiting a mortgage broker from being compensated by both the creditor and the consumer.

- FRB Claim:

Consumers reasonably may believe that when they pay a loan originator directly, that amount is the only compensation the originator will receive.

- Rebuttal:

The FRB has provided no evidence that a when a consumer pays a mortgage broker, they do not expect the mortgage broker to pay its individual loan officer. The FRB has expressly admitted that "consumers expect the creditor to compensate its own loan officers."

Arbitrary and Capricious 2.0 - FRB Ignores the Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires an agency who has proposed a rule to prepare and make available for public comment an initial and final regulatory flexibility analysis. This initial flexibility analysis "shall describe the impact of the proposed rule on small entities."

However, in violation of the RFA requirements, the FRB failed to provide any statement of the need for, or objectives of, the Challenged Section.

Indeed, the suit alleges that the FRB failed to conduct any analysis of the impact that the Rule would cause on small entities, failed to consider the comments made by the SBA's Office of Advocacy during the public comment period, which comments warned of the Rule's devastating impact on the mortgage brokerage industry, and "failed to meaningfully analyze any potential alternatives to prohibiting mortgage brokers from compensating their loan officers through a commission" in a consumer paid transaction.

Arbitrary and Capricious 2.0 - FRB Exceeds TILA Authority

The FRB exceeded their authority under TILA in attempting to regulate the compensation of mortgage brokers, who are not subject to the restrictions or requirements of TILA or HOEPA. TILA and HOEPA apply only to "creditors." Mortgage brokers cannot be defined as a "creditor" under TILA since they do not regularly extend consumer credit and are not the person to whom the debt arising from the consumer credit transaction is initially payable. Therefore, the "FRB does not have the authority to regulate mortgage brokers pursuant to TILA and the Challenged Section should be invalidated.

Furthermore, the FRB "exceeded the authority that was provided under TILA" in prohibiting 'unfair or deceptive' acts on consumers.

Neither in the FRB's final rule nor in the proposed rule does the FRB explain its reasoning or provide any support for the Challenged Section. Although the FRB explains how many of the other prohibited practices harmed or could harm consumers, it entirely fails to explain how a mortgage broker's practice of paying its employees based on the fees paid by a consumer is deceptive or unfair to the consumer. Thus, according to the suit, the FRB has exceeded its authority under TILA and HOEPA in promulgating the Challenged Section.

An interesting claim is made in the suit, as follows: the Challenged Section contradicts the purposes of TILA "by reducing competition and providing consumers with less choices for mortgage loans." This is part of the earlier series of claims, but it now is brought back to prove the FRB's arbitrary and capricious actions. The claim is that implementation and enforcement of the Challenged Section results in broker businesses and wholesale lenders closing their doors and ceasing operations, that consumers in both rural and urban areas who do not have direct access to creditors will be significantly affected by these closings, and that the result of these harmful outcomes to consumers is in direct conflict with the objectives of TILA. Therefore, the Challenged Section should be invalidated.

Finally, there is the claim that mortgage broker companies are not technically loan originators or mortgage originators because, according to the scope and definitions of Dodd-Frank, a "mortgage originator" like the definition of a "loan originator" under the SAFE Act, is defined only as only to an "individual" or natural "person" who, for gain or compensation, takes a residential loan application and/or offers or negotiates the terms of a residential mortgage loan. Thus, neither Dodd-Frank or the SAFE Act expressly includes mortgage brokerage companies in the definition of Loan or Mortgage Originators. States the suit: the Challenged Section "is at stark odds with the definitions in the Safe Act and Dodd-Frank Act and therefore exceeds the [FRB's] authority in promulgating" the Challenged Section.

David 2.0 versus Goliath

The NAMB seeks a temporary and preliminary injunction enjoining and restraining the FRB from enforcing the Challenged Section, until such time as the Court adjudicates the legality of the Rule; expeditious proceedings in this action in light of the Rule's April 1, 2011 effective date;

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Judgment in NAMB's favor and against the FRB; declaration that the Challenged Section is unlawful and void; and, a permanent injunction prohibiting the FRB from implementing the Challenged Section.

Visit the [NAMB website](#) for more information.

The combined strength of the NAMB and NAIHP lawsuits should provide considerable support to efforts to rectify the unresolved issues created by the FRB's handling of the TILA loan originator compensation issues. Both organizations, as well as many other industry associations, have been working toward seeking a delay of the April 1, 2011 effective date or far more reliable and comprehensive guidance prior to that date.

It appears that NAMB and NAIHP have done everything they could to avoid litigation through numerous attempts at negotiating and lobbying. To no avail, leaving them no recourse but costly litigation. Perhaps the FRB will recognize that its actions have the potential to cause unintended consequences. But sometimes there are no unintended consequences, only quite likely consequences that we refuse or neglect to prevent!

[Our Library contains a copy of the lawsuit and press release.](#)



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