

Lenders Compliance Group

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Lawsuit Gets An Assist! (Loan Originator Compensation)

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COMMENTARY: by [JONATHAN FOXX](#)

[Jonathan Foxx](#) is a former Chief Compliance Officer of two publicly traded financial institutions, and the President and Managing Director of [Lenders Compliance Group](#), the nation's first full-service, mortgage risk management firm in the country.

Since the National Association of Independent Housing Professionals (NAIHP) and National Association of Mortgage Brokers (NAMB) filed their separate lawsuits against the FRB three weeks ago, respectively on 3/7 and 3/9, the FRB moved to consolidate them, which the Court granted. The NAMB then moved for a reconsideration of the consolidation, which the Court denied. See: [Archive](#) for previous Commentaries.

An important Amicus Brief was filed on March 24, 2011 by the [Community Mortgage Banking Project](#) and the Community Mortgage Banking Research Fund (collectively, the "CMBP") in support of the NAIHP's and NAMB's application for a temporary restraining order and preliminary injunction.

Amicus Brief 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, please read the Amicus Brief. (See Below)

Amicus Brief

A word about the nomenclature "Amicus Brief" (otherwise known as "amicus curiae," which is Latin for "friend of the court"). Essentially, a court may decide to admit a brief, to wit, a legal opinion offered by someone who is not a party to the subject litigation itself, but whose views express support on behalf of a litigant and, obviously, in favor of its own views. Criteria for an Amicus Brief include: (1) must not be a party to the case, (2) nor an attorney in the case, and (3) must have some knowledge or perspective that makes the expressed view valuable to the court, such as commenting on a point of law, providing additional information, or emphasizing particular areas of the litigation that the court should fully consider. In this article, I will refer to the Amicus Brief filed by the CMBP as "CMBP" or "CMBP Brief."



Radical New Rules

The CMBP claims that, in advance of losing its authority over residential mortgage practices to the Consumer Financial Protection Bureau (CFPB), the FRB announced "**radical new rules** that upend the manner in which industry professionals are compensated." Of course, the CMBP is referring to the Loan Originator Compensation Rule and Anti-Steering Rule. (My emphasis.)

Notably, the Rule comes two years after the FRB's own commissioned, consumer testing study found that no new rules were necessary with respect to loan originator compensation.

Indeed, states the CMBP, [the FRB](#):

- "fails to reference anything that has changed in the intervening period or any new information that compels a different conclusion."

The FRB "inexplicably ignores" its own findings!

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In this section of the CMBP Brief, it is claimed that the Rule:

- (1) circumvents strict rulemaking procedures that Congress, in Dodd-Frank, vested with the new CFPB;
- (2) exceeds the FRB's authority under the Home Ownership and Equity Protection Act (HOEPA);
- (3) violates well-settled requirements of the Administrative Procedure Act (APA).



Who will Speak for the Mortgage Bankers?

Mortgage brokers and affiliates (such as companies that are established as affiliated business arrangements) are not the only entities adversely affected by the Rule. The NAIHP and the NAMB largely represent the brokerage community.

But, as the CMBP points out, independent mortgage bankers are also adversely impacted by the Rule because

"unlike any known regulation of an entire lawful industry, [it] micro-mandates the terms of employment of individual loan originators employed by mortgage bankers" by mistaking "ordinary profit in lending transactions for unfair and deceptive practices."

The CMBP claims the Rule causes mortgage bankers to lose control over basic employment terms, such as incentives based on company profitability, used over the years to attract and maintain competent employees.

Specifically, the Rule

"prevents mortgage bankers' employees from offering to consumers the full range of competitive loan pricing options," by "not only prohibit[ing] loan originators from arranging loan terms that result in higher consumer costs, [but also applying] the same prohibition to offering consumers **LOWER** cost mortgage loans to meet competition and to save the consumer money." (Emphasis in original.)

Thus, according to the CMBP, the Rule results in discrimination against lending programs designed to benefit low-to-moderate income (LMI) borrowers.

The CMBP claims that the FRB has come to the following erroneous conclusion:

"[a]llowing compensation to vary with loan type, such as loans eligible for consideration under the [Community Reinvestment Act] would permit unfair compensation practices to persist in loan programs offered to consumers who may be more vulnerable to such practices."

The CMBP completes its assertions with the view that, "given the severe, loan-by-loan and class action remedies that may accrue" under the Rule, "retail mortgage bankers will encounter new, undefined and virtually limitless legal and economic risks under the Final Rule." (My emphasis.)



Argument # 1

Congress gave the CFPB exclusive authority over loan originator compensation practices.

Dodd-Frank vests the CFPB with exclusive rulemaking authority to implement federal consumer financial law. Indeed, Section 1022 of Dodd-Frank "heightens the standard for promulgation of rules" and requires that courts defer to the CFPB regarding "the meaning or interpretation of any provision of a Federal consumer financial law," notwithstanding actions by other federal agencies.

Thus, Congress intended to bestow the CFPB with authority to:

- (1) promulgate loan originator compensation rule according to heightened rulemaking standards, and
- (2) have exclusive and final say as to how such compensation practices are to be regulated.

Furthermore, Dodd-Frank amends TILA through the new Section 129B - the provision that addresses residential mortgage loan origination and compensation practices - in order to "assure 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."

Dodd-Frank expressly prohibits steering incentives, stating that "no mortgage originator shall receive from any person and no person shall pay to a mortgage originator . . . compensation that varies based on the terms of the loan (other than the amount of principal)."

Yet, as the CMBP rightly observes,

"prior to the enactment of the Dodd-Frank Act, TILA did not address loan originator compensation or anti-steering practices. The [FRB] was not granted authority to regulate loan originator compensation generally. That power falls solely to the CFPB. It is notable, as well, that the Final Rule differs from the Dodd-Frank Act in significant respects. In fact, the very definition of "loan originator" in the Final Rule conflicts with the Dodd-Frank Act definition of this term ("mortgage originator")."

(Actually, as CMBP references, Dodd-Frank does not even empower the CFPB, much less the FRB, to promulgate any regulation under the new law prior to the Congressionally-imposed "designated transfer date." And that transfer date is July 21, 2011.)

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Additionally, the FRB, by its own admission, has not complied with Dodd-Frank's enhanced rulemaking standards, as evidenced by its own disclosure that the Rule does not fully implement all the substantive requirements that Dodd-Frank sets forth for loan originator compensation in Section 129B. This is noted in the FRB's Federal Register issuance of the Rule:

"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)." (My Emphasis.)

Hence, the Rule "fails to adhere to both the procedural and substantive requirements" that Congress intended for loan originator compensation regulations.

Fatal to the FRB's position is the fact that the FRB has "already conceded that it must defer to the CFPB." In fact, the FRB "recently elected to take no further action on **all** of its other pending rules" that would amend mortgage lending regulations under TILA, except this one. (Emphasis in original.)

Bottom Line: the FRB has created a risk that

(1) either "conflicting loan originator compensation rules could soon exist"

or (2) the "industry will be forced to comply with a loan originator compensation rule that is incomplete and doomed to be short-lived."



Argument # 2

FRB violated the APA by exceeding its authority under HOEPA.

The FRB's authority is constrained to the promulgation of rules that prohibit unfair, deceptive, or evasive practices as to certain defined loans, to wit, "discretion was to be limited to the prohibition of acts and practices in connection with mortgage loans and refinancing mortgage transactions; it was **not to be exercised carte blanche to police every possible practice inherent to the mortgage industry, such as creditor compensation to employees.**" (My emphasis.)

Indeed, the FRB's enactment of **the Rule is inconsistent with TILA itself**, because in the Rule the FRB creates new classes of regulated parties that are not even defined by TILA. (My emphasis.)

Consequently, pursuant to the APA, the Rule must be set aside.

(Please allow me a needed digression. The CMBP Brief cites a well-known case in support of its view that the FRB has overstepped its statutory authority. The 1984 case was *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, and is known as "Chevron." It was decided by the U. S. Supreme Court. Chevron provides a legal test for a court to determine whether to grant "deference," (i.e., "administrative deference" or often now termed "Chevron deference") to a government agency's interpretation of a statute which it administers. The deference standard is needed because the Constitution did not set a limit on how much federal authority can be delegated to a government agency but, instead, allows for limits on the authority granted to a federal agency within the statutes enacted by Congress.

Chevron offered a two-step test to determine if an agency has exceeded its statutory authority, quoting the court decision itself, as follows:

(1) "whether Congress has spoken directly to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court as well as the agency must give effect to the unambiguously expressed intent of Congress;" and,

(2) "[I]f the statute is silent or ambiguous with respect to the specific question, the issue for the court is whether the agency's answer is based on a permissible construction of the statute."

The FRB has overreached because HOEPA - primarily a statute that addresses creditor disclosures - specifically states:

"The Board, by regulation or order, shall prohibit acts or practices in connection with (A) Mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and (B) Refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower."

The statute refers, generally, to "mortgage loans" and "refinancing of mortgage loans;" therefore, claims the CMBP Brief, "Congress did not intend to grant the [FRB] open-ended authority to prescribe new business practices and limit existing business practices that had been accepted in the residential mortgage lending industry."

Importantly, the CMBP claims that the FRB has disregarded its mission under HOEPA by prescribing "an extremely broad rule to mandate wide-ranging business practice changes under the assumption that consumer protection would follow." Example: rather than merely targeting the use of YSPs for mortgage broker compensation, the FRB "declared generally that relying on ordinary company profits to compensate loan originators is unfair and deceptive."

And notwithstanding Congress' intent, the Rule is not limited in its reach to unfair or deceptive credit products or practices. In fact, the FRB has imposed an "an entirely novel, comprehensive regime over a new class of parties known as "loan originators."

But TILA grants remedies to consumers against **creditors** who violate TILA and its implementing regulations, though not to rights of action against parties that variously may be

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called "mortgage brokers" or "loan originators." (My emphasis.)
Consequently, the FRB has exceeded its authority under HOEPA.



Argument # 3

Violates the Administrative Procedure Act

Under the APA, a Court must "hold unlawful and set aside agency action, findings, and conclusions found to be ... arbitrary, capricious, and an abuse of discretion, or otherwise not in accordance with law" or "in excess of statutory jurisdiction, authority, or limits, or short of statutory right."

This argument has three parts that, taken separately and collectively, constitute allegations of FRB's loan originator compensation, rulemaking actions to be violations of the APA. In this section of the CMBP Brief, a thorough analysis is provided which scrupulously outlines that the FRB has failed to:

- Supply a reasoned analysis for departing from its longstanding position on loan originator compensation, with respect to compensation to mortgage brokers and compensation by creditors to their own employees;
- Supply a reasoned analysis for its conclusion that loan originator compensation is an "unfair" practice;
- Offer reasoned explanations for rejecting reasonable alternatives.



Preserving a Competitive Market

In its Press Release on March 25, 2011, the CMBP stated that the Rule, "despite being positioned as pro-consumer, will instead have the perverse effect of denying consumers who comparison-shop for mortgages the opportunity to obtain a lower cost mortgage."

Glen Corso, the CMBP's Managing Director, believes:

"The Fed rule was supposed to address the issue of loan officers who raise the cost of a mortgage in order to increase their compensation, but it has ended up depriving loan officers of the ability to discount the mortgage rate to the consumer and absorb the cost of that discount by reducing their compensation. That's a competitive choice and what a healthy market is all about. Independent community mortgage lenders want to be able to vigorously compete on cost, but in a bizarre twist of poorly conceived regulation, the Fed rule prevents that."

And, in the same Press Release, Scott Stern, Chairman of the Community Mortgage Lenders of America (CMLA), states:

"Consumers in the market for a new mortgage regularly comparison-shop to get the best price. Loan officers, especially those affiliated with independent community mortgage lenders, regularly reduce their compensation in order to discount the price of a loan to be competitive."

Other "compensation variations" that benefit consumers are also adversely impacted by the rule. For an example, Mr. Corso points out that "bank-affiliated lenders often pay incentives to encourage their loan officers to originate more complex, difficult-to-originate loans, such as those eligible for credit under the Community Reinvestment Act (CRA). The Rule, however, specifically prohibits the payment of such incentives for CRA loans."

Concludes Mr. Corso: "Rather than drafting rules focused exclusively on eliminating inappropriate compensation incentives for loan officers, the Fed 's rule instead prohibits any variation in compensation to loan officers based on loans terms - even when it benefits the consumer."



Wheels of Justice

The CMBP implores the court to set aside the Rule, or, alternatively, delay the effective date of the Rule to permit the properly empowered agency, the CFPB, to take action as prescribed by Congress.

I have provided a cursory outline of the CMBP Brief. Although it is only 28 pages, it is compactly worded, carefully and concisely reasoned, and it succinctly sets forth cogent grounds for delaying the Rule.

Often, the wheels of justice turn slowly, maybe too slowly. The Motion for Hearing is imminent and the Rule's effective date is just a few days away. Perhaps this time the need for celerity and relief will be forthcoming.

[Our Library contains a copy of the Amicus Brief and Press Release.](#)



Labels: [CFPB](#), [CFRB](#), [CMBP](#), [Community Mortgage Banking Project](#), [Community Mortgage Banking Research Fund](#), [Loan Officer Compensation](#), [Loan Originator Compensation](#), [NAIHP](#), [NAMB](#), [Truth in Lending Act](#)

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