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Monday, March 14, 2011

COMES NOW the Senate!

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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.

Last week I outlined the salient aspects of lawsuits against the Federal Reserve System (FRB) filed by the [National Association of Independent Housing Professionals \(NAIHP\)](#) [filed 3/7/11], followed by the [National Association of Mortgage Brokers \(NAMB\)](#) [filed 3/9/11], respectively, [NAIHP v FRB: David v. Goliath](#), and [NAMB v FRB: David 2.0 v. Goliath](#). On March 10, 2011, the FRB moved to consolidate the two related cases on the basis that both challenge the FRB's loan originator compensation rule. This is not an uncommon opening gambit, so let's not dwell on legal strategy for the time being.

More importantly, on March 11, 2011 two prominent Senators sent a letter to the FRB (Letter), unequivocally requesting a delay of the April 1, 2011 effective date. A brief outline of the Letter, therefore, is in order.



Letter's 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 Letter. (See Below)

The Signatories

The Letter is signed by David Vitter (R-LA) and Jon Tester (D-MT). Among his Senate committee assignments, [David Vitter](#) is a Member of the Senate Committee on Banking, Housing, and Urban Affairs, Ranking Member, Subcommittee on Economic Policy, a Member of the Subcommittee on Financial Institutions and Consumer Protection, and a Member of the Senate Committee on Small Business and Entrepreneurship.

Among his committee assignments, [Jon Tester](#) is a Member of the Senate Committee on Banking, Housing, and Urban Affairs, Member, Chairman of the Subcommittee on Economic Policy, Member of the Subcommittee on Financial Institutions and Consumer Protection, and a Member of the Subcommittee on Housing, Transportation and Community Development.

Unintended Consequences

In the very first sentence of the Letter the Senators urge a delay of implementation of the April 1, 2011 effective date. They put forth the following reasons for requesting the delay.

- Implementation of the loan originator compensation rule (Rule) may have the "**unintended effect** of further increasing concentration in [the] home mortgage market." (My emphasis)
- The Rule will have the "**unintended consequence** of creating more uncertainty for small lenders and further impede home loan originations." (My emphasis)

Left in Limbo

The Senators observe that "even before the beginning of the housing crisis in 2007, the home mortgage market has been dominated by three of the largest U.S. banks." These banks

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account for more than 51% of residential mortgage loan originations, with 43% of the market itself going to the top two of those three banks. However, as the Senators correctly state, the FRB has "declined to provide any written guidance to small mortgage lenders and brokers which would provide clarity and assist them with compliance."

Put another way, the Senators take the position that the FRB's lack of responsiveness has led to community-based local lenders and mortgage brokers essentially being "left in limbo, unable to effectively design compliant compensation systems for the future."

Obviously, the implication is that the market is dominated by too few actors, and there is an entrenchment of competitive disadvantage, and substantially increased operating costs, to mortgage brokers and small lenders if the FRB declines to provide clear, unambiguous, written guidance to effectuate compliance.

Defense to Foreclosure

The Senators bring up a subject that has not been adequately addressed thus far, but it should be better understood due to its impact on the housing market.

To explain: there are provisions in Section 1413 of the Dodd-Frank Act that provide a "defense to foreclosure." These provisions will go into effect on July 21, 2011. According to these provisions, **a violation of the Rule will allow a borrower to assert that violation as a "defense to foreclosure for the life of the loan."** (My emphasis)

If a borrower prevails in such an action, the borrower is entitled to an award of "enhanced penalties" under TILA and every loan originated under the Rule would then become a liability.

I can already see the plaintiff's class action bar lining up!

So, the Senators unequivocally state that the interaction of the FRB's compensation rule with the provisions of the Dodd-Frank Act could have a "devastating impact on the mortgage market as large lenders may be unwilling to take the risk of acquiring loans from community banks, mortgage bankers and brokers."

Therefore, this "uncertainty" should be resolved **before** implementation of the Rule, otherwise implementation "will severely impair the ability of community-based lenders and small mortgage brokers to compete in the market."

FRB Defers Rulemakings - Except For One Rule In Particular!

The Letter rightly points out that the FRB recently announced it does not expect to finalize three pending rulemakings under Regulations Z prior to the transfer of authority for such rulemakings to the Consumer Financial Protection Bureau (CFPB). The FRB stated its decision was taken because it "would not be in the public interest;" that is, "adopting those portions of the Board's proposals in a piecemeal fashion would be of limited benefit, and the issuance of multiple rules with different implementation periods would create compliance difficulties."

To the Senators, it makes sense "to apply the same standard to this case to ensure new rules on one segment of the mortgage finance industry do not create **perverse unintended incentives.**" (My emphasis)

Since aspects of the Rule will soon be taken up by the CFPB, "the focus should be on getting these rules right, not getting these rules done right now particularly since we know that they will be rewritten in a few months."

The Big Get Bigger and The Smaller Fail

It is clear that the Senators are concerned that overreaching regulation, without proper consideration of industry impact and careful study of potentially adverse consequences, leads to "further consolidation of the mortgage market which will lead to higher consumer costs and fewer choices."

Both Senators recognize the immense challenges that the mortgage industry has faced in the last few years. And while the mortgage brokerage and small lenders have been endeavoring to adapt and survive, I think it is worth noting that these Senators state an unimpeachable truth: "One of the sad facts of the financial crisis is that the big institutions got bigger and the smaller institutions failed."

To eliminate uncertainty, the Rule should be promulgated "in a manner that ensures consistency with other forthcoming rules required by the Dodd-Frank Act." The Rule may eventually conflict with the CFPB's requirements, and such an outcome will "unnecessarily disrupt" the market and create uncertainty.

Delay Requested - A Growing Furor

Those now publicly objecting to the Rule, for various reasons, include major industry organizations, such as the National Association of Independent Housing Professionals (NAIHP), National Association of Mortgage Brokers (NAMB), Impact Mortgage Management Advocacy & Advisory Group (IMMAAG), Mortgage Bankers Association (MBA), Community Mortgage Banking Project (CMBP), Consumer Mortgage Coalition (CMC). National Association

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of Homebuilders (NAHB), National Association of Realtors (NAR), Real Estate Services Providers Council, Inc. (RESPRO), and the The Realty Alliance.

Those filing suits against the FRB are National Association of Independent Housing Professionals (NAIHP) and the National Association of Mortgage Brokers (NAMB).

And Senators David Vitter and Jon Tester have joined the attempts to stay the FRB's effective date.

Next up, let's hear from the House!

[Our Library contains a copy of the Letter and the Motion to Consolidate.](#)



Labels: [CFPB](#), [Consumer Financial Protection Bureau](#), [David Vitter](#), [FRB](#), [Jon Tester](#), [Loan Officer Compensation](#), [Loan Originator Compensation](#), [NAIHP](#), [NAIHP v FRB](#), [NAMB](#), [NAMB v FRB](#), [RESPA](#), [TILA](#)

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