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CFPB Solidifies Loan Originator Compensation Restrictions, Dumps Zero-Zero Requirement

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Even though the loan originator compensation rule (the "Final Rule" or "Rule") finalized by the Consumer Financial Protection Bureau ("CFPB" or "Bureau") in January passed without as much fanfare as the Bureau's Qualified Mortgage ("QM") rule, the Rule will result in significant challenges to the mortgage lending industry's compliance efforts.[1]

The CFPB's Final Rule answers some of the questions left open by the previous loan originator compensation rule ("Existing Rule") implemented by the Federal Reserve Board ("FRB" or "Board") in 2010, prior to the transfer of Truth-in-Lending Act ("TILA") authority from the Board to the Bureau. Of particular interest to lenders, brokers and loan originators are answers to the following questions:

- what constitutes a proxy for a loan's terms?
- when may a loan originator grant concessions to a borrower?
- what bonuses may a creditor pay its loan originators?

The Final Rule provides partial answers to these questions, but does not resolve other questions under the Existing Rule, and unfortunately generates some new questions. This client alert summarizes the Final Rule, addresses loan originator compensation under both the Existing Rule and new CFPB Rule, and addresses the New Rule's provisions that set standards for loan originator qualifications.

What (or Who) is a "Loan Originator"

The CFPB's Final Rule governs a "loan originator's" compensation. Under the Existing Rule, a "loan originator" means, "with respect to a particular transaction," a person who, for compensation or the expectation of compensation, "arranges, negotiates, or otherwise obtains an extension of consumer credit for another person."[2] The term includes mortgage brokers ("loan originator organizations"), including table-funding brokers, and employees of both creditors and mortgage brokers who perform those functions.[3] The term does not include lenders, *i.e*., the person that provides the funds for the transaction at consummation.

The Final Rule expands on the Existing Rule's general definition of "loan originator," while at the same time adding some limited exemptions.[4] First, the Rule expands on the types of activities covered by the definition of a "loan originator," in accordance with the definition in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), to include taking an application; offering, arranging, or assisting[5] a consumer in obtaining or applying to obtain, negotiating, or otherwise obtaining or making an extension of consumer credit for another person; or through advertising or other means of communication representing to the public that such person can or will perform any of these activities.

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The Final Rule exempts individuals who perform "purely administrative tasks," but as you might surmise from the preceding paragraph, the term is defined narrowly.[6] Certain minimum clerical activity, such as physically handling an application while transferring it from an applicant to a loan officer, remains outside of the scope of the definition, but even typing an applicant's information into an application apparently "play[s] an important enough role in the origination process that [it] should be subject to the requirements the Dodd-Frank Act establishes with respect to loan originators."[7]

Generally, the CFPB interprets the scope of "loan originator" broadly—in fact, broadly enough that lenders and brokers should review their existing operations to ensure they are not caught off guard. The definition captures many employees who perform any task that is part of the process of originating a credit transaction, including merely referring a consumer to another person who is a loan originator, orienting the consumer to a particular loan originator's or creditor's origination process, or arranging consummation of the transaction.[8]

The Final Rule defines "refer" to include "any oral or written action directed to a consumer that can affirmatively influence the consumer to select a particular loan originator or creditor."[9] This definition is similar to the concept of a referral found in Section 8 of the Real Estate Settlement Procedures Act ("RESPA") and its implementing regulation. This means that creditors that compensate employees who are not loan officers for referring a borrower (such as is often the case with a bank's payment to its tellers or other employees) should consider whether the Final Rule might apply to those employees.

The Final Rule also defines "arranging" to include "initially contacting and orienting the consumer to a particular loan originator's or creditor's origination process or credit terms, assisting the consumer to apply for credit, taking an application, offering or negotiating credit."[10] The Final Rule defines "assisting a consumer in obtaining or applying for consumer credit" to include advising the consumer "on specific credit terms (including rates, fees, and other costs), filling out an application form, preparing application packages (such as a credit application or pre-approval application or supporting documentation), or collecting application and supporting information on behalf of the consumer to submit to a loan originator or creditor."[11] Again, creditors and brokers should review their practices to determine whether employees who engage in these activities are impacted by the Rule.

Notwithstanding the breadth of the definition, back-end production staff, including loan processors and underwriters, as well as managers other than producing managers, may still conduct certain activities without triggering the "loan originator" definition.[12] The Official Commentary portion of the Final Rule uses the extent of an employee's communication with an applicant as a key factor in determining whether that employee has acted as a "loan originator." Typically, a back-end employee who does not communicate regarding loan terms or products is more likely to avoid being deemed a "loan originator."[13] The CFPB also continues to exempt from the definition of "loan originator" for purposes of the Final Rule mortgage loan servicers and their agents or employees, when offering loss mitigation options to borrowers in default or who "have a reasonable likelihood of defaulting."[14]

The Existing Rule contains the qualifier "with respect to a particular transaction" in defining loan originator compensation. The CFPB removed this qualifier in the Final Rule to clarify that the restrictions on loan originator compensation apply even if the loan is not consummated.[15] Under prior informal FRB guidance, a transaction that was not consummated did not result in any loan originator compensation, and therefore did not trigger the Existing Rule. The CFPB's amendments unfortunately drop that bright line, thus allowing for the application of the Rule even when no loan is originated. Further, the Final Rule appears to prohibit referral fees that vary based on the type of loan initially applied for, regardless of whether the transaction is consummated.[16] Additionally, the Final Rule appears to prohibit a loan originator from, for example, offering to cover the costs of an appraisal

or credit report in connection with a loan application that is not ultimately closed or funded, even though there is no compensation "with respect to a particular transaction,"[17] since there is no consummated transaction.

Restrictions on Compensation

Those familiar with the Existing Rule's restrictions on loan originator compensation will find few surprises in the Final Rule's provisions applicable to loan term-based compensation and dual compensation. One of the CFPB's primary concerns continues to be eliminating incentives for loan originators to steer borrowers toward loans with higher interest rates or other unfavorable terms.[18] The CFPB unfortunately overreached in pursuit of this goal, and has narrowed or eliminated some pro-consumer options that would have presented little if any steering risk.

The same two anti-steering features that formed the basis of the Existing Rule are present in the Final Rule: (i) a prohibition against compensation based on a term of the transaction other than the loan amount (expanded by the Dodd-Frank Act and the CFPB's Final Rule to apply in both consumer- and creditor-paid transactions); and (ii) a prohibition on dual compensation schemes, in which the loan originator is paid by both the borrower and another person (typically the creditor).[19]

Prohibition on Compensation Based on Loan Terms or Proxies

The Final Rule codifies the prohibition against compensation based on a factor that is not a loan term but that constitutes a proxy for one. The FRB addressed proxies for loan terms only in the Supplementary Information to the Existing Rule and in subsequent informal guidance. That guidance was often unclear and difficult to implement.[20] The Final Rule provides a more formal, analytical approach in the text of the regulations (with examples provided in the Official Commentary).

The Final Rule applies a two-step analysis in determining whether "[a] factor that is not itself a term of a transaction is a proxy for a term of the transaction.

- The CFPB will first determine whether the factor consistently varies with the term over a significant number of transactions.
- If the first test is satisfied, the CFPB will consider whether the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating the transaction."[21]

Although this two-step test in some cases yields uncertain conclusions, it is nevertheless an improvement over the Existing Rule's somewhat *ad hoc* approach. Further, the Final Rule provides specific answers to some of the issues that plagued the industry under the Existing Rule. For example, the Official Commentary to the Final Rule clarifies that the CFPB might find a difference in compensation for loans held in portfolio and loans sold on the secondary market to be based on a proxy. The CFPB suggests this is the likely result, since the criteria for secondary market sales will likely, and consistently, include loan terms and the loan originator has the ability to affect whether a consumer chooses a loan with terms meeting the creditor's secondary market criteria.[22]

The Final Rule in some cases moderates the Existing Rule in favor of creditors. For example, the location of the security property is less likely to be a proxy, even if interest rates vary by state or other geographic regions, since the loan originator is unlikely to be able to influence the location of the security property, resulting in the second prong of the test not being satisfied.[23] Moreover, the CFPB has decided to treat certain aspects of a loan transaction differently than they would likely have been treated under the Existing Rule. For instance, while the FRB took the position that credit scores might be a proxy, the Final Rule emphasizes that an analysis of that factor's correlation with loan terms and

the loan originator's ability (or lack thereof) to effect a change in that factor could lead to a different result.[24]

While the CFPB's approach appears to provide clearer standards for creditors and brokers than the FRB's informal guidance, those clearer standards do not always work to the mortgage industry's benefit. For example, the CFPB also indicated that it will not be "permissible to differentiate compensation based on credit product type, since products are simply a bundle of particular terms."[25] The Official Commentary issued by the FRB permitted creditors to back into differentiating compensation across loan products in some cases by acknowledging that certain products—such as FHA or VA loans—are more time intensive to originate, justifying greater compensation. Under the Final Rule, compensation based on the number of hours a loan originator actually works on a file is generally allowable, but compensation based on an estimate of hours worked driven partially by loan type is not.[26]

Pricing Concessions

The CFPB takes a strict approach to pricing concessions that will limit a loan originator's flexibility to concede some compensation for a borrower's benefit, although it recognizes a narrow exemption that was not expressed in the Existing Rule. In particular, the CFPB continues to significantly limit a loan originator's ability to provide amounts to a borrower through a voluntary reduction in the loan originator's compensation.[27] (A creditor remains free, of course, to offer pricing and term concessions to borrowers, but those concessions generally must not be funded through a reduction in the loan originator's compensation.)[28]

However, the Final Rule expressly allows a loan originator to concede some compensation in response to unforeseen circumstances, to defray the cost, in whole or part, of an increase in an actual settlement cost above an estimated settlement cost disclosed to the consumer pursuant to section 5(c) of RESPA or omitted from that disclosure.[29] For example, if an unforeseen title issue causes an origination delay that results in the borrower being required to pay a rate-lock extension fee, the fee may be paid from the compensation the loan originator would otherwise have received.[30] The same is true for the cure amount related to an unexpected RESPA tolerance violation.[31] The CFPB notes, however, that a loan originator who routinely underestimates settlement costs on initial RESPA disclosures may not be using the "best information reasonably available" at the time of the estimate.[32] In that case, the Final Rule suggests that the resulting overcharge would likely not be an unexpected increase that would allow for concession of part of the loan originator's compensation. Rather, the reduction would appear to either be unlawful under the Rule if a loan term changed or subject to proxy analysis if a loan term did not change.[33]

The CFPB shares the concern expressed by the FRB in the Existing Rule that a loan originator may effectively evade the prohibition against loan term-based compensation by selectively reducing the originator's established compensation in favor of the consumer, which would result in loopholes and permit evasions of the Rule.[34] The Final Rule clarifies that the loan originator is prohibited from conceding compensation simply to meet competition (presumably even without any changes to the loan's terms).[35] Similarly, if the loan originator made an honest error in quoting or disclosing the amounts of certain charges in the transaction, or otherwise seeks to cover certain transaction costs for the consumer, the Final Rule will generally not permit the loan originator to pay those amounts, even though no terms of the loan would change.[36]

The Final Rule does leave open the possibility of compensation concessions under limited circumstances, such as if a creditor reduces a loan originator's compensation due to poor customer service. In this and a few other instances, the creditor should apply the two-prong proxy analysis to

attempt to determine whether the compensation reduction is prohibited.[37] This proxy analysis would appear to prohibit basing compensation on a factor such as poor customer service only if it constitutes a variation in a significant number of transactions (*i.e.*, it meets the first prong of consistently varying with a loan term or terms over a significant number of transactions). Reducing a loan originator's compensation to account for poor customer service arguably would be prohibited only if the quality of the loan originator's customer service varied predictably with the terms of borrowers' loans. However, the CFPB does not clearly endorse that result in its Final Rule.

Thus, while the CFPB admits that consumers would benefit from the opportunity to negotiate compensation concessions from a loan originator, the CFPB believes the need to protect other consumers who lack the knowledge or shrewdness to do so outweighs that benefit.

Profit Sharing and Bonuses

As a starting point, the CFPB has effectively declined to allow creditors or brokers to compensate loan originators based on the overall profitability of the loan originator's originations, since this will necessarily vary with the terms of the originated loans.

This does not, however, mean that all bonuses are off the table. While the CFPB believes that bonuses based on profitability are inextricably tied to loan terms, it also implicitly acknowledges that bonuses are a common way of fairly compensating employees. The CFPB addressed this conflict by allowing profit-based bonuses for loan originators under certain "de minimis" circumstances in which the compensation is not likely to create sufficient steering concerns. Specifically, loan originators may participate in profit-sharing plans provided that:

(i) the compensation is not directly or indirectly based on the terms of the individual loan originator's transactions, and:

(ii) (a) the loan originator's compensation under the profit-sharing plan does not exceed 10% of the person's total compensation; or

(b) the loan originator originated 10 or fewer transactions in the 12 months preceding determination of compensation under the plan.[38]

The Final Rule permits contributions to defined contribution tax-advantaged retirement plans—such as 401(k)s or IRAs[39]—as long as they are not directly or indirectly based on the terms of the individual loan originator's transactions. This creates opportunities for company- or group-wide profit sharing, either in real-time or as a source of retirement funding.[40] The final version of this exemption found in the Rule is generally broader than that in the proposed rule, which conditioned bonus pools and other profit-based compensation on more complex definitions of qualifying accounts and qualifying amounts of compensation, and arguably would have prevented many monoline mortgage lenders from offering bonuses to loan originators.

Prohibition on Dual Compensation

The Final Rule prohibits a loan originator from receiving compensation from both the borrower and another person (typically the creditor), in connection with a transaction.[41] There is good news, though. The dual compensation prohibition does not prohibit a broker's individual loan originator from receiving compensation from both the borrower and the employing broker in connection with a transaction, as long as neither portion of the compensation varies according to loan terms (other than the amount of credit extended).[42] A strict reading of the dual compensation prohibition, previously

espoused at least informally by the FRB, would have effectively prohibited the loan originator from receiving commissions from the broker in consumer-paid transactions.

The Bureau thankfully did not adopt the provision in the proposed rule that would have required loan originators to offer borrowers a zero-point/zero-fee option in most transactions (the so-called "zero-zero alternative").[43] The Dodd-Frank Act extends the "dual compensation" restriction to prohibit a loan originator from receiving compensation from any person other than the borrower when the borrower paid upfront discount points, origination points, or fees for the loan.[44] Concerned primarily that the Dodd-Frank Act provision would harm borrowers by limiting the extent to which creditors could offer pricing options in creditor-paid transactions, the CFPB initially proposed to provide a limited waiver.[45] Specifically, the CFPB's proposed rule would have allowed the borrower to choose a loan with upfront points and fees, even in a creditor-paid transaction, but only as long as the borrower was also disclosed the terms of, and offered, a zero-zero alternative.[46] In response to numerous comments on the zero-zero alternative, the CFPB decided that requiring creditors to offer no cost alternatives might significantly curtail access to mortgage credit for certain borrowers, and that the zero-zero alternative would not offer the best approach to serving consumers' interests. On that basis, the CFPB decided, for now, that rather than adopt the zero-zero alternative approach it would use its statutory authority to waive in its entirety the Dodd-Frank Act's requirement.[47] The CFPB notes that the full waiver of the Dodd-Frank Act's no-fee requirement for creditor-paid transactions "will allow the Bureau to continue to conduct consumer testing and market research to improve its ability to regulate upfront points and fees in a way that maximizes consumer protection while preserving access to credit and empowering consumer choice."[48] Reading the tea leaves, this could mean that the CFPB will eventually adopt some version of the Dodd-Frank Act's broader prohibition on "dual compensation" and no-fee loans in creditor-paid transactions.

Interplay with Other Recent Rulemakings

The Final Rule on loan originator compensation is not the only recent CFPB rulemaking that addresses loan originator compensation. The QM Rule also addresses loan originator compensation. One of the more contentious and ambiguous elements of the QM Rule is the role that loan originator compensation will play in determining points and fees.[49] Below, we highlight the primary interactions between the CFPB's QM Rule and its loan originator compensation rule. (The K&L Gates Consumer Financial Services Group will shortly issue a client alert on the QM Rule.)

The QM Rule establishes thresholds for points and fees paid by borrowers, above which lenders will not be able to take advantage of a safe harbor or presumption of compliance with the rule's ability-to-pay requirements. For a loan to qualify as a Qualified Mortgage entitled to a safe harbor or rebuttable presumption of compliance, points and fees must not exceed 3% of the loan amount (for loans greater than $100,000).[50] The definition of "points and fees" under the QM Rule includes compensation paid to the loan originator by the creditor or borrower.[51] The lending industry expressed concerns that the loan originator compensation formulation in the points and fees test could result in double-counting of loan originator compensation. For example, loan originator compensation is often included in the TILA finance charge. And because the Final Rule includes in the points and fees test both compensation paid to a broker and compensation the broker pays its loan officers, brokers could be disadvantaged relative to creditors.[52] In response, the Bureau sought public comment on how to resolve these concerns while still satisfying Congress's intent with respect to Qualified Mortgages.[53] The CFPB intends to respond to comments it receives and finalize its "points and fees" definition well before the January 10, 2014 effective date of the QM Rule and the Final Rule.

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Loan Originator Qualifications

Although the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the SAFE Act) imposes requirements for licensing and registration of individual loan originators, the Dodd-Frank Act amended TILA to provide that mortgage originators (including individuals and mortgage originator entities) must be "qualified," and registered and licensed in accordance with applicable state or federal law (including the SAFE Act).[54] Under the SAFE Act, states must require entity licensees to conduct criminal background checks; financial responsibility, character, and general fitness standards; and training requirements on state-licensed individual loan originators. However, the SAFE Act imposes less stringent standards on employee loan originators of a depository institution or of an owned-and-controlled, federally regulated subsidiary of a depository institution. The CFPB remarked in the proposed rule that as a matter of sound business practice and to comply with prudential regulatory requirements, those institutions already impose qualification criteria on employees.[55] Nonetheless, in implementing the Dodd-Frank Act/TILA qualification requirements, the CFPB is now requiring that individual loan originators who are not subject to the state licensing and qualification requirements must meet character, fitness, and criminal background check standards, and must receive periodic training.

Specifically, the Final Rule provides that – as a matter of TILA compliance – "loan originator organizations" (other than government agencies or state housing finance agencies) must obtain criminal background checks and credit reports on their individual loan originator employees who are not licensed under state SAFE Act laws. Accordingly, depository institutions (and certain of their subsidiaries)[56] whose individual loan originators are not required to be licensed under state law will be required to obtain:

(A) A criminal background check (either through the Nationwide Mortgage Licensing System and Registry ("NMLSR") or, for individuals who are not "registered loan originators" under the NMLSR, a criminal background check from a law enforcement agency or commercial service);

(B) A credit report from a consumer reporting agency; and

(C) Information (either from the NMLSR or from the individual) about any administrative, civil, or criminal findings by any government jurisdiction.

In addition, those institutions must determine, on the basis of the information described above and any other information reasonably available to them, that their loan originator individuals:

(1) Have not been convicted of, or pleaded guilty or *nolo contendere* to, a felony in a domestic or military court during the preceding seven-year period or, in the case of a felony involving an act of fraud, dishonesty, a breach of trust, or money laundering, at any time; and

(2) Have demonstrated financial responsibility, character, and general fitness such as to warrant a determination that they will operate honestly, fairly, and efficiently.

For purposes of screening out individuals with felony records, a crime is a felony only if at the time of conviction it was classified as a felony under the law of the jurisdiction under which the individual was convicted. Expunged convictions and pardoned convictions do not render an individual unqualified.[57] Further, a conviction or plea of guilty or *nolo contendere* does not, by itself, render an individual unqualified if the institution has obtained consent to employ the individual from its regulator.[58] (The CFPB's SAFE Act regulations applicable to state licensing systems for unregistered (and nonexempt) loan originators do not expressly allow for regulatory exemptions from the felony disqualification standards.)

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These standards apply to an individual before he or she may act as a loan originator in a consumer credit transaction secured by a dwelling, to the extent that the employee: (i) is hired by the institution on or after January 10, 2014; (ii) was hired by the institution before that date, but there were no applicable statutory or regulatory background standards in effect at the time of hire or before January 10, 2014, used to screen the employee;[59] or (iii) regardless of when hired, likely does not meet the standards based on reliable information known to the institution or subsidiary, as applicable. The institution must make the required determinations for an individual before the individual acts as a loan originator. However, the institution must reassess the individual's qualifications if it becomes aware of reliable information indicating that the employee likely no longer meets the standards (*e.g*., the institution learns of the individual's criminal conduct in the newspaper). Although the Rule does not expressly state what the institution must do under those circumstances, it seems clear the institution must prevent the individual from continuing to act as a loan originator.

That raises a broader point. Other than the ban on felony convictions (permanent for certain types of felonies, seven years for others), the Final Rule provides very little guidance to entities attempting to determine whether information gleaned through the credit report or financial responsibility check is sufficient to disqualify an individual, for how long the disqualification will attach, or the extent to which mitigating circumstances may counteract a blemish in an individual's background. The CFPB states that an institution can establish timeframes for considerations of bankruptcies and foreclosures under the financial responsibility standard, but the Rule does not provide any guidance on how short or long the timeframes must be. Although institutions must obtain a credit report on an applicable individual, they are not required to consider the individual's credit score. A review and assessment of financial responsibility is sufficient if it considers the existence of current outstanding judgments, tax liens, other government liens, nonpayment of child support, or a pattern of bankruptcies, foreclosures, or delinquent accounts. The review need not, however, give adverse weight to debts arising from medical expenses. An institution's review of an individual's character and general fitness is sufficient if it considers "acts of unfairness or dishonesty," including dishonesty in seeking employment or any disciplinary actions by regulatory or professional licensing agencies. Apparently "no single factor necessarily requires a determination that the individual does not meet the standards for financial responsibility, character, or general fitness, provided that the loan originator organization considers all relevant factors and reasonably determines that, on balance, the individual meets the standards."[60]

An institution may be subject to TILA penalties for getting the determination wrong. The Rule establishes a "safe harbor" to provide some comfort for institutions, if they (i) establish written procedures for determining whether individuals meet the financial responsibility, character, and general fitness standards, and (ii) follow those procedures. However, the Final Rule does not provide parameters for those procedures (besides those tidbits described above), so it is not clear how much immunity an institution would gain by following that procedural advice.

Loan Originator Training

A loan originator organization (that is not a government agency or state housing finance agency) also must provide periodic training for its loan originator employees who are not required to be licensed. The training must cover federal and state law requirements that apply to the individual loan originator's loan origination activities. It must be "sufficient" in frequency, timing, duration, and content, and based on the particular responsibilities of the individual and the nature and complexity of the mortgage loans with which the individual works. The Final Rule offers a safe harbor of sorts—NMLSR-approved training is deemed to satisfy the training required for an institution's loan originators, but the institution still is on the hook to ensure the training covers the applicable types of

loans and the applicable federal and state laws and regulations. The training requirements apply to individual loan originators regardless of when they were hired.

Scope of Qualification Requirements

As described at the beginning of this alert, the Rule defines "loan originator" broadly to include individuals performing any type of activities in connection with loan originations. This even includes preparing application packages, collecting information on behalf of the consumer, or perhaps even referring, recommending, or steering a consumer to a particular loan originator, creditor, credit terms, or credit product. It also includes not only employees but agents and contractors of a creditor or mortgage broker that satisfy the definition. This means that some individuals who are registered as loan originators in accordance with the SAFE Act will be subject to the Final Rule's criminal background and other qualification standards.

The CFPB recognizes that there are three primary differences between the Final Rule's definition of "loan originator" and the SAFE Act's definition. (For this purpose, the CFPB is referring to the definition in the federal SAFE Act itself, and not to the definition or other requirements the states adopted when implementing that Act. The states were free to go beyond the minimum requirements of the SAFE Act in establishing licensing regimes for applicable individuals.) For a registration requirement to be imposed on an institution's employees under the SAFE Act, the individual must participate in both taking an application and offering or negotiating terms. The Final Rule's definition, on the other hand, is triggered by conducting any one of the listed activities, including "assisting a consumer" in obtaining or applying to obtain a loan, which includes advising on terms, preparing loan packages, or collecting information on behalf of the consumer, among other activities. The SAFE Act itself does not specifically refer to those activities, and thus arguably would not require an individual conducting those activities to register as a loan originator (unless he or she also takes applications and offers or negotiates loan terms).

The Official Commentary to the Final Rule makes clear that simply because an employee is a loan originator under the Final Rule does not mean the employee is a loan originator under the SAFE Act or state and federal licensing and registration requirements. Accordingly, the Final Rule's broad definition of "loan originator" and its qualification requirements do not mean that additional individuals must either get licensed or registered under the SAFE Act. Nonetheless, due to the Final Rule's broad definition, a depository institution may need to obtain criminal background checks and credit reports on a potentially broad group of individuals and provide them periodic training. (Individuals required to be licensed under the SAFE Act and state implementing laws will continue to be subject to the respective state's requirements and its definitional scope.)

Additional Provisions

While the focus of the Final Rule is on loan originator compensation and qualification issues, the Rule also implements several miscellaneous provisions of the Dodd-Frank Act that do not necessarily affect loan originators directly, but will nonetheless impact a mortgage lender. First, the Final Rule prohibits mandatory arbitration clauses and waivers of federal statutory causes of action in mortgage contracts.[61] Second, it prohibits most single-premium credit insurance, other than credit unemployment insurance for which the unemployment insurance premiums are reasonable, the creditor receives no compensation in connection with the premiums, and the premiums are paid pursuant to a separate insurance contract and not to an affiliate of the creditor.[62] Finally, the Rule extends recordkeeping requirements for compensation issues to three years to match the affirmative litigation limitations period under the CFPB's QM Rule.[63]

Penalties

A failure to comply with the CFPB's Final Rule may result in significant liability, not just for a creditor, but also for the loan originator organization or individual. A consumer in a transaction in which a TILA violation occurred, such as the receipt by a loan originator of loan term based or dual compensation, may pursue from a creditor: (i) actual damages sustained by the consumer as a result of the violation; and (ii) statutory damages of twice the transaction's finance charge, or up to $4,000 in an individual action or the lesser of $1,000,000 or 1% of the creditor's net worth in a class action.[64] Moreover, violations of TILA's anti-steering provisions, under which the CFPB's loan origination compensation requirements arise, may result in enhanced damages in "an amount equal to the sum of all finance charges and fees paid by the consumer unless the creditor demonstrates that the failure to comply is not material."[65]

While those are the same penalties that have been available prior to the CFPB's Final Rule, the Dodd-Frank Act extended the statute of limitations on TILA violations to three years from the date of the violation.[66] In addition, the Dodd-Frank Act provides that a consumer can raise a TILA violation as a defensive claim for recoupment or set off in a foreclosure or collection action without regard to the three year limitation.[67]

As indicated above, the Dodd-Frank Act also amended TILA to provide that the loan originator—not merely the creditor—could be liable to the borrower for statutory damages. For loan originators other than the creditor, the maximum liability that may be imposed is the greater of actual damages or three times the loan originator's compensation or gain from the transaction giving rise to the violation, plus the cost to the consumer of the action, including a reasonable attorney's fee.[68]

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[1] *See* Loan Originator Compensation Requirements Under the Truth in Lending Act (Regulation Z), Bureau of Consumer Fin. Protection, 78 Fed. Reg. 11,280 (Feb. 15, 2013) *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-02-15/pdf/2013-01503.pdf (initially issued via the CFPB's website on January 20, 2013).
[2] 12 C.F.R. § 1026.36(a)(1).
[3] *See id.*
[4] Beyond the exemptions detailed in this client alert, the CFPB's Final Rule provides limited exemptions for employees of manufactured home retailers, real estate brokers, seller-financers, and third-party advisors such as accountants, attorneys, and housing counselors. *See* 78 Fed. Reg. 11,280, 11,410, 11,415-16.
[5] "Assisting a consumer in obtaining or applying to obtain a loan" is further defined under TILA to include "advising on terms, preparing loan packages, or collecting information on behalf of the consumer." 78 Fed. Reg. 11,280, 11,297.
[6] *See* 78 Fed. Reg. 11,280, 11,410 (to be codified at 12 C.F.R. § 1026.36(a)(1)(i)(A)).
[7] 78 Fed. Reg. 11,280, 11,299.
[8] Official Staff Commentary, Paragraph 36(a)(1)-1; 78 Fed. Reg. 11,414 (Feb. 15, 2013).
[9] *Id.*
[10] Official Staff Commentary, Paragraph 36(a)(1)-2; 78 Fed. Reg. 11, 414 – 11,415 (Feb. 15, 2013).
[11] Official Staff Commentary, Paragraph 36(a)(1)-3, 78 Fed. Reg. 11,415.
[12] *See* 78 Fed. Reg. 11,280, 11,416 (to be codified as Comment 36(a)-4 in the Official Staff Commentary to 12 C.F.R. § 1026).
[13] *See, e.g.*, 78 Fed. Reg. 11,280, 11,416 (providing, among other similar interpretations, that none of the following trigger an employee's treatment as a "loan originator": (i) an employee who responds to a customer query by explaining credit terminology or lending policies; (ii) an employee who merely confirms written offer terms already communicated to the borrower; (iii) a loan processor who verifies information by asking the consumer for supporting documentation; or (iv) an underwriter who approves credit terms or sets credit terms in an offer or counteroffer, provided that only a loan originator communicates to or with the consumer regarding specific credit terms or engages in negotiation).
[14] 78 Fed. Reg. 11,280, 11,410 (to be codified at 12 C.F.R. § 1026.36(a)(1)(i)(E)).
[15] 78 Fed. Reg. 11,280, 11,298.
[16] *See* 78 Fed. Reg. 11,280, 11,414 (Official Staff Commentary indicating that providing a referral will generally make a person a "loan originator").
[17] *See* 78 Fed. Reg. 11,280, 11,330 (discussing significant limitations on a loan originator's ability to provide discounts on fees to borrowers through a voluntary reduction in the compensation the loan originator would otherwise receive).
[18] *See, e.g.*, 78 Fed. Reg. 11,280, 11,286 (describing the anti-steering rationale behind a prohibition on compensation based on the terms of a transaction and a loan originator receiving compensation from both the consumer and a third party, such as the creditor).
[19] *See, e.g.*, 78 Fed. Reg. 11,280, 11,286, 11,329, 11,359.
[20] *See* 78 Fed. Reg. 11,280, 11,323-24.
[21] 78 Fed. Reg. 11,280, 11,441 (to be codified at 12 C.F.R. § 1026.36(d)(1)(i)).
[22] *See* 78 Fed. Reg. 11,280, 11,419.
[23] *See id.*
[24] *See* 78 Fed. Reg. 11,280, 11,325-26.
[25] *See* 78 Fed. Reg. 11,280, 11,327 n. 82.
[26] *See* 78 Fed. Reg. 11,280, 11,328; Official Staff Commentary, Paragraph 36(d)(1)-3.iii.
[27] *See id.*
[28] *See* 78 Fed. Reg. 11,280, 11,423 (to be codified as Comment 36(d)(3)(i)-5 in the Official Staff Commentary to 12 C.F.R. Part 1026).
[29] *See* 78 Fed. Reg. 11,280, 11,334.

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[30] *See* 78 Fed. Reg. 11,280, 11,334, 11,423 (to be codified as Comment 36(d)(3)(i)-7 in the Official Staff Commentary to 12 C.F.R. Part 1026).
[31] *See id.*
[32] *See* 78 Fed. Reg. 11,280, 11,335.
[33] *See id.*
[34] *See* 78 Fed. Reg. 11,280, 11,330.
[35] *See* 78 Fed. Reg. 11,280, 11,423 (to be codified as Comment 36(d)(3)(i)-5 in the Official Staff Commentary to 12 C.F.R. Part 1026).
[36] *See* 78 Fed. Reg. 11,280, 11,332.
[37] *See* 78 Fed. Reg. 11,280, 11,335.
[38] *See* 78 Fed. Reg. 11,280, 11,395.
[39] The full breadth of the term "designated tax-advantaged plan" includes "any plan that meets the requirements of Internal Revenue Code section 401(a), 26 U.S.C. 401(a); employee annuity plan described in Internal Revenue Code section 403(a), 26 U.S.C. 403(a); simple retirement account, as defined in Internal Revenue Code section 408(p), 26 U.S.C. 408(p); simplified employee pension described in Internal Revenue Code section 408(k), 26 U.S.C. 408(k); annuity contract described in Internal Revenue Code section 403(b), 26 U.S.C. 403(b); or eligible deferred compensation plan, as defined in Internal Revenue Code section 457(b), 26 U.S.C. 457(b)." 78 Fed. Reg. 11,280, 11,411 (to be codified at 12 C.F.R. § 1026.36(d)(1)(iii)).
[40] *See id.*
[41] *See* 78 Fed. Reg. 11,280, 11,412 (to be codified at 12 C.F.R. § 1026.36(d)(2)).
[42] *See id.*
[43] *See* 78 Fed. Reg. 11,280, 11,368 (describing the proposal of a "zero-zero alternative"), 11,370 (describing the complete exemption offered in the Final Rule).
[44] *See* 78 Fed. Reg. 11,280, 11,367.
[45] *See* 78 Fed. Reg. 11,280, 11,368.
[46] *See id.*
[47] *See* 78 Fed. Reg. 11,280, 11,370.
[48] *Id.*
[49] *See* Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z), Bureau of Consumer Fin. Protection, 78 Fed. Reg. 6,408 (Jan. 30, 2013) available at http://www.gpo.gov/fdsys/pkg/FR-2013-01-30/pdf/2013-00736.pdf.
[50] *See* 78 Fed. Reg. 6,408, 6,531.
[51] *See* 78 Fed. Reg. 6583-84 (to be codified at 12 C.F.R. § 1026.32(b)(1)(ii)).
[52] *See* 78 Fed. Reg. 6,435-38.
[53] *See* Ability To Repay Standards Under the Truth in Lending Act (Regulation Z); Proposed Rule, Bureau of Consumer Fin. Protection, 78 Fed. Reg. 6,622 (Jan. 30, 2013) available at http://www.gpo.gov/fdsys/pkg/FR-2013-01-30/pdf/2013-00739.pdf.
[54] The Dodd Frank Act also requires that mortgage originators include on all loan documents any unique identifier of the mortgage originator provided by the Nationwide Mortgage Licensing System and Registry.
[55] 77 Fed. Reg. 55,326 (Sept. 7, 2012).
[56] In accordance with the SAFE Act, "registered loan originators" are not required to obtain a state license in order to engage in loan originator activities. "Registered loan originators" include employees of depository institutions, of subsidiaries that are owned and controlled by depository institutions and are regulated by a federal banking agency, or of an institution regulated by the Farm Credit Administration. 12 U.S.C. § 5102.
[57] The exemption for expunged or pardoned convictions is consistent with the CFPB's SAFE Act regulations for state-licensed loan originators. 12 C.F.R. § 1008.105.
[58] The depository institution or subsidiary may seek consent to hire an individual loan originator with a felony record from its regulator, namely (as applicable) the Federal Deposit Insurance Corporation or the Board of Governors of the Federal Reserve System pursuant to section 19 of the Federal Deposit Insurance

Act (FDIA) (12 U.S.C. § 1829); the National Credit Union Administration pursuant to section 205 of the Federal Credit Union Act (FCUA) (12 U.S.C. § 1785(d)); or the Farm Credit Administration pursuant to section 5.65(d) of the Farm Credit Act of 1971 (FCA) (12 U.S.C. § 227a–14(d)), notwithstanding the bars posed with respect to that conviction or plea by the FDIA, FCUA, and FCA, as applicable.

[59] The CFPB asserts that most loan originator organizations are already screening their individual loan originators under applicable background standards. To avoid duplicative compliance burdens with respect to individual loan originators that were screened under standards in effect at the time of hire, the CFPB provides that the new screening requirements in the Final Rule will not apply to those individuals.

[60] Official Staff Commentary, Paragraph 36(f)(3)(ii)(B)-1; 78 Fed. Reg. 11,426 (Feb. 15, 2013).

[61] *See* 78 Fed. Reg. 11,280, 11,413 (to be codified at 12 C.F.R. § 1026.36(h)).

[62] *See* 78 Fed. Reg. 11,280, 11,413 (to be codified at 12 C.F.R. § 1026.25(i)).

[63] *See* 78 Fed. Reg. 11,280, 11,410 (to be codified at 12 C.F.R. § 1026.25(c)(2)).

[64] *See* 15 U.S.C. § 1640(a)(1)-(2).

[65] 15 U.S.C. § 1640(a)(4).

[66] *See* 15 U.S.C. § 1640(e).

[67] *See* 15 U.S.C. § 1640(k).

[68] *See* 15 U.S.C. § 1639b(d).

Consumer Financial Services Practice Contact List

K&L Gates' Consumer Financial Services practice provides a comprehensive range of transactional, regulatory compliance, enforcement and litigation services to the lending and settlement service industry. Our focus includes first- and subordinate-lien, open- and closed-end residential mortgage loans, as well as multi-family and commercial mortgage loans. We also advise clients on direct and indirect automobile, and manufactured housing finance relationships. In addition, we handle unsecured consumer and commercial lending. In all areas, our practice includes traditional and e-commerce applications of current law governing the fields of mortgage banking and consumer finance.

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