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Submitted via Regulations.gov

Ms. Monica Jackson
Office of the Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

Re: Docket No. CFPB- 2012-0037; RIN 3170-AA13
Truth in Lending Act (Regulation Z); Loan Originator Compensation

Dear Ms. Jackson:

American Bankers Association (ABA)[1] appreciates the opportunity to comment on the Bureau's proposed rulemaking to implement amendments to the Truth in Lending Act (TILA) pertaining to Loan Originator compensation. The proposal would add new restrictions on the imposition of any upfront points and origination fees on consumers under certain circumstances, and offer alternatives for compliance. The proposal would also provide additional guidance and clarification under the existing regulation's provisions restricting loan originator compensation practices, including guidance on the application of those provisions to certain bonus and profit-sharing plans and the appropriate analysis of payments to loan originators based on factors that are not terms but that may act as proxies for a transaction's terms.

Overview

ABA appreciates the necessity and importance of implementing the new Dodd-Frank provisions pertaining to Loan Originator (LO) compensation, and values the efforts in this proposal to clarify the Federal Reserve Board's transferred rules regarding important interpretations applicable to this rulemaking. ABA has concerns about the potential impact of these rules as proposed. When finalized, these new requirements will have a substantial effect on mortgage loan origination practices, so we urge that the Bureau afford proper consideration to our concerns. In these comments, ABA offers various alternatives that we think will assist in keeping our mortgage markets open and vibrant. The recommendations set forth below were drafted after much analysis and earnest attempts to understand the proposed provisions and to assist in crafting options that satisfy the important consumer protection objectives imposed under Dodd-Frank. ABA consulted broadly with in-house banking counsel and private legal experts on all aspects of these proposed regulations.

Overall, the Bureau is proposing rules that will impose far-reaching limits on loan originator compensation. These changes do not come in isolation. Over the last two years, new federal

[1] ABA represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets.

laws have been implemented that have answered concerns regarding loan originator abuses and addressed certain perverse incentives in loan originator compensation schemes. These laws included new disclosure methodologies under RESPA, tighter disclosure tolerance laws under RESPA and TILA, comprehensive restrictions under TILA's unfair and deceptive provisions, as well as licensing and registration requirements under the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE). These new provisions have redrawn the protections pertaining to mortgage loan officers and brokers, and have addressed the abuses that contributed to the housing meltdown. The new requirements proposed here would add yet another layer of regulations over those existing protections, with additional provisions being considered under Section 32 of TILA and even more disclosure changes under the RESPA-TILA integration process.

As we have expressed in previous comments, we are troubled by the pace and process of this and other mortgage-related rulemakings. We believe that these enormous expansions of loan originator compensation regulations must be properly calibrated, and must be adequately measured against all other regulatory changes occurring simultaneously under these legislative reforms. As we explain below, there is real risk that many of the numerous and disparate changes will add little to consumer protection, but will instead injure to the ability and willingness of banks, particularly community banks, to serve the mortgage needs of their communities.

We strongly urge that deeper and more careful consideration be given to these proposed rules, and request that the Bureau engage in more analysis of the adverse impact that these new restrictions can have on consumers and lending institutions. ABA fears that an overly hasty and uncompromising sprint to ensure that deadlines are met will come at a cost of important considerations that must be factored into the regulatory process—considerations that Congress fully intended be weighed in the promulgation of these rules. We offer recommendations below.

Summary of Main Arguments

- ABA requests that decision-making concerning this rulemaking be transferred to the more general RESPA-TILA Integration discussions, as the elements of this rule are too integrated with loan selection and consumer education. Shifting this decision-making to the disclosure reform discussions will allow for a more thorough presentation of options and more adequate time to consider the delicate pricing and loan selection issues posed here.

- ABA believes that the overly stringent Dodd Frank Act prohibitions that ban borrowers' options to pay upfront points and origination fees to creditors will greatly damage the availability of financing alternatives for consumers. ABA therefore supports the Bureau's efforts to create alternative compliance options so that creditors can continue to offer diverse financing choices to all segments of the market. Like the Bureau, ABA believes there is considerable consumer benefit in affording consumers the financial option of structuring their loans through adjustments to the interest rate, upfront points, and origination fees.

- ABA advises that for various structural and market reasons, the proposed “0-0 Alternative” loan option, where lenders must offer loans that include no discount points or origination points or fees, will not be a viable option for most banks. In addition, as proposed, the Bureau’s alternative loan proposal raises various uncertainties with respect to compliance with timing and disclosure requirements.

- ABA respectfully submits an alternative recommendation that would be as protective as the Bureau’s proposal. ABA believes an Alternative loan option could be constructed following two general principles—it should be disclosed to the consumer together with the 3-day RESPA-TILA disclosures, and should present the consumer with an option for lower points and fees (but not necessarily required to go to zero upfront fees).

- ABA does not agree with the proposal’s interpretation that all bonus plans for loan originators need to be prohibited as proxies for transaction terms. Bonuses and profit-sharing plans can be appropriately structured without violating the law.

- ABA requests that the Bureau add additional clarifications to better delineate the functions that managers may engage in without crossing the definitional lines of “loan originator.”

- ABA requests that the *de minimis* loan exemption provisions of the proposal be increased to 15 or fewer transactions. Such *de minimis* exemption is especially important to allow managerial staff to properly serve consumers.

- ABA requests that the Bureau adopt a clear and comprehensive list of allowable activities under the “proxy” rule.

- ABA requests ample time to implement these rules, as there are technical and complex changes that banks will have to incorporate into existing systems and coordinate with other rulemakings currently being proposed. ABA believes that 18 months would be required to ensure that banks are in full compliance.

These comments are fully described in the sections that follow.

A. Zero-Zero Alternative

Overview:

The proposal implements the Dodd-Frank provisions that restrict compensation to mortgage loan originators from anyone other than a consumer. The Dodd-Frank Act, pursuant to TILA section 129B, adds an exception that allows compensation from someone other than the consumer under two conditions: (1) the loan originator does not receive any compensation directly from a consumer; and (2) the consumer does not make an upfront payment of discount points, origination points, or fees, other than bona fide third party fees.

The Bureau proposes, in new § 1026.36(d)(2)(ii)(A), to implement these restrictions on discount points and origination points or fees in closed-end mortgage transactions. In summary, the

Bureau interprets that the prohibition in TILA section 129B(c)(2)(B)(ii) on the consumer paying upfront discount points, origination points, or fees in a transaction generally applies in three scenarios: (1) The creditor pays compensation in connection with the transaction (e.g., a commission) to individual loan originators, such as the creditor's employees; (2) the creditor pays a loan originator organization compensation in connection with a transaction, regardless of how the loan originator organization pays compensation to individual loan originators; and (3) the loan originator organization receives compensation directly from the consumer in a transaction and pays individual loan originators compensation in connection with the transaction.

TILA section 129B(c)(2)(B) also provides the Bureau authority to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points or fees where doing so is in the interest of consumers and the public. The Bureau believes that the restrictions in Dodd-Frank will unduly and negatively affect credit options for consumers, and is therefore willing to use its exemption authority in this instance. The Bureau states that "permitting creditors to offer consumers the option to choose to pay discount points and origination points or fees may benefit consumers by giving them additional options in choosing a loan product that fits their needs." (77 FR 55312)

Pursuant to this exemption authority, the Bureau proposes that a creditor may charge consumers any discount points and origination points or fees in connection with the transaction if the creditor makes available to the consumer a "comparable, alternative loan" that does not include discount points and origination points or fees that are retained by the creditor, broker, or an affiliate of either (''0-0 Alternative''). The creditor need not make available the alternative, comparable loan, however, if the consumer is unlikely to qualify for such a loan.

ABA Comments:

ABA appreciates the Bureau's willingness to use its exemption authority under this provision. We agree with the Bureau that there is considerable consumer benefit in affording consumers the option to pay upfront discount points and origination points or fees. This flexibility allows customers the ability to determine whether they can best lower the overall costs of the mortgage loan by paying discount points and origination points or fees upfront in exchange for a lower interest rate. In many instances, it allows for the accommodation of required costs to ensure that a transaction is feasible and even affordable.

We note, however, that the proposed "0-0 Alternative" will not be an entirely viable option for most banks. For the various reasons listed below, lenders will have a very difficult time offering "alternative" loans that include no discount points or origination points or fees, other than the interest rate.

- Although lenders have some flexibility to reduce upfront points and fees by incorporating such costs into the interest rate, many secondary market sources do not allow for sufficient rate expansions to accommodate all the upfront costs necessary to create a 0-0 Alternative loan option. Many if not all secondary market aggregators who purchase loans on a servicing released basis have rate caps that they establish on the loans they purchase for fair lending, risk reduction, and other reasons. Their pricing structures do not universally allow for the rate increases needed to eliminate all upfront origination costs.

- Due to the fixed nature of transactional costs in mortgage loans (where many costs are rigid, regardless of the loan amount), smaller loans are impacted more, and often less likely to have enough premium above a lender's cost of business margin in order to pay for everything required to make for a 0-0 Alternative option.

- Creating a higher rate (or "0-0 Alternative") loan leads to the creation of an "alternative" asset that is not, as the Bureau suggests, necessarily identical to the original loan. The infusion of all origination fees into the rate changes the risk characteristics of the loan, therefore creating a more risky "Alternative" loan asset. Expanding the interest rate on a loan means that the long-term risks of default for that second loan are actually increased due to the higher monthly payments. This would mean that the "0-0 Alternative" loans become more risky and ultimately, more expensive loans vis-à-vis the comparable loan that carries upfront fees and points. Loans without discount points would require a credit premium to the borrower that would put the "Alternative" loan above the so-called "par" rate as is contemplated in the proposed rule.

- The proposed Alternative loan poses high potential of conflict with other laws. For instance, the infusion of all origination costs into the interest rate means that the expanded interest rate will trigger the High-Cost (HOEPA) and/or Higher-Priced (TILA) provisions, therefore eliminating lenders' abilities to offer the loan product. Likewise, should the Bureau determine that the "Ability to Repay" final rule will include a quantifiable debt-to-income ratio ("DTI") in order to meet the Qualified Mortgage (QM) segment, then the offering a 0-0 Alternative (with a higher interest rate) will significantly raise the potential that the loan's swelled DTI ratio will exceed QM limitations (thereby disqualifying the loan from special legal treatment afforded by QM). We cannot be certain of the shape or content of these other pending proposals, but there is certainty that they risk tripping over each other, and we cannot, therefore, ensure what the final impact will be.

- Infusing all costs into the interest rate would require that many banks impose a charge for prepayment on the loan. If a consumer accepts the 0-0 Alternative loan, it will be entering into a loan that has higher interest payments, and thus higher risks vis-à-vis prepayment speed. Members affirm that they will have to ensure that they reduce such risks, and prepayment provisions would be the only means of ensuring that banks can recoup upfront costs on a loan, thereby allowing them to at least break even on expenditures required to originate the transaction. Dodd-Frank imposes severe limitations on prepayment fees thereby creating the concern that such transactions would become impossible. (QM/ATR provisions will be affected and the new HOEPA standards are likely to be triggered with the imposition of prepayment fees.)

All said, most ABA banks report that these structural realities make the “0-0 Alternative” unworkable. In some instances, banks report that should the alternative loan option be finalized, it would drive them to substantially reduce the number of products that banks are able to offer to consumers, and may, in some instances, force creditors into salary-only compensation schemes (which would, in turn, eliminate incentives and destroy their ability to adequately compete in their markets).

In addition to these structural infeasibility issues, the proposed “0-0 Alternative” proposal raises various uncertainties with respect to compliance with timing and disclosure requirements. The more significant uncertainties of the proposal are as follows—

- “Make Available”: The proposal would provide that, in a retail transaction, a creditor would be deemed to have made the “0-0 Alternative” loan available if: (1) at any time the creditor gives an oral or written quote specific to the consumer of the interest rate, regular periodic payments, the total discount points and origination points or fees, or the total closing costs for a loan that includes discount points and origination points or fees, the creditor also provides a quote for those same types of information for the comparable, alternative loan that does not include discount points and origination points or fees, and (2) the quote for the alternative loan would need to be given only if the quote for the loan that includes discount points and origination points or fees is given prior to when the consumer receives the Good Faith Estimate (required under RESPA).

  There are various difficulties with this provision.

  1. There is no precise time certainty for the provision of the quote, and this makes it difficult to construct compliance systems that will ensure conformity with the provision. ABA appreciates the flexibility that the proposal attempts to provide creditors, but a simple requirement that something be uttered to the consumer in conjunction with some other event (the provision of a price quote) does not provide banks with a precise “regulatory moment” that creditors can use to prove that they are in compliance with the alternative option.

     This inability to prove compliance would be harmful in two respects. First, secondary market purchasers (and wholesalers) must assure compliance and they will see the need to collect proper assurances that the alternative loan requirements are properly followed at the appropriate stage. Without this definable “regulatory moment,” investors are likely to create their own trigger points, thereby causing divergence and uncertainty across all markets. Second, even in instances of bank-held, portfolio loans, creditors are likely to craft restrictive internal guidelines that would “control” the communication between the loan officer and the consumer. Lenders cannot chance the inadvertent “giving of an oral or written quote” to the consumer without assuring that there is an accompanying offer for a “0-0” loan. The high potential for breach on a provision that carries such high levels of liability will lead to overly restrictive guidelines that would all but mute exchanges between the consumer and the mortgage professional.

We offer some alternatives to resolve this problem below.

2. We cannot fully understand the interplay between the elements of this sub-rule at proposed Paragraph 1026.36(d)(2)(ii)(A) and accompanying commentaries. It is unclear what is meant by the proposed provision that the alternative loan needs to be given "only if the quote for the loan that includes discount points and origination points or fees is given prior to when the consumer receives the Good Faith Estimate." (*See* 77 FR 55313) Does this mean that if the loan officer refrains from giving the consumer an "oral or written quote specific to the consumer of the interest rate, regular periodic payments, the total discount points and origination points or fees, or the total closing costs," and only provides the consumer with a general prediction of price before the delivery of the GFE, that this provision does not apply? Does this mean that if a quote is given only in conjunction with the GFE, that no "0-0 Alternative" loan need be offered to the consumer? In both instances above, would the lender still be allowed to engage in "dual compensation arrangements" to the LO where the conditions are met and no "0-0 Alternative" loan is offered?

   We believe this second prong of the "make available" definition is crucial to understanding the feasibility of this rule, and we cannot read this item with any precision. We offer some alternatives to resolve this uncertainty below.

3. The requirement to "make available" the "0-0 Alternative" loan comes very early in the transaction, but would impose defined regulatory responsibilities at a point in the relationship where the LO and consumer are just initiating a relationship. We understand that any quote that is "specific to the consumer" should carry some weight of formality. The reality, however, is that consumers may be shopping among various sources, and may declare personal information regarding their situation and loan needs to the loan officer, not necessarily in full candor, but in an attempt to just get generalized quotes. We view this as healthy behavior, and such interchange should be allowed—the problem is that such exchanges will, under this proposal, pose an affirmative obligation that the creditor make a live offer of a no-fee, no-point loan. The originator cannot, at early points of the relationship, ascertain any facts that can assure a valid quote, other than a generalized statement of where the rates generally are at that point in time.

   We don't view this as prudent, and we offer some alternatives below.

- <u>"Discount Points and Origination Points or Fees"</u>: The Bureau proposes in new § 1026.36(d)(2)(ii)(B) to define the term "discount points and origination points or fees" for purposes of § 1026.36(d) and (e) to <u>include all items that would be included in the finance charge</u> under § 1026.4(a) and (b), and any fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2), that are payable at or before consummation by the consumer to a creditor or a loan originator organization, except for: (1) interest, including per-diem interest; (2) any bona fide and reasonable third-party charges not retained by the creditor or loan originator organization; and (3) seller's points and premiums for property insurance that are excluded from the finance charge under § 1026.4(c)(5), and (d)(2), respectively. Proposed § 1026.36(d)(2)(ii)(B)(3) specifies that items that are excluded from the finance charge under § 1026.4(c)(5), (c)(7)(v) and (d)(2) are also excluded from the definition of discount points and origination points or fees. Property insurance premiums may be excluded from the finance charge if the conditions set forth in § 1026.4(d)(2) are met, and these premiums also may be excluded if they are escrowed. See § 1026.4(c)(7)(v), (d)(2). In addition, charges in connection with transactions that are payable in a comparable cash transaction are not included in the finance charge. (*See* comment 4(a)-1). (Under the proposal, the phrase "payable at or before consummation by the consumer to a creditor or a loan originator organization" would include amounts paid by the consumer in cash at or before closing or financed and paid out of the loan proceeds.)

After much consultation with various legal experts, we cannot adequately decipher this formula. The definition is complicated by various factors. It includes general statements ("exclude charges payable in comparable cash transactions") that may or may not supersede more precise elements of the overall definition. In addition, rather than explicitly listing the exclusions or inclusions, this proposed provision cross-references into existing "finance charge" definitions that are themselves confusing or dependent upon certain additional conditions. It is therefore difficult to ascertain whether the entire cross-referenced rule applies with the appurtenant conditions, or if only the specifically listed fee in the cross-referenced provision is included, regardless of any conditions. Perhaps the most obvious complication is that this is an extremely lengthy definition that contains several twists and kinks—it is illegible without full assistance from legal counsel.

We believe that the definition of "Discount Points and Origination Points or Fees" is crucial to understanding the impact and feasibility of this rule, and yet, we cannot read this item with any degree of precision. ABA consulted legal professionals, both in-house and private counsel, and we received differing interpretations regarding which fees are in and which are out of the definition of "Discount Points and Origination Points or Fees."

We offer some alternatives to resolve this confusion below.

- <u>"Safeguards"</u>: The Bureau states that it recognizes that creditors who do not wish to make loans that do not include discount points and origination points or fees available to particular consumers could possibly manipulate their underwriting standards so that those consumers do not qualify for such a loan. To prevent this practice, the Bureau is considering safeguards designed to prohibit creditors from changing their qualification standards, such as loan-to-value ratios and credit score requirements, solely for the purpose of disqualifying consumers from receiving loans that do not include discount points and origination points or fees and safeguards against setting the interest rates high for certain consumers, which could increase the monthly payment on those loans to be high so that those consumers cannot satisfy the creditor's underwriting rules.

  The uncertainty that the Bureau may add yet more conditions and restrictions to this congested provision is worrying. This is a crucial rule, with deep repercussions for lenders in terms of risk and liabilities. The precise conditions and elements that will apply to this "0-0 Alternative" are critical to understanding the impact and feasibility of this rule, and failing to define the entirety of such conditions would be unacceptable in this rulemaking. Any additional conditions in this area must be done through notice and comment rulemaking.

ABA's Alternative Recommendation:

ABA believes that the Bureau can achieve the same level of protections it seeks through the "0-0 Alternative" by simplifying the proposal and slightly changing the elements of the proposal. Our recommendation below sets forth a similar but more feasible alternative that meets all relevant policy objectives.

ABA's substitute recommendation can be summed up to two adjustments to the Bureau's proposal. First, the Alternative loan should be disclosed to the consumer in tandem with the 3-day GFE/TIL disclosures. Second, the alternative loan should present "bank specific"—not "borrower specific"—information on the interplay between points, fees and interest rates. The following points clarify this approach.

- Timing: The alternative disclosure proposed by ABA would be submitted in connection with the three-day GFE/TIL disclosure. The rules applicable to pre-GFE communications would remain unchanged. The effectiveness of this alternative safe harbor is premised on the fact that the first "official" set of disclosures received by the consumer would contain a clear description of the point, fee and interest rate possibilities that are available to the consumer.

- Content: The Alternative loan disclosure provided with the GFE would have to delineate an alternative "points and fees" option that the consumer can select. Under ABA's plan, this Alternative loan option is not required to lower the points and fees all the way to zero. It must, however, present the consumer with a real lowering of the point and fee structure, so that the consumer can clearly identify that there are available options.[2] As in the proposed rule, the ABA's Alternative loan options presented in the disclosure must be readily available through the creditor. The Alternative need not be "identical" to the original loan, because as described above, such "identical" options may be non-existent or illusory in terms of risk profile. The ABA-recommended Alternative loan would have to demonstrate a discount, however, which is the element that affords the consumer with the awareness that options exist.

  As the Bureau states in the preamble (77 F.R. 55318), once consumers understand the trade-off, they will be better able to compare loans. In general, this will lead to more competitive pricing in the creditor pricing policies "to attract consumers that understand

[2] We suggest that the Bureau should also allow for options where the creditor offers a lowered interest rate structure instead, with accompanying higher points. This would also be of consumer benefit, and would allow for an accommodation of situations where the consumer asks, as a first request, for a loan that has the lowest upfront costs. In such instances, the fees are already as low as they can go, and the lender's only option is to show that alternatives exist through a lower rate loan with increased points.

the trade-off." What is important about the Bureau's observation is not that creditor must take upfront costs all the way to zero. Rather, the important point is that the consumer be allowed a tool to comprehend that there is a trade-off, and that they can structure such payment alternatives. ABA's alternative provides that tool to the consumer, and is as effective as providing a "0-0 Alternative" loan.

- Acceptance: If the consumer accepts the Alternative loan option, the creditor would advance with the alternative loan and resolve any disclosure discrepancies by providing the consumer with a "changed circumstances" disclosure. The rules applicable to the "changed circumstances" disclosure would be identical to those that would otherwise apply under the RESPA-TILA proposed rulemaking.

- Additional Disclosure: If the creditor cannot offer an Alternative loan option, it would provide the consumer with a clear disclosure, in bold print, that it is not able to offer any alternatives to the loan presented in the GFE, but that there are other lenders that MAY have the ability to offer products that reduce upfront fees and points.

In the end, ABA's alternative would provide borrowers with the same level of protection and equal amount of information as the proposed "0-0 Alternative" loan option. We think that our proposed approach may even allow for loan offers that expand the choices that the shopping consumer can consider. ABA's alternative also resolves compliance burdens and lowers the legal risks associated with this provision. Our alternative does not muddle compliance with formulaic complications regarding finance charge—it is a straightforward statement to the consumer that there are viable options, and that such options are readily available should the consumer find them preferable.

We urge that the Bureau consider this approach to a safe harbor instead of the "0-0 Alternative" option. Our members fully support the objectives of the Bureau's proposed alternative loan approach, and the recommendation advanced here does not diminish the goals of properly informing the consumer. It does, however, set forth a viable alternative that all banks, regardless of size, will be able to institute. In fact, we believe that most banks are providing these options today—and this regulation, should it be finalized with this alternative, would expand such best practices to all mortgage credit providers universally.

"Bona Fide" Requirement

In connection with the "0-0 Alternative" loan option, the Bureau is seeking comment on whether the Bureau should adopt as proposed a "bona fide" requirement to ensure that consumers receive value in return for paying upfront points and/or fees and, if so, the relative merits of several alternatives on the details of such a requirement.

In the preamble, the Bureau expresses concerns that there will be some consumers who are less sophisticated in terms of understanding the points, fees and interest rate trade-off, and that creditors may be able to present those consumers less competitive pricing than what is in the creditor's pricing policy. The Bureau therefore solicits views on whether a "bona fide" requirement is necessary to ensure that all consumers receive a competitive market trade-off between the interest rate and the payment of discount points and origination points or fees.

ABA believes that the alternative solution offered by ABA effectively removes the necessity for a bona fide test. As expressed above, the real element that must be assured is that consumers realize that there is a trade-off, and that such trade-offs can be structured differently to fit one's needs and situation. We think that this consumer awareness and comprehension can be achieved without the complex "bona fide" formulations that the proposal describes.

We understand the Bureau's concerns that less sophisticated consumers may receive less than competitive pricing. We think, however, that the Bureau must consider this concern in light of all the other reforms that are being instituted in this fuller mortgage reform process. First, creditors cannot use the point-rate trade-off mechanism as a means to over-pay or perversely incentivize the loan officer—the existing restrictions on loan officer compensation (being clarified and reinforced in this rulemaking) ensure that this does not happen. Moreover, the tolerance provisions under RESPA (and TILA) will ensure that the consumer can shop with very accurate numbers. The improved disclosures (being proposed now) have been subject to consumer testing by the Bureau and will help consumers to make credit-related decisions that best suit their individual needs. The Bureau has also announced that as part of the RESPA-TILA Integration process, it will improve the Special Information Booklet to increase the legibility and usefulness of that disclosure. We anticipate that this useful disclosure will take on interactive forms so as to better educate consumers. The booklet and interactive guidance could provide information regarding upfront costs and rate better than any disclosure discussed in this proposal. Should consumers have any confusion, they can access the expanded counseling networks established under the Dodd-Frank Act.

More importantly, it will be extremely difficult, if not impossible, for a regulatory prescription to account for all the market-related considerations that are required to configure pricing levels and origination fees. The so-called "Origination points or fees" are payments used to compensate originating lenders for the expenses incurred in marketing, advising, processing and generally making credit available to consumers. It reflects brick and mortar costs, legal fees, employee costs, among other elements. Banks must set these fees in a way that allows them to stay in business, and in a way that generates a profit within the competitive margins that markets dictate. Overall, these costs and fees are part of a very complex mixture of elements, and also part of a pricing calculus that is unique to each bank and its position in individual markets.

Given the complexities and the numbers of protections currently available to consumers, and those that are still to come, it is difficult to understand why more complicated formulas need to be added to already intricate provisions. The endless accumulation of protections in this area has no marginal value to the consumer. To the contrary, the accumulation of overlapping protections have the ancillary effect of multiplying regulatory burden, and are today driving community banks and other institutions out of the mortgage market. ABA can affirm that many community banks are considering whether they will continue their mortgage lending operations because of the complexity of this provision alone, and because of their inability to fully assess whether they are fully compliant. Our conversations with members provide much testimony to this effect. The community banking model is not structured to withstand the high-risk, very expensive and tremendously mechanical application of regulatory controls that are being thrust on every movement or decision that banks make in connection with extensions of credit to their customers.[3]

B. Request For Delay and Joint Consideration With Disclosure Reform Rule

At some point, the Bureau must trust that the multi-faceted reforms being adopted under the Dodd-Frank Act (and under this regulation) will provide robust consumer protections. In this sense, we advance a most important request. ABA urges that the Bureau pause and give the issues involved here more thorough analysis. Our examination of the issues highlights the point that the "Alternative 0-0" loan discussion is in reality an issue that concerns "product selection" rather than "LO compensation" policies. The fuller policy conversation about the preferred method to ensure that consumers understand the trade-off between points, fees and interest rates must be had in connection with the RESPA and TILA shopping disclosures. Any solution reached under this proposed rule would implicate—and indeed, would be incomplete without—a parallel discussion on how all the "alternative" LO options and disclosures will operate under the broader loan shopping options contained in the RESPA and TILA disclosures.

We urge that the decision-making concerning this point be moved to the more universal discussions of loan shopping and consumer education—that discussion is RESPA-TILA Integration. Shifting this decision-making to that regulatory initiative will allow more time and a better context to consider the important issues posed here—the RESPA-TILA reform process has no explicit deadline, and allows for a more considered crafting of this important rule.[4]

Authority and Need for Waiver

We believe that the Dodd-Frank Act expressly permits the Bureau to establish waivers and exemptions to the dual compensation prohibition, as delineated in Section 1639b(c)(2)(B) of the statute, if it is in the interest of consumers or the public to do so. In a memorandum attached herein as Appendix A, outside counsel confirms the CFPB's express waiver and exemption authority based on a finding or findings. Accordingly, ABA respectfully submits that Bureau may exercise this authority without establishing a zero-zero alternative. The finding could make

[3] In this sense, we also think that Federal examiners will not be able to fully decipher or apply the complex rules being created here, and banks will have to prepare for difficult bank examinations that will be exacerbated by misunderstandings of the law.

[4] Should the Bureau advance with setting a "bona fide" requirement "bona fide" requirement to ensure that consumers receive competitive market trade-offs in the "Alternative 0-0" loan, ABA would recommend adoption of the approach delineated under the "bona fide" test set forth in the Qualified Mortgage proposed rule (QM/ATR), and described in the proposed rule as the "Market-based benchmarks" approach. We note that practically all mortgage lending banks have to be fully compliant with the QM conditions, and will therefore incorporate the QM test for all their mortgage loan activities. This test will be required to calculate LO compensation into the QM and HOEPA "points and fees" thresholds. We think, therefore, that the "bona fide" definition of QM should generally cover LO compensation safe harbors as well. As described in the preamble, the QM proposal indicates that "bona fide" discount points would be defined as defined as any percent of the loan amount" paid by the consumer that reduces the interest rate or time-price differential applicable to the mortgage loan by an amount based on a calculation that: (1) Is consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer; and (2) accounts for the amount of compensation that the creditor can reasonably expect to receive from secondary market investors in return for the mortgage loan.

clear that if this prohibition were allowed to go into effect, it would force lenders to make a choice of foregoing commission-based compensation to loan originators and potentially lessening the availability of service to consumers or unduly increasing rates to build in the costs of loan origination, making mortgages less affordable and unavailable to many consumers.

More urgently, as the Bureau recognizes, if these provision were to go into effect solely under the terms of the statutory provisions, it would require creditors in the vast majority of transactions in today's market to restructure their current pricing practices or compensation. Some community bankers have informed us that they will discontinue their mortgage lines. The short term effects would be very damaging, as mortgage sources will shrink, and rates would rise since originators that cannot receive points or fees from the consumer will be forced to recoup their origination costs through higher rates. Such results make loans more scarce and unaffordable to many borrowers. Also, without the option of discount points, consumers will not be able to lower their interest rates and monthly payments with an upfront expenditure through points. Less credit supply and higher interest rates will be the immediate and very visible outcome of such a scenario.

The attached document suggests that the Bureau can avoid this by accessing the limited discretion vested by Congress, and could advance with more serious and focused analysis under the RESPA-TILA Integration process. The authority to issue only temporary waivers or exemptions will tie the industry over to a process where better and more comprehensive disclosure options can be crafted to the benefit of both creditors and consumers.

We strongly urge that such waiver or exemption be implemented prior to the January 21, 2013 date.

C. Bonus Payments and Profit Sharing

Overview

The Bureau proposes to clarify that the LO Compensation provisions prohibit compensation based on the terms of multiple transactions by an individual loan originator. (Proposed comment 36(d)(1)-1.ii) The Bureau is proposing a new comment to clarify that the prohibition on payment and receipt of compensation based on the transaction's terms (§ 1026.36(d)(1)(i)) covers compensation that directly or indirectly is based on the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators employed by the person. (See comment 36(d)(1)-1.ii)

The Bureau would, however, create exemptions to take into account circumstances where potential incentives are "sufficiently attenuated" to permit for such compensation. Specifically, the Bureau's proposal would—(1) Permit employer contributions made to "qualified plans" in which individual loan originators participate; (2) permit payment of bonuses under profit-sharing plans and contributions to non-qualified defined benefit and contribution plans even if the compensation is directly or indirectly based on the terms of multiple individual loan originators' transactions where: (a) the revenues of the mortgage business do not predominate with respect to the total revenues of the person or business unit to which the profit-sharing plan applies, as applicable, or (b) the individual loan originator being compensated was the loan originator for a *de minimis* number of transactions (pursuant to proposed § 1026.36(d)(1)(iii)(B)(2)).

The preamble states that the Bureau is cognizant of the burdens that restrictions on compensation may impose on creditors, loan originator organizations, and individual loan originators. The Bureau believes that, "when paid for legitimate reasons, bonuses and contributions to defined contribution and benefit plans can be useful and important inducements for individual loan originators to perform well." The Bureau solicits comment on whether the proposed restrictions on bonuses and other compensation paid under profit-sharing plans and contributions to defined contribution and benefit plans accomplish the Bureau's objectives without unduly restricting compensation approaches that address legitimate business needs.

ABA Comments

ABA appreciates the Bureau's efforts to delineate specific instances where bonuses would be acceptable under the proposed rules. We especially welcome the clean and straightforward clarifications that employer contributions to qualified plans are legal and permissible. We also appreciate the following clarifications, as they will go a long way in establishing order in the application of these prohibitions—

- A bonus payment that is made without reference to profitability, such as a retention payment budgeted for in advance, does not violate the prohibition on payment of compensation based on transaction terms, as clarified by proposed comment 36(d)(1)-1.ii, meaning that the provisions of proposed § 1026.36(d)(1)(iii) do not apply. ABA believes this clarification is based on sound policy considerations.

- The Bureau would deem that where a creditor does not permit its individual loan originator employees to deviate from the creditor's pre-established loan terms, such as the interest rate offered, the creditor's payment of a bonus at the end of a calendar year to an individual loan originator under a profit-sharing plan would not be related to the transaction terms of multiple individual loan originators. Again, ABA believes this is a correct application of the rule, and we appreciate the explicit articulation of this interpretation.

ABA members report, however, that the additional proposed requirements applicable to bonuses, profit sharing plans and non-qualified plans are onerously complex, unworkable, and are not likely to be implemented if finalized as proposed. We are concerned that, as crafted, the Bureau's rule and underlying interpretation will adversely affect the employment relationship between the bank and its employees and will lead to a situation where loan officer employees are not vested in the success of the banking venture, and are therefore emotionally and monetarily separated from its achievements. As we explain below, such isolation is entirely unnecessary, and will only have detrimental effects on mortgage origination operations.

- *Over-inclusiveness*: ABA believes that the Bureau's main lapse in its policy considerations regarding bonuses is the leap to deem that all revenue is a proxy for transaction terms. The Bureau states that it is "treating revenue as a proxy for profitability, and profitability as a proxy for transaction terms in the aggregate." (77 F.R. 55300) The Bureau is using a double "proxy" bridge to reach its conclusion—and we believe this is inappropriate. ABA acknowledges that bonuses can be improperly used as a "proxy." What is troubling about the Bureau's logic, however, is that it deems every revenue-based bonus decision to be a proxy.

A bank may, for instance, wait until year-end to determine whether any profits exist in the venture, and only then decide whether to give bonuses on an evenly divided basis, or decide that a holiday retreat is within the budget. This decision would be considered a "proxy," however, because the amounts are based on profit calculations (which involve revenue), and they are not "budgeted for in advance," even though the distributions (or benefits) to employees are impartial and uniform across all staff. We believe that this would be an incorrect application of this rule—and it would unfairly hit cautious yet unsuspecting banks.

ABA believes that the possibility that bonuses are used as a subterfuge for loan terms should be a focus for enforcement and examination. It should not be assumed, however, that they are a subterfuge in every instance. If bonuses are structured and improperly adjusted to reward specific loan officers for loan terms they produce in originations, then this fact will be ascertainable through examinations, and would be properly punishable. But this fact must be established and connected to the precise prohibition that is set forth in the law.

- *Complexity*: The Bureau proposes to permit compensation in the form of a bonus or other payment under a profit-sharing plan or a contribution to a non-qualified defined benefit or contribution plan, even if the compensation relates directly or indirectly to the terms of the transactions subject to § 1026.36(d) of multiple individual loan originators, so long as not more than a certain percentage of the total revenues of the person or business unit to which the profit-sharing plan applies, as applicable, are derived from the person's mortgage business during the tax year immediately preceding the tax year in which the compensation is paid. The Bureau is proposing two alternatives for the threshold percentage—50 percent, under Alternative 1 proposed by the Bureau, or 25 percent, under Alternative 2 proposed by the Bureau. The Bureau then defines alternative approaches for determining what "revenue" would mean.

  We respectfully submit that in the aggregate, this provision is too complex. None of our members will chance this level of inquiry into their accounting. Most importantly, any minor miscalculation of "revenue" or "profitability" will abruptly render illegal a full year's worth of loans makes this option untenably dangerous. If these threshold percentage numbers are in any way miscalculated, the entire pool of loans originated by that bank will be "poisoned." A lapse in accounting calculation means that the entire compensation scheme in a bank is improper under these rules. In such instances, the bank will be subject to buy-backs and full TILA liability on <u>all</u> the loans made during the fiscal time period. Our members report that the complexity of these calculations, coupled with the disastrous results if anything goes wrong, means that no institution will rationally dare to access these exemption options.

- *Solution*: The solution is relatively uncomplicated, and was discussed above. We ask that the Bureau refrain from adjudging all bonuses as illegal proxies under the rule. Where bonuses are used as proxies, there should be fair enforcement. This easy approach will eliminate the need for extraordinary exemptions, and will enable bankers to engage in proper bonus programs that are still subject to the full oversight of regulators.

D. Managers and "Administrative or Clerical Tasks"

ABA requests that the Bureau add additional clarifications to better delineate the functions that managers may engage in without crossing the definitional lines of "loan originator." In particular, ABA believes there should be absolute clarity around the point that where managers engage in customary loan approval functions, or where they set terms in counter offer situations, such activity would not qualify the manager as "loan originator" for purposes of this rule.

This element has been a source of considerable confusion among member banks, and among examiners. Existing comment 36(a)–4 clarifies that managers, administrative staff, and similar individuals who are employed by a creditor or loan originator but do not arrange, negotiate, or otherwise obtain an extension of credit for a consumer, or whose compensation is not based on whether any particular loan is originated, are not loan originators. We agree with the Bureau that this comment is consistent with TILA section 103(cc)(2)(C)'s treatment of administrative and clerical tasks. The meaning of the term "arranges," however, is very broad, and the Bureau states that it "believes that it includes any part of the process of originating a credit transaction, including advertising or communicating to the public that one can perform loan origination services and referrals of a consumer to another person who participates in the process of originating a transaction." This "inclusive" language is broad and has been read to include the act of approving deals in application and counter offer situations.

ABA believes that the function of loan approval is removed from "originating," and is more akin to underwriting. Managers often must approve one-off transactions or special deals, and they often have certain override authorities in their internal underwriting overlays that require their specific involvement in individual transactions. Such approval functions, by themselves, should not be deemed to be core originating functions.

ABA requests that there be a minor technical revision to comment 36(a)–4, regarding "Managers and administrative staff," to explicitly state that loan approval functions are not deemed to be originating activities. This addition would be non-controversial, and would add great clarity for banks and regulators.

E. De minimis Exemption

For similar reasons, ABA requests that there be more latitude extended under the *de minimis* loan exemption set forth under Section 36(d)(1)(iii)(B)(2). In that section, the Bureau analogizes to existing TILA provisions to propose that an individual loan originator who is a loan originator for five or fewer transactions is not truly active as an individual loan originator and thus is insufficiently incentivized to steer consumers to different loan terms.

ABA agrees with the establishment of a *de minimis* measure under these rules, but we ask that such number be expanded to 15. In community banks and smaller mortgage subsidiaries across all jurisdictions, managers' duties are often expansive, and must encompass a wide variety of activities in order to meet customer demand and convenience. Very often, managers (and sometimes their superiors) have to face seasonal shortages, or must cover for employees that are on vacation or handling urgent family issues or other matters. In such instances, managers step in to temporarily fill their role, and will respond to customers who want to immediately lock interest rates, or may need to urgently discuss terms of their loans. Where there are no other viable staff, managers offer an invaluable role in bridging the gaps to ensure that the consumer is well served and is immediately offered information they need to negotiate their home purchase deal.

Our banks report that in such instances, an otherwise "non-producing" manager will necessarily cross the line and perform duties that are in the definitional realm of a "loan originator." The manager is serving only an intersticiary role that is fundamental to continuity in communications and certainly accrues to the consumer's benefit. In most instances, the non-producing manager may not be receiving a transaction-specific compensation for the particular loan they assist, but existing rules would still be of great detriment because the managers' narrow and temporary participation in one or two transactions will render them "loan originators," and thereby disqualify them for bonus incentive programs that are otherwise legal for non-production employees.

Finally, we note that in those instances where a manager serves to fill in with LO-related activities, they would still be expected to obtain NMLS licensing and/or registration in full accordance with the terms of the SAFE Act. This adds a layer of consumer protection that should quell any concerns that the agency may have.

In summary, ABA believes that this unfairness can be greatly remedied by increasing the *de minimis* amount to 15 transactions per year. Should the Bureau deem this to be too expansive for purposes of all originators, it could adopt this as a special rule applicable to managers and administrative staff only, keeping the more limited *de minimis* rule for all other staff.

***F.* Proxy Rule**

ABA applauds the proposal's addition of more precision to the definition of "proxy." This clarification was needed to ensure proper guidance regarding the exact application of this rule in terms of allowable compensation structures in banks. We note, however, that the best compliance tool that bankers can rely upon is descriptive examples that explicitly articulate what is allowed, and what is prohibited. A clear and comprehensive list of allowable activities under the "proxy" rule would save considerable resources in terms of legal fees and compliance efforts.

ABA recommends that any final rule contain a list that would explicitly permit:

- Differences in compensation based on quantifiable revenue differences to the company because of market differences. For example, in instances where a lender does not offer a particular product, a loan may be brokered to another lending source. Such transactions bring in less revenue to the company, and this should be deemed an "immutable" basis for less compensation to the originator. In addition, loans that are originated for the bank's portfolio often bring in considerably less revenue than those sold to the secondary market. An example articulating this principle would help both lenders and examiners in their compliance functions.

- Differences in compensation based on quantifiable differences in the work it takes for a loan officer to originate a loan. We understand that Board staff has previously made pronouncements that clarified that work differential could justify higher pay. This concept has not been properly understood, however, and written clarification would be useful.

- Differences in compensation to originate loans subject to the Community Reinvestment Act. CRA transactions are an important priority for many banks, and banks want to ensure that originators are properly incented to pursue and work on such transactions. It would be helpful if any final rule explicitly stated this point.

- Differences in compensation to encourage state agency and other government program loans. We understand that there is some concern that permitting program loans to become a basis for additional compensation raises the specter of "steering," but we note that such steering would lead to loans that are beneficially structured, have internal protection mechanisms built into the product, and often restrict the amount of compensation that can be paid to loan originators.

G. Implementation Timetables

The proposed rule solicits comments on implementation periods for this rulemaking. It is critical that the Bureau provide ample time for banks to implement the final rules, as there will be technical and complex provisions that banks will have to incorporate into existing systems and coordinate with other rulemakings that the Bureau has proposed. In recent months, the Bureau has issued thousands of pages of proposed mortgage-related rules, and the task of implementing all of these requirements will be overwhelming for most banking institutions.

While community banks pride themselves on being flexible and capable of adapting in order to meet new challenges, there is a tipping point beyond which community banks will find it impossible to compete. We note that the tipping point will be January 2013, when much of the Bureau's new regulatory regime is slated to be finalized. Based on feedback from our members, unless the CFPB adopts final rules that are more workable, there will likely be a constriction in the number of banks that offer mortgage products in their communities.

Our member banks report that they are adding one or several full-time compliance persons to their operations to help manage compliance with the CFPB's requirements alone. For the median-sized bank in this country with $166 million in assets and 38 employees, the burdens of these reforms are magnified tremendously. Typical reporting from our banks reveal frustration that at least 20 percent (and more) of their staff must be devoted entirely to managing government regulations that contribute nothing to the expansion of lending in their small communities. All of these employees (and supervisory staff) must, of course, be retrained in the new laws and technical requirements that interpret and implement them. This creates a quasi-regulatory burden because the "new compliance" must be instilled in human staff as well as lending systems.

Larger banks are not, of course, exempt. Large members report that these new LO rules, along with all the other Dodd-Frank rules, impose significant changes that are already driving an entire reevaluation of business lines and models. Together with the new Basel capital and liquidity rules, these added costs total in the hundreds of millions of dollars.

Within this milieu, and considering the liabilities, repercussions, and scope of these and other simultaneous changes, ABA urges that, at minimum, the mandatory implementation date for the rule be at 18 months after the rule is final and written guidance is provided. We understand that there are pressures to implement these rules quickly so that protections are afforded to consumers in the shortest possible timetable. If these rules are rushed, however, our members—particularly the smaller banks—will be forced to opt out of mortgage lending due to their inability to properly ensure full compliance. They will, of course, weigh in other factors, such as costs, redesigning employee plans, employee retention risks, loan pricing structure changes, compliance risks, fair lending risks, and more—all factors that weigh against retaining mortgage lending operations. This choice is already being considered by hundreds of bank managers.

As we've explained in previous comments to CFPB rulemakings, we cannot fully predict nor unravel the technical difficulties that the intertwined mortgage provisions under Dodd-Frank will create. When placed together, the full array of triggers, prohibitions and disclosure/timing strictures will combine to create countless categorizations of mortgage product segments, each defined by a different collection of restrictions, disclosures and thresholds. We urge that the Board understand that this LO compensation rule, when combined with all the ongoing mortgage reform initiatives and existing state laws for high-cost loans, will completely redraw the mortgage markets and force lenders to adapt their systems—and mortgage business—in very profound ways. A bank's compliance burdens are composed of much more than just reactions to ongoing tweaks in the regulatory fabric—the full burdens banks face are massive compliance responsibilities and brand new systems that are uncertain in shape, and unpredictable in market impact.

We expect that compliance vendors will require a considerable time-frame to construct new disclosure and compliance systems from scratch. The delays that compliance vendors will impose means that full compliance readiness for banks will come in three, or possibly four, stages. At the initial point, compliance vendors will have to develop systems. After development, the next stage will be for banks to review vendor systems for compliance with the rules and compatibility with their products and systems and to incorporate those systems into their own. Only at stage three would banks advance to the efforts we describe above—the integration of these compliance rules and workflows into individual product lines. Stage four would be to troubleshoot and test these systems, and their interface with other bank systems. This fourth stage would be combined with massive retraining and constant testing and quality control.

We note that each stage is dependent upon the completion of the previous stage—there is no way to advance to stage 3 without stages 1 and 2 as predicates. Stages 1 and 2 are likely to take a full 12 months, if not more. Such staggered progression means that time is a most important component for getting the rules properly integrated into lender systems.

ABA reminds the Bureau of the confusion created by the 2009-2011 implementation of the RESPA reform rules, where urgent and important clarifications to the rules were issued even after the final rules became effective. In that instance, massive reformations to the RESPA disclosures became effective in January 2010, and HUD staff continued to issue detailed regulatory interpretations and instructions regarding the forms for the 14 months that followed. These post-effective date guidances spanned for more than 60 pages, and were constantly corrected and updated by follow-up issuances (called “Round-ups”). HUD staff was sincerely diligent in resolving problems—the difficulty was that the application of the new law to the hundreds of transactional variances across all states and loan types posed insurmountable challenges. These post-implementation guidances created a baffling compliance condition where loans that were originated on month one suddenly fell into breach on month two because a new “clarification” was issued (or amended) via internet notice. We urge, therefore, that before the 18 month period begins, industry and stakeholders should be given sufficient opportunity to review the rule and have uncertainties and conflicts fully and authoritatively answered in writing so that compliance systems will not need to be changed multiple times due to lack of regulatory clarity.

Our request has added urgency given the fact that this rulemaking has direct effects on the pending Ability-to-Repay and the HOEPA High-Cost rules under TILA. These rules will establish the very boundaries and contours of mortgage lending in the future, and the compensation paid to loan originators is included in the thresholds of both of these laws. The intertwined provisions of this reform must be fully weighed and given critical attention when considering the compliance timetables under this proposal.

H. Conclusion

ABA again appreciates the opportunity to comment and is very appreciative for the Bureau’s efforts to provide clarity in the development of this proposal. The banking industry deems the protections under this rule to be important for all consumers and for the future of mortgage lending generally. If the elements of this rule are incorrectly calibrated and improperly implemented, they will do serious harm to loan origination activities going forward.

Should you have questions or wish to discuss any aspect of these comments further, please contact the undersigned or Rod J. Alba (ralba@aba.com).

Sincerely,

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ATTORNEY-CLIENT COMMUNICATION

M E M O R A N D U M

To	Ken Markison, Mortgage Bankers Association Rodrigo J. Alba, American Bankers Association
From	Jeffrey P. Naimon, Joseph M. Kolar and H Joshua Kotin
Re	CFPB's Authority to Exclude Certain Statutory Requirements From its Loan Originator Rules
Date	October 16, 2012

Under new Section 129B(c) of the Truth in Lending Act ("TILA"), which was added by the Dodd Frank Act and codified at 15 U.S.C. § 1639b(c),[1] Congress essentially prohibits a loan originator from receiving an origination fee or charge (compensation) from any party other than the consumer when the consumer makes any upfront payment to the lender for points or fees on the loan. The Mortgage Bankers Association and the American Bankers Association (the "Associations") are concerned that a strict implementation of that provision will both disrupt the market and harm consumers. The Associations believe the provision would reduce the flexibility that lenders and borrowers have to structure appropriate transactions, either forcing the loan originator to choose between foregoing such compensation thereby lessening customer service, or unduly increasing rates and making mortgages less affordable and available to consumers. The Associations also believe that the Consumer Financial Protection Bureau ("CFPB") should waive or exempt transactions from the restriction in 15 U.S.C. § 1639b(c).

You have asked us whether the CFPB has the authority to waive or exempt mortgage transactions from the provisions of 15 U.S.C. § 1639b(c), or whether it is required to implement the statute strictly in accordance with the complete text of the new limitation. As set forth below, our analysis concludes that Congress granted the CFPB ample authority – both specific to the section in question and with regard to its general rulemaking powers – to waive the provision or exempt transactions from its provisions consistent with Congress's objectives in adopting the

[1] For ease of reference, we refer to sections of TILA throughout this memorandum by their U.S. Code citations within Title 15.

provision.[2] Therefore, in promulgating loan officer compensation rules, it is within the CFPB's authority not to restrict the payment of upfront origination (or discount) points and fees to the creditor.

DISCUSSION

1. Congress Gave to the CFPB the Authority to Waive or Exempt Transactions from Certain Provisions of Section 1639b Where it is in the Interest of Consumers and the Public.

In Title XIV of the Dodd Frank Act, which was signed into law July 21, 2010, Congress set forth a series of requirements pertaining to loan officer compensation similar to those requirements proposed by the Federal Reserve Board (the "Board") on August 26, 2009 and subsequently finalized September 24, 2010. In its final rule, the Board stated that "Congress was aware of the Board's proposal and that in enacting TILA Section 129B(c), Congress sought to codify the Board's proposed prohibitions while expanding them in some respects and making other adjustments." Truth in Lending, 75 Fed. Reg. 58,509 (Sept. 24, 2010).

The new provision provides, in relevant part, as follows:

15 U.S.C. § 1639b—Residential Mortgage Loan Origination

(a) Finding and Purpose.

(1) Finding.—The Congress finds that economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers.

(2) Purpose.—It is the purpose of this section and section 129C 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.

…

(c) Prohibition on Steering Incentives.

(1) In General.—For any residential mortgage loan, no mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal).

(2) Restructuring of financing origination fee.

(A) In General.—For any mortgage loan, a mortgage originator may not receive from any person other than the consumer and no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or

[2] This memorandum focuses on the narrow question of whether language in the Dodd-Frank Act can be read as vesting certain discretionary exemption authority to the CFPB in their implementation of Section 1639b(c) of the statute. This opinion does not explore broader questions of administrative authority that involve Constitutional matters of separation of powers or permissible delegations of rulemaking authority by Congress. Nor does this opinion delve into the validity of statutory interpretations that are outside the purview of Section 1639b(c).

will directly compensate a mortgage originator may pay a mortgage originator any origination fee or charge except bona fide third party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator.

(B) Exception.—Notwithstanding subparagraph (A), a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if—

(i) the mortgage originator does not receive any compensation directly from the consumer; and

(ii) the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator), except that the Bureau may, by rule, waive or provide exemptions to this clause if the Bureau determines that such waiver or exemption is in the interest of consumers and in the public interest.

…

(4) Rules of Construction.—No provision of this subsection shall be construed as—

(A) permitting any yield spread premium or other similar compensation that would, for any residential mortgage loan, permit the total amount of direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of the loan (other than the amount of the principal);

…

(C) restricting a consumer's ability to finance, at the option of the consumer, including through principal or rate, any origination fees or costs permitted under this subsection, or the mortgage originator's right to receive such fees or costs (including compensation) from any person, subject to paragraph (2)(B), so long as such fees or costs do not vary based on the terms of the loan (other than the amount of the principal) or the consumer's decision about whether to finance such fees or costs; . . . .

We believe that the CFPB's waiver authority contained in Section 1639b(c)(2)(B)(ii), which applies to "this clause," clearly applies to the waiver of condition (ii) and can plausibly be read as applying to both conditions (i) and (ii). We arrive at this result based on the plain language of the statute, the rules of construction set forth in the statute, and the context in which the statute was enacted.

There is a strong argument to be made that the waiver authority is narrowly aimed at the second condition because the authority is contained within the language of the second condition rather than being enacted as its own subparagraph.

Understanding the proposal in the broader context in which it was proposed also supports a reading that the waiver authority applies only to the second condition because the other parts of this section are merely a codification of the Board's rule. As the Board noted in its final rule, the rule "is consistent with TILA Section [1639b](c)(2), which allows mortgage loan originators to receive payment from a person other than the consumer (such as a yield spread premium paid by the creditor) only if the originator does not receive any compensation directly from the consumer. TILA Section [1639b](c)(2) also imposes a second restriction when an originator receives compensation from someone other than the consumer . . . . This restriction was not contained in the proposed rule, and therefore is not included in this final rule and will be addressed in a subsequent rulemaking." 75 Fed. Reg. 58,509, 58,510.

There is also, however, a sound argument that the waiver authority applies to the entirety of the section. In setting forth Section 1639b(c)'s rules of construction, Congress outlined the end posts within which it wanted Section 1639b(c) interpreted, whether by regulatory agencies, enforcement authorities or courts. At one end, Congress sought an outright ban of yield spread premiums, which is made explicit in Section 1639b(c)(4)(A). At the other end, Congress directed in Section 1639b(c)(4)(C) that it does not want the provision interpreted to restrict the consumer's ability to finance origination fees or costs through principal or rate, so long as the fees or costs do not vary based on the terms of the loan, other than the amount of the principal. By providing to the CFPB the authority to waive the Section's specific requirements on the condition that the waiver is in the interest of consumers and the public, Congress appears to be giving the CFPB great flexibility to promulgate a rule as it sees fit so long as the rule stays within the bounds of the Congressional end posts.

Therefore, to the extent the CFPB is in possession of information suggesting that waiver of the section's specific conditions is in the interest of consumers, as well as in the public interest, the CFPB will have a strong textual argument if it desires to implement a final rule under this section that omits these requirements.

2. In Circumstances Such as this the CFPB Has Broad Latitude to Adjust Requirements or Except Transactions From Certain TILA Provisions Where Consistent with TILA's Statutory Purpose.

a. Section 1604(a) Authority

In addition to the specific exemption noted above, TILA offers to the CFPB a broad grant of authority to adjust by rule TILA's statutory requirements or waive the requirements from applying to certain transactions. According to the preamble to the CFPB's proposal, the CFPB is relying in part on its rulemaking authority under 15 U.S.C. § 1604(a). This section states that "[t]he Bureau shall prescribe regulations to carry out the purposes of this subchapter . . . such regulations may contain such additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, as in the judgment of the Bureau are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604(a).[3]

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[3] While the Board relied on, and the CFPB relies on, the broad authority under Section 1604(a) in undertaking the loan officer compensation rulemakings, we note that Section 1604 is titled "Disclosure Guidelines." It is unclear whether this would in any way limit the CFPB's authority in this instance. While statutory section titles may be considered to shed light the section's basic thrust or on ambiguous language in the text, it cannot limit the plain

Although Congress has steadily expanded the scope of TILA in recent years, the purpose of TILA remains to "assure meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." 15 U.S.C. § 1601(a). The additional, specific purpose of Section 1639b, which serves as the basis for the CFPB's loan originator compensation rules, is 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." 15 U.S.C. § 1639b(a)(2).

Under Section 1604(a), the CFPB has flexibility in determining how to implement the new requirements set forth in Section 1639b. However, to justify this flexibility the CFPB must, as stated in the Congressional finding, demonstrate that the adjustment or exception "supports the availability of responsible, understandable and affordable mortgage credit to the consumer." 15 U.S.C. § 1639b(a)(1). To the extent the CFPB believes the previously promulgated Board rulemaking provided the appropriate balance of consumer protection and marketplace flexibility, it could exempt from the new requirements those transactions that comply with the existing loan originator compensation requirements. It should also be noted that the CFPB has already begun relying on its Section 1604(a) exception authority. In its Integrated TILA/RESPA Mortgage Disclosure proposal, the CFPB often cites to Section 1604(a) as justification for exempting certain transactions from its proposed rules because consumer testing or research indicate that the disclosures were in certain circumstances confusing or unhelpful. *See, e.g.*, Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth In Lending Act (Regulation Z), 77 Fed. Reg. 51,116, 51,136 (proposed Aug. 23, 2010) ("Specifically, the Bureau is proposing to use its authority under TILA section 105(a) . . . to omit from the Loan Estimate provided three business days after receipt of the consumer's application . . . .).

Courts, including the Supreme Court, previously granted to the Board substantial deference and latitude in the interpretation of TILA because of the "administrative expertise" required in "setting [the statutory] machinery in motion." *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 566 (1980). In *Consumers Union of U.S., Inc. v. Federal Reserve Bd.*, 938 F.2d 266, 271 (D.C. Cir. 1991), the Consumers Union challenged a series of provisions contained in the Board's regulations issued pursuant to the Home Equity Loan Consumer Protection Act of 1988. In its regulations, the Board implemented requirements related to changes in terms of open end credit that provided for exceptions in addition to those required by the statute. The Court upheld the validity of the challenged exceptions because it found the Board had reasonably interpreted the ambiguous meaning of the statute.

While courts have not yet had the opportunity to rule on the level of deference due to the CFPB's notice and comment rulemakings, as the Board's regulatory successor on TILA, we expect that courts will follow a similar approach in adjudicating the CFPB's TILA rulemakings.

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meaning of the text. *See e.g.*, *Trainmen v. Baltimore & Ohio R.R.*, 331 U.S. 519, 528 (1947). ("[Section headings] are but tools available for the resolution of a doubt. But they cannot undo or limit that which the text makes plain.").

We note, however, that courts did not give the Board unlimited authority in how it implemented statutory requirements, specifically when the implementation goes against the plain language of the statute. In the same case, the Consumers Union also challenged the Board's implementation of requirements related to teaser rates on home equity loans. Although the plain language of the Act required the disclosure of an initial discount rate, the Board chose not to require disclosure because of the difficulty of providing disclosure so early in the transaction and for other competitive considerations. Although the District Court stated that, "in light of the Board's explanation for the regulations, this is such an issue on which the Court finds it appropriate to defer to the Board under its "exception authority," *Consumers Union of U.S., Inc. v. Federal Reserve Bd.*, 736 F. Supp. 337, 342 (D.D.C. 1990), the D.C. Circuit was not convinced that the Board could contravene the plain language of the statute and remanded the issue to the Board. *Consumers Union of U.S., Inc.*, 938 F.2d at 273.

In response to the D.C. Circuit's ruling, the Board put out the teaser rate provisions for notice and comment and decided, based upon the comments received, to stay with the rule as initially proposed because the approach it had originally set forth provided the most useful information to consumers about discounted rates. The Board noted that the approach "fulfills Congress' intent to ensure that applicants know the most important features of home equity lines, and is an appropriate case for making an adjustment to the statutory provision." Home Equity Disclosure Rules, 57 Fed. Reg. 34,676 (Aug. 6, 1992). The Board went on to comment that, while it believes its "exception authority" is broad and was appropriate in these instances, it does have limits. It further stated: "The Board does not take the view that it is permitted to radically undermine the Congress' purpose in enacting key elements of a statutory scheme, even if the Board strongly disagreed with the wisdom of the Congress' decision. *The Board does believe it is authorized to fashion rules that are faithful to the essential purposes of the law and that take account of the needs and capacity of both consumers and creditors*." *Id. [emphasis added]*.

This case and the subsequent Board interpretation suggests that, so long as the CFPB avoids contravening the plain language and in this case waives or exempts provisions in accordance with the statute, courts will show substantial deference to the CFPB's interpretation so long as that interpretation is accompanied by sufficient reasoning. Therefore, to the extent the CFPB believed its authority under Section 1639b(c) was insufficient to omit the compensation restrictions where the consumer pays upfront points and fees, the CFPB's authority pursuant to 1604(a) would be sufficient so long as the omission is supported by TILA's general purpose.

b. Section 1603(5) Authority

The CFPB also has authority, pursuant to Section 1603(5) of TILA, to exempt by rule those transactions where the CFPB "determines that coverage under this subchapter is not necessary to carry out the purposes of this subchapter." 15 U.S.C. § 1603(5). It appears that the Board only once relied upon this authority to exempt transactions from a rulemaking. In its January 21, 2009 final rule to significantly reform disclosures on open-end credit the Board, in reliance on Section 1603(5), chose to exempt employer-sponsored retirement plans because those plans did not pose the risks to consumers that, for instance, credit cards pose to consumers. In addition, the Board noted that Department of Labor regulations already required certain disclosures be made that offered consumers protections. Thus, although Section 1604(a) may prove to be sufficient, the CFPB does have this additional stand-alone authority in TILA to exempt certain transactions from the statute and its implementing regulations.

3. The CFPB's Independent Rulemaking Authority Allows for Entity-Based Exemptions Under Certain Circumstances.

Although the CFPB should have sufficient flexibility to craft the loan originator rules it desires through the use of the above-mentioned exemptions, it is worth noting that the CFPB may exempt certain entities from complying with its rules. Pursuant to 12 U.S.C. § 5512, which authorizes the CFPB to write rules implementing consumer financial services laws, the CFPB may, by rule, "conditionally or unconditionally exempt any class of covered persons, service providers, or consumer financial products or services, from any provision of this title, or from any rule issued under this title, as the Bureau determines necessary or appropriate to carry out the purposes and objectives of this title." 12 U.S.C. § 5512(b)(3)(A). To do so, the CFPB must justify the exemption by taking into consideration the total assets of the class of covered persons, the volume of the transactions being exempted, and existing provisions of law are already applicable and provide consumers with adequate protections. 12 U.S.C. § 5512(b)(3)(B).

As with the exception authority in 15 U.S.C. § 1604(a) described above in Section 2 of this memorandum, the CFPB could argue that the Board rules already in existence are sufficient to provide to consumers adequate protection, and therefore that all loan originators subject to the existing rules promulgated by the Board should be exempt from the CFPB loan originator rules promulgated pursuant to the Dodd-Frank Act.

CONCLUSION

Although the Dodd Frank Act mandates that the CFPB promulgate new loan originator compensation rules, it is also clear that Congress seeks to rely upon the CFPB's expertise in balancing consumer protection and the availability of credit. To this end, Congress included in the new Section 1639b(c) language that affords the CFPB the opportunity to conduct additional analysis, and seek additional input, on the wisdom of implementing those additional requirements. In addition to this specific authority, Congress also transferred to the CFPB (as the rulemaking agency responsible for implementing TILA) the Board's former discretion to add, adjust, or in some cases subtract from, TILA's statutory requirements, so long as the variance is reasoned and in keeping with the purposes of the statute. Thus, so long as the CFPB agrees that it is not in the consumer's best interest to limit loan originators' ability to both charge discount points or origination fees and receive commission-based compensation, the CFPB has authority not to restrict upfront origination (and discount) points and fees in its final rule.