ABA Staff Analysis: Compliance Advisory: TILA-Mortgage Loan Originator Compensation Rule
December 2011

ABA is issuing this alert to ensure that member banks are fully informed of their compliance risks and responsibilities pertaining to mortgage loan transactions covered by the Truth in Lending Act (“TILA”). In recent days, officials from the Consumer Financial Protection Bureau (“CFPB”) have announced that the Bureau will not be issuing any immediate official clarifications to recently finalized TILA regulations governing compensation to mortgage loan originators (See 75 F.R. 58509, September 24, 2010) (“MLO Rule”). These announcements mean that ABA members will have to carefully review and cautiously consider a number of regulatory issues pertaining to the compensation of mortgage originators that these final rules have left unresolved and that pose legal uncertainty going forward. This Alert describes the more important regulatory difficulties raised by the absence of clarifications. We urge that banks take appropriate consultative measures with legal counsel and regulatory experts to ensure compliance and lawful operations.

We note that over the past couple of months, ABA has strongly implored that the Bureau issue clarifications on a number of issues that remain unanswered and unclear under the final MLO Rule. ABA has noted that official answers to these items are of urgent importance as these regulations were enacted pursuant to Section 129 of TILA, pertaining to unfair and abusive practices, which presents immense legal risk for all segments of the mortgage finance industry. ABA has urged that clarifications to these questions be rendered in written form, as banks cannot safely rely on informal oral advice, especially given the volumes of existing, and sometimes varying, verbal interpretations on these matters.

CFPB officials have informed ABA that they do not intend to issue clarifications within the remaining weeks of 2011. CFPB officials have communicated that they intend to clarify outstanding MLO compensation issues in comprehensive fashion via formal rulemaking only. ABA expects that such rulemaking will begin in the initial months of 2012 and will not, therefore, be finalized until several months into the calendar year. ABA is concerned about potential liabilities that may arise as banks prepare to make year-end profit-sharing contributions, and is therefore issuing this alert to notify the full membership of potential interpretive issues.

The elements described below represent the more important regulatory deficiencies that remain in this rule, and members must take appropriate steps to guard against potential liabilities in these fronts-

1. **Bonuses to MLOs:** The new MLO Rule generally prohibits that compensation paid to mortgage loan originators be based on the loan's interest rate or other terms. Through commentary and examples, the final rule further provides that compensation based on a factor that serves as a "proxy" for a transaction's terms or conditions would also be prohibited. This "proxy" concept has caused extreme confusion, however, because it has not been adequately defined, and has been subject to expansion through informal interpretations by Federal Reserve Board staff. Before the administration of TILA formally transferred to the Bureau, the Board's agency staff made several oral statements indicating that payments to mortgage loan originators based on the bank's overall profitability are prohibited by the rule. Since those pronouncements, bank examiners have taken the rigid position that all year-end bonus payments, including contributions to 401k plans, are rendered illegal if they are related to, or based upon, overall bank profit.

We note that the interpretation that bank profits serve as a "proxy" for terms and conditions is not clarified in the final rule itself, nor anywhere else through formal written form. There is no formal guidance for what constitutes "profit" or "profitability." Nor is there any clarity as to whether the rule prohibits traditional employee benefit plans that provide for profit sharing, or whether they permit originating employees to be compensated from profit centers that may exclude mortgage origination-related income.

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2. **Cross-Selling**: There are real doubts regarding the application of the MLO Rule’s compensation restrictions to ancillary compensation that may be paid in connection with a covered mortgage transaction. For instance, questions arise in instances where mortgage loan originators are paid, not on the basis of the mortgage loan’s terms or conditions, but rather on the cross-selling of other bank products. There is no clarity as to whether loan originators may be paid bonuses premised upon the sale of non-mortgage bank products—such as deposit accounts—even where such sales do not affect the price or term of the particular mortgage loan. Members should be extremely cautious in establishing such bonus programs.

3. **Definition of “Loan Originator”**: Through oral webcasts made before the administration of TILA formally transferred to the Bureau, the Federal Reserve Board staff offered the interpretation that “referrals” of mortgage business within a bank is an activity that constitutes “arranging” for the extension of consumer credit for another person. The Board staffs’ oral descriptions offered no further explanations of this interpretation. Under this verbal construction, if a bank teller submits a loan to the bank’s own mortgage division, the bank teller would be deemed to fall under the definition of a “mortgage loan originator,” and therefore be subject to the rule’s compensation restrictions. This verbal description by Board staff is exacerbated by the absence of any definition for what constitutes "referral" activity under the TILA rules. The extremely broad extension of this rule’s definitional reach creates much uncertainty as to the application of the rule’s restrictions regarding the compensation of bank tellers, managers, and any other employee that may be deemed to "refer" mortgage business.

4. **Compliance Mistakes**: In various venues, and before the administration of TILA formally transferred to the Bureau, Federal Reserve Board staff stated verbally that monetary losses for closed loans stemming from regulatory/compliance mistakes (particularly RESPA tolerance problems) cannot be deducted from a loan originator’s compensation payment. According to the oral explanation of this interpretation, deducting any costs or expenses attributable to mortgage loan originator error would amount to basing compensation on "terms or conditions." This verbal Board advice appears contrary to the written text of official commentaries the final regulations. In the final MLO rule, the official staff commentaries, at Section 226.36(d)(3), state that lenders may adjust compensation based on the "quality of the loan originator's loan files (e.g., accuracy and completeness of the loan documentation)." ABA members must take note of this apparent discrepancy.

We also remind members that ABA issued a set of "Questions and Answers" in April 2011 to assist banks in the implementation of the MLO Rules. (See [http://www.aba.com/Members+Only/Regulatory/FAQsTILALoanOriginatorCompensationRule.htm](http://www.aba.com/Members+Only/Regulatory/FAQsTILALoanOriginatorCompensationRule.htm)).

This document contains focused and detailed answers to the compliance questions that were raised by the final MLO Rule. The Q&A’s were issued in conjunction with the Mortgage Bankers Association, with the intent of ensuring consistent interpretations of the more difficult aspects of the MLO compensation regulation.

ABA will continue to advocate that clarifications to these questions be rendered immediately and in written form, as banks cannot risk the consequences that could result from existing ill-defined verbal interpretations. Until such guidance is issued, banks must assess the compliance risks stemming from these regulatory uncertainties and ensure that their exposure is minimal.

Questions? Contact ABA’s Rod J. Alba for more information.

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