



October 16, 2012

The Honorable Richard Cordray  
Director  
Consumer Financial Protection Bureau  
1700 G Street NW  
Washington, DC 20006-4702

Re: **2012 Truth in Lending Act (Regulation Z) Loan Originator Compensation (Docket No. CFPB-2012-0037, RIN3170-AA13)**

Dear Mr. Cordray:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits this comment on the proposed rules on *2012 Truth in Lending Act (Regulation Z) Loan Originator Compensation*.<sup>1</sup>

### **Advocacy Background**

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The RFA,<sup>2</sup> as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),<sup>3</sup> gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.<sup>4</sup> The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to these

<sup>1</sup> 77 Fed. Reg. 55272, September 7, 2012.

<sup>2</sup> 5 U.S.C. § 601 et seq.

<sup>3</sup> Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

<sup>4</sup> Small Business Jobs Act of 2010 (PL 111-240) § 1601.

written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.<sup>5</sup>

In July 2010, the United States Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act).<sup>6</sup> Section 1011 of the Act establishes the Consumer Financial Protection Bureau (CFPB) to supervise certain activities of financial institutions. Section 1100G, entitled “Small Business Fairness and Regulatory Transparency,” amends 5 U.S.C. § 609(d), to require the CFPB to comply with the Small Business Regulatory Enforcement Fairness Act (SBREFA) panel process, making it the third agency with this responsibility, joining EPA and OSHA.

The SBREFA panel process requires the CFPB to conduct special outreach efforts to ensure that small entity views are carefully considered prior to the issuance of a proposed rule, if the rule is expected to have a significant economic impact on a substantial number of small entities. This outreach is accomplished through the work of small business advocacy review panels, often referred to as SBREFA panels, consisting of a representative or representatives from the rulemaking agency, the Office of Management and Budget’s Office of Information and Regulatory Affairs (OIRA) and the Chief Counsel for the Office of Advocacy. The panel solicits information and advice from small entity representatives (SERs), who are individuals who represent small entities affected by the proposal. SERs help the panel better understand the ramifications of the proposed rule. The product of a SBREFA panel’s work is its panel report on the regulatory proposal under review. The CFPB convened a SBREFA panel for this rulemaking.

The Office of Advocacy performs outreach through roundtables, conference calls and other means to develop its position on important issues such as this one. Advocacy held a roundtable on this issue on September 26, 2012.

## **The Proposed Rule**

On September 7, 2012, the CFPB published in the Federal Register a proposed rule amending Regulation Z (TILA) to implement amendments to TILA made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The proposal would implement statutory changes to Regulation Z’s current loan originator compensation provisions, including a new additional restriction on the imposition of any upfront discount points, origination points, or fees on consumers under certain circumstances. In addition, the proposal implements additional requirements imposed by the Dodd-Frank Act concerning proper qualification and registration or licensing for loan originators. The proposal also implements Dodd-Frank Act restrictions on mandatory arbitration and the financing of certain credit insurance premiums. Finally, the proposal provides 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 profit-sharing plans and the appropriate analysis of payments to loan

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<sup>5</sup> Id.

<sup>6</sup> Public Law 111-203.

originators based on factors that are not terms but that may act as proxies for a transaction's terms.

### **Flat Fee**

Advocacy commends the CFPB's decision not to include the flat fee requirement in the proposed rulemaking. As noted in the proposed rule, during the SBREFA process, the SERs were presented with a provision that would ban origination points and prevent origination fees from varying based on loan size. The SERs strongly opposed this flat fee requirement at the meeting and during a subsequent conference to discuss the topic. After hearing their concerns, the CFPB did not include the flat fee requirement in the proposed rule.<sup>7</sup>

### **Recordkeeping**

The proposed rule would require creditors to create and maintain records to demonstrate their compliance with provisions that apply to the compensation paid to or received by a loan originator for three years rather than two years. The CFPB is soliciting comment on extending the period to five years.<sup>8</sup>

The participants at Advocacy's roundtable were concerned about the definition of compensation. They asserted that the definition was too broad. As such, it will be difficult to determine what is and is not compensation. They were also unclear about the requirements for maintaining records. They were also concerned that if a mistake was made on the compensation structure, all loans could be returned from secondary market. This could result in a massive buyback. The participants suggested a safe harbor to prevent one violation from poisoning an entire pool of loans.

Advocacy encourages the CFPB to clarify what is considered compensation. Advocacy also encourages the CFPB to consider a safe harbor for this provision of the rulemaking.

### **Upfront Points and Fees**

The Dodd-Frank Act prohibits consumer payment of upfront points and fees in all residential mortgage loan transactions except those where no one other than the consumer pays a loan originator compensation tied to the transaction. The CFPB is proposing to require that before a creditor or loan originator may impose discount points and origination points or fees on a consumer, the creditor must make available to the consumer a comparable, alternative loan that does not include such points or fees. If the consumer is unlikely to qualify for such a loan, making available the comparable, alternative loan would not be necessary.<sup>9</sup>

The CFPB is proposing two safe harbors for how a creditor may comply with the requirement to make available a comparable, alternative loan. In transactions that do not involve a mortgage broker, a creditor will be deemed to have made available a comparable, alternative loan to a

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<sup>7</sup> 77 Fed. Reg. 55311.

<sup>8</sup> 77 Fed. Reg. 55345.

<sup>9</sup> 77 Fed. Reg. 55345.

consumer if, any time prior to application that the creditor provides to the consumer an individualized quote for a loan that includes discount points and origination points or fees, the creditor also provides a quote for the comparable, alternative loan. In transactions that involve mortgage brokers, a creditor will be deemed to have made a comparable, alternative loan available to consumers if it provides to mortgage brokers the pricing for all of its comparable, alternative loans that do not include discount points and origination points or fees. Mortgage brokers then will provide quotes to consumers for loans that do not include discount points and origination points or fees when presenting different loan options to consumers. The requirement would not apply where the consumer is unlikely to qualify for the comparable, alternative loan.<sup>10</sup>

The CFPB is also seeking comment including whether the CFPB should adopt a "bona fide" requirement to ensure that consumers receive value in return for paying discount points and origination points or fees, and different options for structuring such a requirement; whether additional adjustments to the proposal concerning the treatment of affiliate fees would make it easier for consumers to compare offers between two or more creditors; whether to take a different approach concerning situations in which a consumer does not qualify for a comparable, alternative loan that does not include discount points and origination points or fees; and whether to require that information about a comparable, alternative loan be provided not just in connection with informal quotes, but also in advertising and at the time that consumers are provided disclosures three days after application.<sup>11</sup>

As noted in the panel report, the SERs strongly supported CFPB using its exemption authority to allow consumers to pay upfront discount points. However, they were concerned about the specific details of requirements to make these discount points bona fide. Many SERs pointed out difficulties in mandating a discount equal to a fixed percent of the interest rate for each discount point given the non-linearity of the value for each point, and some SERs recommended exploring other options for ensuring that discount points are bona fide, including basing the discount on market rates or a lender's rate sheet. SERs expressed different opinions on the requirement that lenders offer a no-discount point loan, with a sizable number stating that they already offer such a loan.<sup>12</sup>

At Advocacy's roundtable, the industry representatives stated that the zero point zero fee alternative was a bad choice that may be unrealistic for small players. They also stated putting all points and fees into interest rates may create a riskier loan. The loan could possibly conflict with the Home Ownership and Equity Protection Act requirements and, depending on the provisions, the CFPB's rulemaking for qualified mortgages. Also, the riskier the loan, the more difficult it is to sell it to the secondary market.

Furthermore, originators that also service the loans may have to impose prepayment penalties because prepayment penalties would be the only way for financial institutions to recoup upfront costs on a loan and break even on the expenditures required to originate the transaction. This is particularly problematic for credit unions because they are not allowed to charge prepayment

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<sup>10</sup> 77 Fed. Reg. 55346.

<sup>11</sup> 77 Fed. Reg. 55346.

<sup>12</sup> *Final Report of the Small Business Review Panel on CFPB's Proposals Under Consideration for Residential Mortgage Loan Origination Standards Rulemaking*, July 11, 2012, page 30.

penalties. As such, they would incur a loss. In addition, some things will not be able to be included in a zero-zero loan. As such, the originator will have to absorb the costs.

The roundtable participants were also concerned about the bona fide aspect of the proposal. The small lenders are worried that they may not have the ability to comply with that part of the proposal.

Advocacy encourages the CFPB to give full consideration to the concerns of small entities and not impose the zero points-zero fees alternative. In addition, Advocacy understands that the small entities may be working on their own alternative to reduce the economic burden of this proposal. Advocacy urges the CFPB to carefully consider the alternatives that are set forth by the industry.

### **Compensation Based on Transaction Terms**

The proposed rule also clarifies and restricts pooled compensation, profit sharing and bonus plans for loan originators, depending on certain incentives to steer consumers to different transaction terms. It would permit employers to make contributions from general profits derived from mortgage activity to 401(k) plans, employee stock option plans and other “qualified plans.” It also permits employers to pay bonuses or make contributions to non-qualified profit-sharing and retirement from general profits derived from mortgage activity, if the loan originator affected has originated five or fewer mortgage transactions in the last 12 months or if the company’s mortgage business revenues are limited. The CFPB is seeking comment on whether 25 percent or 50 percent would be the proper test for such limitation.<sup>13</sup>

During the SBREFA panel SERs outreach meeting, the SERs urged the CFPB to analyze the incentive issues arising from qualified and non-qualified plans carefully before issuing clarifications on existing regulations or proposing new regulations. SERs stated that mortgage-related revenue limits, even if set at 50 percent of company revenue, may not provide relief for many small businesses because their revenues are often derived predominately from mortgage originations. Moreover, SERs suggested that the CFPB consider relaxing the revenue test to exclude revenue derived from existing loans held in portfolio.<sup>14</sup> At the roundtable, the participants were also concerned about the definition of “revenue.”

Advocacy encourages the CFPB to provide some clarification as to the definition of revenue. Advocacy also encourages the CFPB develop a mortgage related revenue limit that reflects the unique business structure of smaller industry members and provides relief to small entities.

### **Mandatory Arbitration and Credit Insurance**

The proposed rule would prohibit agreements requiring consumers to submit any disputes that may arise to mandatory arbitration. The roundtable participants were uncertain as to why this

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<sup>13</sup> 77 Fed. Reg. 55347.

<sup>14</sup> *Final Report of the Small Business Review Panel on CFPB’s Proposals Under Consideration for Residential Mortgage Loan Origination Standards Rulemaking*, July 11, 2012, page 31.

was included in the loan originator compensation proposal. Advocacy recommends that the CFPB consider this proposal at a later date.

## **Conclusion**

Advocacy encourages the CFPB to give full consideration to the concerns of small loan originators regarding the proposed rule. There are provisions of the proposal that are potentially costly to small loan originators. Advocacy encourages the CFPB to work with small loan originators to develop a solution that reaches the agency's goals without being unduly burdensome on small entities. Advocacy is available to assist the CFPB in this task.

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943.

Sincerely,

/s/

Winslow Sargeant, Ph.D.  
Chief Counsel for Advocacy

/s/

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Cc: Boris Bershteyn, Acting Administrator, OIRA