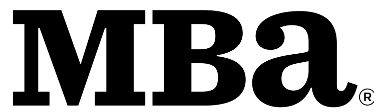

MORTGAGE BANKERS ASSOCIATION

May 1, 2023

Comment Intake
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Re: Docket No. CFPB-2023-0017
Regulation Z's Mortgage Loan Originator Rules Review Pursuant to the Regulatory Flexibility Act

To Whom it May Concern:

The Mortgage Bankers Association (MBA)[1] believes the Consumer Financial Protection Bureau (Bureau or CFPB) should make changes to the Loan Originator Compensation Rules (LO Comp Rules) to further assist consumers and reduce regulatory burden. The original impetus for the LO Comp Rules was to protect consumers from steering. While the Bureau has a statutory obligation to implement certain loan originator compensation requirements, the present rule is overly complex and does not accurately reflect the post-Dodd-Frank market realities.[2]

In the current regulatory environment, the harm associated with steering – borrowers being offered loans that reward the LO but are not necessarily in the borrower's interest – is less likely due to regulatory actions adopted following the passage of the Dodd-Frank Act, including the LO Comp Rule. For example:

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 2,100 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.
[2] *See* 15 U.S.C. 1639b(c)(3). We note that the statute as written was not workable in part and the Bureau's rules provided significant value in clarifying and reflecting the actual operation of the market. This is why the changes suggested here are limited relative to the scope of the rule and serve primarily to benefit small entities and consumers.

- The Bureau's TILA-RESPA Integrated Disclosure (TRID) rule made mortgage terms and costs easier to understand by heightening disclosure requirements.

- The SAFE Act assists in preventing bad actors from performing the duties of a mortgage loan originator by its requirements around background screening, testing, and other licensing requirements.

- The Ability-to-Repay (ATR) Rule with the Qualified Mortgage (QM) amendments to Regulation Z, Truth-in-Lending Act, has also effectively removed risky loan terms and features to which lenders might steer a borrower by imposing heavy penalties associated with originating a loan that fails to meet the basic ATR requirement.

Together, these regulations reduce the risk of steering by shielding consumers from unsuitable mortgage loan products and ensuring they are aware of the costs of credit.

Any review or "lookback" of the LO Comp Rules should be viewed holistically, taking the positive shielding effects of these other regulations into account. While these regulatory developments have reduced the risk of steering, the LO Comp Rule, in certain circumstances, actually works against consumers by placing strict limits on some practices that would result in lower costs and increased market competition. These aspects of the LO Comp rule warrant reconsideration.

One of the Bureau's core functions, as established by Congress, is "issuing rules, orders, and guidance implementing Federal consumer financial law."[3] Congress directed the Bureau to ensure, among other things, that "markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation" and that "outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens."[4] As part of its Section 610 review under the Regulatory Flexibility Act, the Bureau must also review issued rules to determine whether such rules should be changed to minimize any significant economic impact of the rules upon a substantial number of such small entities.[5] The LO Comp Rule is well-suited to this type of review, as it was implemented alongside many other rules, that as described above function to regulate many of the same or closely related issues. The benefit of experience with the current rules – obviously not available at their promulgation – argue for a small number of modest changes to the LO Comp Rules that would align the rule with market realities, better serve consumers, and help small businesses compete.

Certain aspects of this complex rule place high compliance costs on small businesses and inhibit lenders from competing based on their ability to provide consumers with the best rates and customer service. The Bureau should reconsider the following aspects of the LO Comp Rule as part of their review.

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[3] 12 U.S.C. § 5511(c)(5).
[4] 12 U.S.C. § 5511(b)(3), (5).
[5] 5 U.S.C. § 610(a).

I. The Bureau Should Encourage Price Competition by Expanding the Circumstances in Which a Loan Originator's Compensation May Be Decreased

The mortgage lending market is a complex ecosystem, and any rule can create incentives that distort that market. The current LO Comp rule creates structural advantages for some mortgage lending business models and inhibits others. Its prohibitions against competitive concessions by a loan originator artificially limit the ability of all lenders to compete to offer consumers lower-priced mortgage credit. The Bureau should allow for such concessions, which would be subject to both existing fair lending laws and the competitive pressures of a transparent market.

Encouraging price competition will help smaller lenders compete against larger lenders without upsetting the purpose of the LO Comp Rule.[6] The Bureau disconnected loan originator compensation from loan terms by adopting a general rule whereby a loan originator's compensation may not be increased or decreased once loan terms have been offered to a consumer, including *decreases* in compensation that allow the creditor to provide the consumer with a lower-priced, more affordable loan.[7] While the Bureau believed that this prohibition was necessary to prevent loan originators from pricing loans high at the outset and then selectively negotiating lower pricing, this has the unintended consequence of discouraging creditors from reducing prices for borrowers who shop multiple lenders and use that information to negotiate for the best rates and terms. In these circumstances, a lender may simply decide against making a loan if doing so is unprofitable due to the requirement to pay the loan originator full compensation for a discounted loan. This consequence is acutely felt by smaller lenders who cannot absorb this loss due to smaller economies of scale. For the consumer, the result is a more expensive loan, or the inconvenience and expense of switching lenders.

The current LO Comp Rule makes price competition unprofitable, and therefore less likely to occur. To address this unfortunate outcome, the Bureau should amend the LO Comp Rule to permit loan originators to agree with their lenders to respond to price competition by reducing their compensation. This would allow smaller lenders to accept a loan originator employee's offer to decrease a loan originator's compensation in order to compete with larger lenders that may have lower cost of funds and greater ability to absorb lower margins. Smaller lenders – indeed all lenders – should be permitted to compete for borrowers by having the option to lower loan originator compensation to meet or beat a competitor's rate. It is important to remember that fair lending concerns over possible selective application are mitigated by the same guidelines and procedures that guide fair lending compliance in all other pricing matters. This change to the LO Comp rule would significantly enhance competition in the marketplace and provide a benefit to lenders and consumers alike.

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[6] Mortgage Bankers Association, MBA's Annual Performance Report (2022 data) (April 6, 2023), available at https://www.mba.org/news-and-research/research-and-economics/single-family-research/mortgage-bankers-performance-reports-quarterly-and-annual (showing that loan origination fees are hundreds of dollars higher per loan for smaller lenders).
[7] 12 U.S.C. § 1639b(c)(1).

II. The Bureau Should Allow Changes or Claw Backs to a Loan Originator's Compensation in Order to Increase Loan Originator Accountability

The LO Comp Rule's prohibition on decreasing compensation after loan terms have been offered has another perverse result. It prevents creditors from holding their loan originators financially accountable for losses that result from clerical mistakes or intentional noncompliance with company policy or the law. Under the rule, a loan originator who is responsible for an error cannot be held accountable for that mistake at the loan level. Originators receive the same compensation regardless of whether their actions violate lender policy or cause an error – even when the mistake causes a demonstrable loss to the lender. This result runs directly contrary to a central premise of the Dodd-Frank Act amendments to TILA that led to the LO Comp rule – compensation at the loan level is the most effective way to incentivize loan originator behavior.

Lenders, and smaller lenders in particular, are harmed by the cost associated with the inability to tie compensation to the quality of a loan originator's work on a given loan. If a loan originator makes an error, the lender is effectively left with two options: fire the loan originator or pay them full commission despite the error. This binary choice does not serve the interests of consumers, lenders, or loan originators. This prohibition restricts the creditor's ability to manage its employees and to disincentivize future errors. Greater accountability on the part of loan originators will incentivize them to reduce errors and consistently comply with regulatory requirements and company policy, leading to a safer and more transparent market for consumers. As it stands, smaller lenders with tighter profit margins are less able to absorb the costs of mistakes than larger lenders.

The Bureau should allow reductions in compensation in response to originator clerical errors to incentivize compliance with TILA and other consumer protection regulations and allow smaller lenders to mitigate any associated losses consistent with federal and state employment and wage requirements. Additionally, in the context of fraud, misconduct, or early payment defaults and payoffs, lenders should be able to claw back LO compensation from the LO. Incentivizing good market behavior is clearly a beneficial result for consumers and will result in lower costs.

III. The Bureau Should Provide an Alternative Path to Compliance for Certain Loan Types

The LO Comp rule is understood to forbid varying compensation for different loan types or products. These restrictions should be lifted for certain loan types, including bond loans, construction loans, Special Purpose Credit Program (SPCP) loans, Down Payment Assistance (DPA) Loans, and assumptions, which provide a public good and allow smaller lenders to offer niche products.

A. Housing Finance Agency Loans

Housing Finance Agencies (HFAs) are state- and local government-run agencies that provide favorable terms on loans to low- and moderate-income prospective borrowers.

These loans are also referred to as “bond loans” because they are sometimes funded by state bond issuances or made with other forms of public backing. HFA programs are particularly important for families who are often underserved or face affordability constraints under market interest rates and terms. These programs provide participants with much-needed lower interest rates or access to down payment assistance in tandem with housing counseling and financial education, encouraging responsible homeownership in a well-regulated manner.

The assistance provided through these programs is not without costs. Robust underwriting, tax law-related paperwork, yield restrictions, and other program requirements make HFA loans more expensive to produce. HFAs also frequently cap lender compensation at levels below what a lender typically receives on a non-HFA loan. Covering these expenses is particularly difficult given that many HFA programs include limits on the interest rates, permissible compensation, and other fees that may be charged to borrowers. Prior to the LO Comp rule, lenders would address this challenge by paying loan originators a smaller commission for an HFA loan than for a non-HFA loan. The inability to do so today reduces the ability of companies to offer HFA loans, particularly when producing these loans results in a loss.

In the first revision to the initial ATR rule, which was adopted before the rule became effective, the Bureau added an exemption from the rule for “[a]n extension of credit made pursuant to a program administered by a Housing Finance Agency, as defined under 24 C.F.R. 266.5.”[8] In the preamble to the final rule the Bureau addressed how HFA loan programs assist low- to moderate-income (LMI) borrowers in becoming homeowners, and stated “the Bureau believes that it is appropriate to exempt credit extended pursuant to an HFA program from the ability-to-repay requirements. The comments received confirm that HFA programs generally employ underwriting requirements that are uniquely tailored to meet the needs of LMI consumers, such that applying the more generalized statutory ability-to-repay requirements would provide little or no net benefit to consumers and instead could be unnecessarily burdensome by diverting the focus of HFAs and their private creditor partners from mission activities to managing compliance and legal risk from two overlapping sets of underwriting requirements. Additionally, in practice, HFA loans are treated as a separate product stream from other loans. The Bureau is concerned that absent an exemption, this diversion of resources would significantly reduce access to responsible mortgage credit for many LMI borrowers.”[9]

Significantly, the Bureau also stated, “[t]he exemption adopted by the Bureau is limited to creditors or transactions with certain characteristics and qualifications that ensure consumers are offered responsible, affordable credit on reasonably repayable terms. The Bureau thus finds that coverage under the ability-to-repay requirements provides little if any

[8] 78 Fed. Reg. 35430, 35502, Amendments to the 2013 Mortgage Rules Under the Equal Credit Opportunity Act (Regulation B), Real Estate Settlement Procedures Act (Regulation X), and the Truth in Lending Act (Regulation Z) (Oct. 1, 2013) (adding Regulation Z section 1026.43(a)(3)(iv)).
[9] *Id.*, at 35462.

meaningful benefit to consumers in the form of useful protection, given the nature of the credit extended through HFAs."[10]

Thus, in the context of the ATR Rule, the Bureau was motivated in part by the significant protections for borrowers under HFA loan programs. However, the goals of the CFPB in adopting the exemption are frustrated by the lack of ability of lenders to compensate their originators at lower levels in connection with HFA loans. The combination of pricing restrictions under HFA program loans and the inability of lenders to pay lower loan originator compensation in connection with such loans creates a strong disincentive to originate such loans and, thus, creates an access to credit concern for LMI borrowers.

B. Construction Loans

For construction loans that are originated with two closings, it is inordinately expensive to compensate a loan originator the same amount on two loans within the construction period, which is typically nine months to one year. Many lenders have addressed these issues by allowing only a certain sub-set of loan originators to originate construction to permanent loans. This is another area where the LO Comp Rule has had a substantial and significant impact on the hiring and operational structures of mortgage lenders. While larger lenders may be able to hire, train and retain such specialized and limited loan originators, it is difficult for smaller lenders to do so.

Construction loans are crucial for borrowers seeking to live in underserved rural areas who often face issues with the lack of availability and affordability of starter homes. The Bureau recognized this reality when they announced the testing of an alternative mortgage disclosure for construction loans under its Trial Disclosure Programs.[11] Smaller lenders that operate in predominantly rural areas would benefit from this change because of the decreased cost of origination. Allowing this exception to the LO Comp rule will help underserved rural borrowers.

C. SPCP, DPA Loans, and Assumptions

SPCP and DPA programs directly benefit low- and moderate-income borrowers and should be encouraged by the Bureau. Currently, SPCP loans can be significantly less profitable than a typical loan because of the added compliance costs and lower average loan balance and other lender contributions to reduce cost burdens to the consumer. Allowing an exemption for these types of loans to the LO Comp rule would allow firms to encourage these types of loans among LOs. The change would also help make these loans profitable for smaller lenders by reducing the cost of LO compensation. This would further the purpose of SPCPs. The Bureau issued an advisory opinion to encourage these programs "in the hope that broader creation of special purpose credit programs by creditors will help expand access to credit among disadvantaged groups and will better address special social

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[10] *Id.*, at 35462.

[11] Consumer Financial Protection Bureau, Seeking Public Input: New Proposal for Alternative Mortgage Disclosures for Construction Loans (Feb. 27, 2023), available at https://www.consumerfinance.gov/about-us/blog/new-proposal-for-alternative-mortgage-disclosures-for-construction-loans/.

needs that exist today."[12] Allowing an LO Comp exemption for both types of loans will further the Bureau's stated goal.

The Bureau should also allow differing LO compensation for assumptions, either through a regulatory change or guidance making clear this is acceptable. Both the Federal Housing Administration and the Department of Veterans Affair place a cap on the fees lenders can charge borrowers for assumptions. Allowing LOs to work with lenders to lower loan originator compensation will help make assumptions profitable. Assumptions allow prospective borrowers to take over affordable mortgages which usually have a smaller balance and lower interest rate. These loans provide borrowers with affordable mortgages in a rising-rate environment and should be encouraged by the Bureau.

The LO Comp Rule as currently interpreted by the Bureau reduces competition for these loans.[13] The Bureau should increase access to loans primarily designed to serve low to moderate-income borrowers, or underserved borrowers in rural areas. Allowing variable compensation for these loans will make them profitable for smaller lenders and encourage their offering to the borrowers who most need affordable loans. Borrowers would benefit from increased access to beneficial products.

IV. The Bureau Should Narrow the Definition of Loan Originator

As currently written, the LO Comp Rule applies to any person that "[r]efer[s] a consumer to any person who participates in the origination process as a loan originator."[14] The LO Comp Rule exempts certain activities from the definition of a referral, but this exemption hinges upon whether the referral is "based on his or her assessment of the consumer's financial characteristics[.]"[15]

This distinction is unreasonably vague and nearly impossible to implement in practice. It should be revised. A number of financial industry participants may be captured by this definition of "loan originator" even though they clearly do not engage in the actual origination of mortgage loans and do not pose steering risk. For example, a bank teller that simply refers a bank customer to a loan originator in his or her branch office may be deemed a loan originator because the teller could have some knowledge of the customer's financial characteristics. Similarly, a financial advisor may, to serve the interests of his or her client, refer that client to a loan originator as a professional courtesy. Although neither the teller nor the financial advisor is a loan originator by any reasonable definition, the simple act of referring a client to a loan originator could subject them to the LO Comp Rule's restrictions. To clarify these possible interpretations, the definition of "loan originator" should be more closely aligned with the SAFE Act definition.

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[12] 86 Fed. Reg. 3762, 2763 Equal Credit Opportunity (Regulation B); Special Purpose Credit Programs (Jan. 15, 2021).
[13] See section 2.6.1 of the Bureau's June 2021 Supervisory Highlights Issue 24, Summer 2021, pg. 26.
[14] Regulation Z, comment 36(a)-1.i.A.1.
[15] Regulation Z, comment 36(a)-4.ii.B.

V. The Bureau Should Provide Clear Guidance with Respect to Permissible Practices

The Bureau is to be commended for providing several safe harbors that use compensation to incentivize loan originators to do their jobs well in a way that positively impacts consumers.[16] However, different interpretations of these guidelines have led to confusion in the market and, unfortunately, may lead some lenders to compete based on a willingness to accept compliance risk in some circumstances. To avoid this, the Bureau should release guidance clarifying the permissibility of several compensation practices that are present in the market but not expressly granted a safe harbor by the LO Comp Rule. Specifically, the Bureau should amend Regulation Z to address the following practices:

- Permissible factors: The Bureau should provide additional guidance on the factors that the Bureau does or does not consider to be permissible bases for compensation, particularly loan purpose (e.g., purchase versus refinance; reverse mortgage vs. “forward” mortgages), lead source (e.g., “self-generated” by a loan originator versus “company generated” by the creditor and then assigned to a loan originator), and origination channel (e.g., “banked” when a creditor makes a loan originated by its employee or “brokered” when a creditor’s loan originator takes the application but the loan is sent to another creditor).

- Non-Deferred Profit-Based Compensation Plans: The Bureau should relax the restrictions on non-deferred profit-based compensation plans. Currently, these compensation plans are only allowed if the individual loan originator is not paid directly or indirectly based on the terms of that individual loan originator's transactions and if the compensation paid does not exceed ten percent of the individual loan originator's total compensation.[17] As it stands, smaller community banks offer multiple product lines, often with the same personnel due to their size. The limits and difficulty determining how to segregate profits from different revenue streams make it difficult for these institutions to offer bonus compensation. This limit harms smaller community banks who are seeking to offer compensation to LOs to attract talent or want to provide bonuses to staff that originate other products or provide multiple, non-loan-origination profitable services.

- Closing Disclosure Penalties: The Bureau should reconsider the penalties attached to the requirement that LOs put their name and NMLS number on closing disclosures. This requirement can create compliance challenges for lenders and can lead to severe penalties for what are typically minor technical errors. Currently, a borrower can bring a private right of action against the lender for enhanced damages up to $12,000 plus fees.[18] This requirement is unique in that there is no private right

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[16] Regulation Z, comment 36(d)(1)-2.i.
[17] 12 C.F.R. § 1026.36(d)(1)(iv).
[18] 15 U.S.C. §§ 1639b(d), 1640(a).

of action for any other information in the closing disclosure. The Bureau should consider publishing guidance that that makes it clear that the requirement to disclose the information does not arise out of Section 1402 of Dodd-Frank.[19] This would eliminate the harsh penalties, allow consumers to access the information, and lower manufacturing costs for loans as it would eliminate expensive due diligence costs or inability to sell loans with a minor and unimportant defect.

- Team arrangements: The Bureau should clarify that the prohibition on "pooled compensation"[20] does not prevent the common practice of loan originators working together as a team. The Bureau should also clarify that the reference to "loan originators who originate transactions with different terms and are compensated differently" refers to loan originators using different rate sheets and receiving different commission percentages.

- Reassigning applications: While allowing for competitive concessions is the most straightforward and efficient way to encourage greater competition, there is guidance the Bureau could immediately issue that would allow for this while considering further rulemaking. The Bureau could clarify that, if paying the predetermined fixed commission to the loan originator who took the application would prevent the creditor from lowering its price to match or beat a competitor's price, the creditor is permitted to generate a pricing concession for the borrower by reassigning the application to a different loan originator who will receive a lower fixed commission for that loan. This would benefit the consumer by lowering the price of the loan while allowing the creditor to reduce its costs accordingly.

- Simultaneous seconds: The Bureau should clarify that it is permissible to treat a simultaneous first mortgage and an accompanying subordinate second mortgage as one "unit" for compensation purposes. Under the current LO Comp Rule, lien position is a term of the transaction and therefore it appears that fixed-rate subordinate seconds should be treated the same as first mortgages. In cases where loan originators receive a payment that is fixed in advance for every loan the originator arranges for the creditor, or where loan originators receive percentage-based compensation subject to a per loan minimum dollar amount of compensation, this provides a loan originator with a powerful incentive to double his or her income by steering consumers to a transaction with a simultaneous second, even if a single loan is in the consumer's best interest.

[19] 12 C.F.R. § 1026.36 (defining loan documents to include the disclosed information, thus making a violation of this rule actionable for statutory penalties).
[20] Regulation Z, comment 36(d)(1)-2.iii.

MBA greatly appreciates the opportunity to comment on this review of the LO Comp Rule. Should you have questions or wish to discuss this issue further, please contact Justin Wiseman at jwiseman@mba.org.

Sincerely,

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Residential Policy and Strategic Industry Engagement
Mortgage Bankers Association