COMMENTS
to the
Consumer Financial Protection Bureau

on

12 CFR Part 1026
[Docket No. CFPB-2013-0002]
RIN 3170-AA34
78 Fed. Reg. 6622
Truth in Lending Act – Regulation Z
Ability to Repay Standards under the Truth-in-Lending Act

by the
National Consumer Law Center,
on behalf of its low income clients,

and the

National Association of Consumer Advocates

February 25, 2013

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The **National Consumer Law Center**[1] ("NCLC") submits the following comments, on behalf of its low-income clients, and the **National Association of Consumer Advocates**.[2] These comments address the Bureau's loan originator compensation proposal, as it relates to counting points and fees, and other aspects of the qualified mortgage rule.

We appreciate the opportunity to comment on these important and technical issues. The Bureau's decisions will have long-lasting and far-reaching impacts on mortgage markets, individual homeowners, and the health of communities across the country.

We strongly urge the Bureau to adopt Alternative 1 (the additive approach) for interpreting the definition of points-and-fees. Alternative 1 should be applied to all loan originator compensation paid, whether paid to brokers or in-house loan officers. Alternative 1 reflects congressional intent and best constrains abusive pricing in the mortgage market. None of the arguments advanced against the inclusion of all loan originator compensation are new; they were all considered and rejected by Congress less than three years ago. Including all loan originator compensation as points and fees is a necessary complement to other statutory protections.

We cannot discern any legal authority supporting the adoption of Alternative 2. Alternative 2 is contrary to Congress's clear direction and would undermine other important protections adopted by Congress in the Dodd-Frank Act. Moreover, Congress has repeatedly made clear that the Bureau does not have authority to create exceptions to the definition of HOEPA loans or their disclosure.[3] Therefore, the Bureau would overstep its legal authority if it applied Alternative 2 to all loans, including HOEPA loans. The Bureau may only adopt Alternative 2 if it restructures the recently issued Qualified Mortgage regulations and decouples rules applicable to HOEPA loans from those applicable to all other loans. Of course, providing for two different sets of definitions for points and fees would only increase complexity and decrease transparency, further undermining the advances of Dodd-Frank. Fundamentally, Alternative 2, if adopted for any loans, will represent a step backward.

We also ask the Bureau to narrowly define the other proposed exemptions to the QM standards. While we believe some exemptions for non-profit and small portfolio lenders may be appropriate,

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[1] The **National Consumer Law Center®** (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including *Mortgage Lending, Truth in Lending,* and *Foreclosures*. These comments are written by NCLC attorneys Alys Cohen, Andrew Pizor, Margot Saunders, and Diane E. Thompson. These authors have for many years provided assistance to attorneys and housing counselors helping consumers with problem mortgages across the country. These comments are based on these efforts as well as our knowledge and expertise in Truth in Lending, the mortgage market, and consumer law in general.

[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[3] *See* 15 USC §1604 (a), (f) (withholding exemption authority from HOEPA loans); 15 U.S.C. § 1639(p)(1) (providing for exemptions of "specific mortgage products . . . from any or all of the prohibitions specified in subsections (c) through (i)," not including the disclosures provided for in 15 U.S.C. § 1639(a), or the prohibitions contained in 15 U.S.C. § 1639(j)-(m)). *See generally* III.B., *infra.*

we remain concerned about abusive practices in these markets. We have also seen too many abusive refinancings guaranteed by federal agencies or by government-sponsored entities to be comfortable with the blanket exclusion from the QM standards proposed by the Bureau.

Last, we ask the Bureau to clarify its final rule regarding the manufactured-home retailer exception to the definition of loan originator.

I. The History of Abuse in Loan Originator Compensation and Fees Paid to Affiliates Shows the Need for Regulation

A. Loan Originator Compensation Has Been a Leading Cause of Market Distortions and Abuse

Loan originator compensation has been one of the leading causes of distortions in the marketplace. It will continue to be a leading cause of abuse and distortion if the Bureau fails to adhere to the statutory mandate.

Loan originator compensation structures currently place little-to-no value on affordability or sustainability. Every form of loan originator compensation (other than a salary or hourly wage), whether creditor-paid or consumer-paid, wholesale or retail, gives the originator an incentive to make loans, without regard to the amount of work a loan originator performs or the value provided to the borrower.[4] Creditors have structured these incentives to promote the types of loans that are most profitable to them in the short-term. This leads originators—both wholesale and retail—to steer borrowers to loans that profit the creditor, without regard for borrowers' well-being, the long-term safety and soundness of creditors, or the stability of the economy in general.[5] Creditor-paid loan originator compensation, in particular, has been the least transparent, the most susceptible to creditor manipulation, and the most destructive form of loan originator compensation, whether paid to a broker or a loan officer.

The problems with creditor-paid mortgage broker compensation have been well documented.[6] Loans originated by brokers, compared to loans originated directly by lenders, are more likely to default,[7] more likely to be adjustable rate mortgages, more likely to be stated-income loans,[8] and

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[4] *See, e.g.,* Jack Guttentag, Wharton Financial Institutions Center, *Another View of Predatory Lending* 7/-/12 (Working Paper No. 01-23-B Aug. 21, 2000) (reporting on a survey of mortgage brokers showing no correlation between effort as measured by time expended and payment; brokers largely compensated based on size of loan).

[5] *See, e.g.*, McClelland v. Family Dwellings, L.L.C. (*In re* McClelland), 2008 WL 5157685 (Bankr. W.D. Mo. June 20, 2008) (recounting expert testimony that "the only reason" the broker "would have arranged" for loan at higher cost than homebuyer was eligible for was that it was more profitable for broker to do so).

[6] *See, e.g.*, Howell E. Jackson & Laurie Burlingame, Kickbacks or Compensation: The Case of Yield Spread Premiums, 12 Stan. J. L. Bus. & Fin. 289 (2007); Susan E. Woodward and Robert E. Hall, Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory & Mortgage-Market Evidence, 102 American Econ. Rev. 3249 (Dec. 2012), *available at* www.stanford.edu/~rehall/DiagnosingConsumerConfusionJune2012.

[7] William P. Alexander, Scott D. Grimshaw, Grant R. McQueen, & Barrett A. Slade, Some Loans Are More Equal Than Others: Third-Party Originations and Defaults in the Subprime Mortgage Industry, 30 Real Est. Econ. 667 (2002).

[8] Edward Golding, Richard K. Green & Douglas A. McManus, Imperfect Information and the Housing Finance Crisis 10 (Feb. 1, 2008), *available at* www.knowledgeplex.org/showdoc.html?id=1457741. Stated-income loan will still be widely permitted under the exceptions for refinanced loans.

more likely to be based on fraud.[9] Broker-originated loans, at least in the subprime market, are usually more expensive for borrowers than lender-originated loans.[10] Despite the evidence that too many brokers put themselves ahead of their customers' best interest,[11] many consumers trust brokers and rely on them.[12]

But, while brokered loans are the most vivid example of the problems caused by unregulated compensation practices, retail loans—originated by creditor employees—are often no better and can be just as dangerous for borrowers.[13]

B. Creditor-Paid Loan Originator Compensation Has Contributed to Racially Disparate Pricing By Both Retail and Wholesale Lenders

Incentive compensation has led to racial discrimination by both retail and wholesale loan originators.

- African-Americans and Hispanics have been particularly overcharged by brokers.[14] Latinos and African Americans pay even more for loans originated through brokers than whites pay and are more likely to be overcharged for brokered loans than loans originated directly by the lender without a broker.[15]

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[9] BasePoint Analytics, White Paper: Broker-Facilitated Fraud—The Impact on Mortgage Lenders 2 (2006-2007) ("[T]he most serious mortgage fraud risk is broker-facilitated fraud.").

[10] *See* Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 2-24 - 2-43 (2008) (reviewing the literature); Keith Ernst, Debbie Bocian & Wei Li, Ctr. for Responsible Lending, Steered Wrong: Brokers, Borrowers, and Subprime Loans (2008), *available at* www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-l-oans.html (borrowers in the subprime market pay more when there is a broker); *cf.* Susan Woodward, *A Study of Closing Costs on FHA Mortgages,* U.S. Department of Housing and Urban Development, Office of Policy Development and Research. (2008), *available at* www.urban.org/UploadedPDF/411682_fha_mortgages.pdf (reporting data showing that borrowers on FHA loans pay more in interest, broker fees, and other closing costs when the broker is paid both by the borrower and the lender, as most brokers in the subprime market are).

[11] See, e.g., S. Rep. No. 251, 110th Cong., 1st Sess. at 80 (Dec. 18, 2007) ("Mortgage brokers are salesmen who want to maximize their net income. Their interest in providing the least expensive mortgage is limited. In fact, lenders provide them incentives to do the opposite."); McClelland v. Family Dwellings, L.L.C. (In re McClelland), 2008 WL 5157685 (Bankr. W.D. Mo. June 20, 2008) (recounting expert testimony that "the only reason" the broker "would have arranged" for loan at higher cost than homebuyer was eligible for was that it was more profitable for broker to do so).

[12] *See, e.g.,* Loan Originator Compensation & Steering, 75 Fed. Reg. 58509, 58511 (Sept. 24, 2010); Kellie K. Kim-Sung & Sharon Hermanson, Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans, Data Digest No. 83, 3 (AARP Public Policy Inst., Jan. 2003), *available at* http://assets.aarp.org/rgcenter/post-import/dd83_loans.pdf.

[13] *See Wall Street and the Financial Crisis: The Role of High Risk Home Loans: Hearing Before the Subcomm. on Investigations of S. Comm. on Homeland Security and Governmental Affairs*, 111th Cong. 2d Sess. 5 (2010) (memorandum by Sen. Carl Levin, Chair, & Sen. Tom Coburn, Ranking Minority Member) (discussing Washington Mutual's compensation of in-house loan originators; noting compensation increased the more over-priced the loan was compared to the borrower's credit score.).

[14] Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 Stan. J.L. Bus. & Fin. 289, 350 (2007).

[15] *See* Robert B. Avery, Kenneth P. Brevoort, & Glenn B. Canner, *Higher Priced Home Lending and the 2005 HMDA Data*, Fed. Reserve Bull. A123, A157/-/A158 (2006), *available at* www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf (pricing disparities between whites and minorities highest for broker originated loans); Robert B. Avery & Glenn B. Canner, *New Information Reported Under HMDA and Its*

- In a study of subprime lending in four cities in California, twenty-five percent of borrowers took out loans from a subsidiary or affiliate of a regulated financial institution, yet none were referred to the prime lender for lower-cost loans, even though most of the surveyed homeowners self-reported their credit as good or excellent.[16]

- In 2011, the U.S. Department of Justice settled a case against Countrywide (for many years, one of the largest retail lenders in the nation). Countrywide allowed its in-house loan originators and mortgage brokers to discriminate against over 200,000 Latino and African-Americans families by charging them higher fees than white borrowers or steering them to subprime loans even when they qualified for prime loans.[17] In Illinois, for example, African-American families making $100,000 a year were more likely to receive subprime loans than white families making $35,000 annually.[18]

- More recently, the Department of Justice settled a similar case against Wells Fargo, the largest residential mortgage lender in the United States. Wells Fargo discriminated against African-American and Latino borrowers in both wholesale and retail lending—steering borrowers who were qualified for prime loans into subprime loans.[19]

The mechanics and extent of lender-paid originator compensation reach beyond simply overcharging African-American and Latino borrowers. Lenders use compensation incentives to lock African-Americans and Latinos into downwardly mobile borrowing and destructive products. For example, lender payments to originators have often been conditioned on the borrower's acceptance of a prepayment penalty.[20] Prepayment penalties in these circumstances were seldom chosen by the borrower or in the borrowers' interest.[21] While Dodd-Frank's explicit limitations on

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Application in Fair Lending Enforcement, Fed. Reserve Bulletin 344, 380, 394 (Summer 2005), *available at* www.federalreserve.gov/pubs/bulletin/2005/3-05/hmda.pdf (same); Press Release, Office of the New York State Attorney General, Countrywide Agrees to New Measures to Combat Racial and Ethnic Disparities in Mortgage Loan Pricing (Dec. 5, 2006), *available at* www.oag.state.ny.us/press/2006/dec/dec05a_06.html (pricing disparities between whites and minorities highest for broker originated loans); *cf.* Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. for Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 21/-/23 (May 31, 2006), *available at* www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (discussing evidence and analysis that links pricing disparities with broker activity and incentives).

16 Kevin Stein & Margaret Libby, California Reinvestment Committee, Stolen Wealth: Inequities in California's Subprime Mortgage Market 41, 47, 50 (Dec. 2001).

17 *See* U.S. Dep't of Justice, Press Release, Justice Department Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation (Dec. 21, 2011), available at www.justice.gov/opa/pr/2011/December/11-ag-1694.html.

18 *See* Nat'l Fair Hous. Alliance, Press Release, National Fair Housing Alliance Applauds DOJ's Fair Lending Settlement with Countrywide (Dec. 22, 2011), *available at* www.nationalfairhousing.org/Portals/33/NFHA%20Press%20Release%20on%20Countrywide-US%20Lawsuit.pdf.

19 *See* U.S. Dep't of Justice, Press Release, Justice Department Reaches Settlement with Wells Fargo Resulting in More Than $175 Million in Relief for Homeowners to Resolve Fair Lending Claims (July 12, 2012), *available at* www.justice.gov/opa/pr/2012/July/12-dag-869.html.

20 *See* Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. For Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 21 (May 31, 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (noting that payment of yield spread premiums is often conditioned on the imposition of a prepayment penalty).

21 Loans with prepayment penalties attached have higher rates of foreclosure, and in brokered loans, borrowers generally receive no interest rate reduction in exchange for the imposition of the prepayment penalty. *See, e.g.,* Morgan J. Rose, Predatory Lending Practices and Subprime Foreclosures – Distinguishing Impacts by Loan Category 45 (Dec. 2006), *available at*

prepayment penalties should hinder this particular abusive practice,[22] creative lenders will continue to be motivated to find ways to achieve the same ends.

Lender-paid originator compensation created the incentives that have driven much of the racially disparate pricing.[23] By encouraging loan originators to overprice loans where and when they can, lenders implicitly encouraged originators to target the vulnerable, the gullible, and those perceived as being so. Loan originators, whether wholesale brokers or retail bank employees, encourage borrowers to trust them. This leaves consumers exposed for exploitation by loan originators incentivized to look for the unsophisticated or inexperienced borrower.

Recent reporting that the Bureau is pursuing banks for participating in similar, racially-disparate upcharges[24] suggests that the Bureau understands this dynamic.

C. Dual Compensation Costs Borrowers More

Dual compensation—payments to loan originators from both the homeowner and the creditor in the same transaction—results in inflated closing costs and consumer confusion. Only when closing costs are all borrower-paid or all creditor-paid is pricing be transparent and subject to competitive market pressures. As the Federal Reserve Board noted when issuing its loan originator compensation rule, dual payments act to conceal the lender-paid compensation.[25] Worse, as HUD

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http://www.chicagofed.org/cedric/2007_res_con_papers/car_62_morgan_j_rose_foreclosures_draft.pdf (prepayment penalties and balloon notes combined on a fixed rate refinance subprime loan increase the rate of foreclosure 227%); Ellen Schloemer, Wei Li, Keith Ernst & Kathleen Keest, Ctr. For Responsible Lending, Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners 21 (Dec. 2006), *available at* http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf (higher risk for foreclosure for adjustable rate loans, loans with balloon payments, loans with prepayment penalties, and limited documentation); Gregory Elliehausen, Michael E. Staten & Jevgenijs Steinbuks, *The Effect of Prepayment Penalties on the Pricing of Subprime Mortgages* 15 (Sept. 2006), *available at* http://www.chicagofed.org/cedric/2007_res_con_papers/car_79_elliehausen_staten_steinbuks_preliminary.pdf. (finding that prepayment penalties were associated with higher interest rates unless they controlled for "borrower income, property value, loan amount, whether the loan was originated by a broker, and type of interest rate," in which case the difference shrank); s*ee also* Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. For Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 3-4 (May 31, 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (the presence of a prepayment penalty increased the likelihood that African Americans had a higher cost subprime loan as compared to whites).

[22] *See* 15 U.S.C. § 1602(bb)(1)(A)(iii) (defining a high-cost mortgage to include one with certain prepayment penalties); 15 U.S.C. § 1602(bb)(4)(F) (including certain prepayment penalties in the points and fees test); 15 U.S.C. § 1639c(c) (limiting prepayment penalties within and without the defined sphere of qualified mortgages).

[23] Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. For Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 21-23 (May 31, 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (discussing evidence and analysis that links pricing disparities with broker activity and incentives); *see also* Press Release, Office of the New York State Attorney General, Countrywide Agrees to New Measures to Combat Racial and Ethnic Disparities in Mortgage Loan Pricing (Dec. 5, 2006), *available at* http://www.oag.state.ny.us/press/2006/dec/dec05a_06.html (pricing disparities between whites and minorities highest for broker originated loans).

24 Carla Main, *CFPB-Autos, Ranking Assets, Structured Notes: Compliance,* Bloomberg (Feb. 22, 2013), http://www.bloomberg.com/news/2013-02-22/cfpb-autos-ranking-assets-structured-notes-compliance.html**.**

[25] 74 Fed. Reg. 43,232, 43,282 (Aug. 26, 2009).

has described, lender-paid broker compensation often leads to higher settlement costs and higher broker costs, as well as higher interest rate costs.[26]

In most circumstances, borrowers receive little benefit from lender-paid broker compensation. While the borrower may have some reduction in upfront costs for broker compensation and settlement costs when there is lender-paid broker compensation, such reduction is seldom one-for-one and is often as low as twenty-five cents for every dollar of lender-paid broker compensation.[27]

D. Fees Paid to Affiliates Are Often Inflated and Abusive

Fees from affiliates continue to form a significant part of creditor profits. They are completely opaque to consumers. When consumers shop for a mortgage, they focus on the interest rate and monthly payment—not the closing costs. As a result, consumers seldom question the choice of the title insurer or the cost of other closing services. Closing costs are a profit center for lenders—especially when they can direct business to their affiliates.

Title insurance, in particular, illustrates price gouging involving affiliates.[28] Title insurance pricing increases with the size of the loan, even though the work does not increase, and the risk (due to the widespread use of exclusions from coverage) only increases marginally. Where the creditor's affiliate writes the title insurance, the incentives for the creditor to increase the size of the loan arbitrarily are multiplied.

The lender and the homeowner's interests further diverge in refinancing transactions. In many cases, homeowners in a refinancing transaction can get a discounted rate on the title policy, a re-issue rate, to reflect that the work of examining the title has largely already been done. Unsurprisingly, homeowners refinancing their homes often do not receive the benefit of this lower re-issue rate, but are charged the higher rate.[29] Lenders whose affiliates write the title insurance

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[26] Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 2-24 - 2-43 (2008).

[27] Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 Stan. J.L. Bus. & Fin. 289, T. 6 (2007) (average borrowers' fees reduced by 25 cents for every dollar the broker paid through a yield spread premium, compared to loans without a yield spread premium); *cf.* Keith Ernst, Debbie Bocian & Wei Li, Ctr. for Responsible Lending, Steered Wrong: Brokers, Borrowers, and Subprime Loans 30 (2008), http://www.responsiblelending.org/pdfs/steered-wrong-brokers-borrowers-and-subprime-loans.pdf (borrowers with FICO scores of 640 and below pay, on average, $3146 more over four years for every $100,000 borrowed, or roughly an additional 3% of the loan amount).

[28] *See, e.g.,* Florida Office of Insurance Regulation, An Analysis of Florida's Title Insurance Market: Three Studies that Provide a Comprehensive, Multi-Faceted Review of the Florida Title Insurance Industry (July 2006), *available at* http://www.floir.com/siteDocuments/FLTitleInsMkt.pdf; Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 2-24 to 2-43 (2008); Susan Woodward, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, A Study of Closing Costs on FHA Mortgages (2008), *available at* www.urban.org/UploadedPDF/411682_fha_mortgages.pdf.

[29] *See, e.g.,* Fields v. Option One Mortg. Corp., 2008 WL 2553030 (3d Cir. June 27, 2008); Chiles v. Ameriquest Mortg. Co., 551 F. Supp. 2d 393 (E.D. Pa. 2008); Madera v. Ameriquest Mortg. Co. (*In re* Madera), 388 B.R. 586 (E.D. Pa. Nov. 8, 2008); Davis v. Deutsche Bank Nat'l Trust, 2007 WL 3342398 (E.D. Pa. Nov. 8, 2007); Escher v. Decision One Mortg. Co. (*In re* Escher), 369 B.R. 862 (Bankr. E.D. Pa. 2007); Glauser v. Deutsche Bank Nat'l Trust Co. (*In re*

have an active incentive to ignore the homeowner's entitlement to the lower reissue rate. Such price gouging is unlikely to be detected by the average homeowner.

Most commentators would agree that inflated loans contributed directly to the current economic crisis. Including payments to affiliates in the points-and-fees test, as long mandated by the statute for HOEPA loans and now mandated for all loans in the QM definition, places some downward pressure on the excessive payments to affiliates.

E. Consumers Cannot Protect Themselves from These Practices

Effective, substantive regulations are necessary because consumers are rarely able to protect themselves from these practices. Disclosure alone has proven inadequate.[30] Comparison shopping is often defeated by reverse competition. Compensation structures and relationships with affiliates are opaque. Even the amount or existence of originator compensation in a transaction can be lawfully concealed.[31] Federal Reserve Board testing has proven that homeowners trust their brokers, even when they are explicitly told that the broker's interests are not those of the homeowner.[32] All these factors mean loan-originator compensation practices prevent homeowners from getting a fair deal.

II. The Bureau's Rulemaking Has Already Eroded the Limitations on Abusive Loan Originator Compensation Congress Enacted in Dodd-Frank

A. Congress Acted to Protect Homeowners from Abuse

The Dodd-Frank Act took several significant steps towards reducing the negative influence of loan originator compensation: forbidding steering based on loan terms; banning dual compensation; and requiring inclusion of all originator compensation—from any source—in the points-and-fees test, thus placing downward pressure on excessive and destabilizing compensation. Congress not only banned loan originators from being paid by both the borrower and the creditor, but it also banned transactions with "mixed payments"—those in which borrowers pay some upfront fees

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Glauser), 365 B.R. 531 (Bankr. E.D. Pa. 2007); Stump v. WMC Mortg. Corp. 2005 WL 645238 (E.D. Pa. Mar. 16, 2005); Strong v. Option One Mortg. Corp. (*In re* Strong), 356 B.R. 121 (Bankr. E.D. Pa. 2004)

30 *See, e.g.*, 74 Fed. Reg. 44,522, 44,564–44,565 (July 30, 2008) (discussing results of Federal Reserve Board consumer testing of broker compensation finding disclosures about mortgage broker's conflicts of interest resulted in a greater erroneous belief that the creditor was working on behalf of the consumer); U.S. Dep't of Housing and Urban Dev., Office of Pol'y Dev.& Research, RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs 3-39 - 3-46 (2008); James M. Lacko & Janis K. Pappalardo, Fed'l Trade Comm'n, The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment 28 (2004), *available at* http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf (adding yield spread premium disclosure to prototype disclosures on two loans with the same terms and interest rate resulted in a drop in the identification of the cheaper loan from 94% to 70%).

31 *See, e.g.,* National Consumer Law Center, Truth in Lending § 3.9.6.4 (8th ed. 2012) (discussing the difficulty of determining the amount of broker compensation from the RESPA disclosures).

32 *See, e.g.,* 74 Fed. Reg. 44,522, 44,564-44,565 (July 30, 2008)(discussing results of testing conducted under the auspices of the Federal Reserve Board).

and the creditor pays the loan originator.[33] Congress also mandated the inclusion of fees paid to affiliates in the points-and-fees test.[34] Congress took these steps because, in its judgment, all of these protections were necessary to protect homeowners from the widespread abuses occasioned by loan originator compensation.

B. Permitting Mixed Payments Weakens the Ban on Dual Compensation

The Bureau's rulemaking to date has already weakened the ban on dual compensation by permitting mixed payments. The unfortunate results of that decision make proper application of the points-and-fees rule all the more important to avoid further undermining congressional intent.

In rules finalized last month, the Bureau invoked its limited discretion [35] to grant all creditors a blanket waiver from the Dodd-Frank ban on creditor payments to loan originators in transactions that include upfront, consumer-paid fees.[36] The result is the same as allowing dual compensation, with all the associated problems.

Transactions with mixed payments are confusing to consumers, which is likely one reason Congress banned them. When a creditor says it will pay the originator, the consumer is unlikely to realize that the originator's compensation may actually be coming from inflated upfront charges that the consumer pays—meaning the creditor's offer to pay the originator is actually disingenuous. Alternatively, a consumer who willingly pays discount points to reduce the interest rate is unlikely to realize that the rate-reducing effect of those points may be countered by the rate-increasing effect of creditor-paid compensation.

Regardless of these problems, the Bureau permitted all creditors to make these payments, based on unsupported claims that lenders would restrict access to credit to lower-income borrowers. Of course, the credit "restricted" would largely be undesirable and overpriced credit sold to unsophisticated consumers—those borrowers most likely to be victimized by creditor misconduct.[37] The Bureau allowed mixed compensation payments without any evidence showing that the benefits of the waiver outweighed the known harm to consumers.

The decision to permit mixed payments makes proper implementation of the points-and-fees definition even more important. Had the Bureau remained more faithful to the statute and not waived the statute's ban on mixed payments, the current debate over the proposed alternatives would be unnecessary, because there would be no upfront payments to consider offsetting against creditor-paid loan originator compensation.

[33] 15 U.S.C. § 1639b(c)(2)(B)(ii).
[34] 15 U.S.C. § 1602(bb)(1)(A)(ii), 15 U.S.C. § 1602(bb)(4)(C).
[35] 15 U.S.C. § 1639b(c)(2)(B)(ii).
[36] Reg. Z § 1026.36(d)(2)(ii).
[37] *See generally* III.2, *infra.*

C. **The Exception for Bonuses and Retirement Plans Will Allow Abuses to Continue While Reducing Transparency**

One of the most important changes in Dodd-Frank is the ban on loan originator compensation tied to the terms of a loan (other than the amount borrowed). We believe this will significantly reduce loan originators' incentive to push borrowers into loans that benefit the originator without regard to the borrower's best interests. The Bureau's final rule, however, undermines that improvement by exempting retirement plans and non-deferred bonuses.[38] The exemption allows anyone to pay compensation that is directly tied to the terms of a transaction, with only a few weak limits to prevent abuse.

Payments to a compliant retirement plan need only meet one requirement under the final rule: the compensation cannot be based on the terms of transactions involving the loan originator who is receiving the compensation. Payments to other plans, not to a retirement plan, must meet that requirement and one other: the compensation cannot exceed 10 percent of the recipient's total compensation; or, the recipient must not have originated more than ten transactions in the preceding year. These limits will make compensation consultants rich as they devise ways to evade the intent of the law.

The first restriction—"the contribution shall not be . . . based on the terms of that individual loan originator's transactions"—means the contribution can be based on loans originated by a broker or loan officer's co-workers. It is easy to envision loan originators making deals to help each other, or office managers giving a pep-talk to remind staff that everyone's compensation will go up if they all steer harder.

The 10-percent-or-10-transactions restrictions appear to be arbitrary numbers that serve as a de minimus test not permitted by Dodd-Frank. This invites a return to the days of proliferating brokerage companies, with the same principal sometimes appearing in ten or more starring roles.

Permitting a loophole for deferred-compensation plans makes the untested and implausible assumption that loan originators will be less likely to respond to financial incentives if the reward is delayed. Companies compensate employees via bonuses and retirement plans because it works. Bonuses and retirement plan contributions change employee behavior. Pooling or deferring compensation does not remove the danger that loan originators will seek to originate loans with abusive terms in order to boost their overall compensation package. To suggest otherwise ignores economic realities. Allowing individual loan originators to profit from compensation based on the aggregate terms of their colleagues' loans poses the same risk to consumers as doing so on an individual basis.

The purpose of Dodd-Frank was to remove the incentives to originate loans with terms judged to be abusive. Yet these incentives remain as the rules finalized last month permit both dual compensation and payment based on the terms of the loan, so long as the payments are slightly delayed. As a result, the need for transparency and restrictions on loan originator compensation from the points-and-fees test is increased.

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[38] Reg. Z § 1026.36(d)(1)(i) (exempting (d)(1)(iii) and (iv)).

III. The Bureau Should Adopt the Proposed Additive Interpretation of the Points-and-Fees Definition (Alternative 1) for Both Open-End and Closed-End Credit and for all Loan Originators

A. The Ban on Steering Will Only Be Effective If Complimented by Strong Compensation Rules

The checks on steering based on loan terms cannot be sufficient in themselves. Creative lenders will still be able to find ways to encourage certain kinds of loans, and discourage others. The wide array of lawful compensation methods in Official Interpretation § 1026.36(d)(1)-2(i) should provide fertile ground for evasion of the Bureau's restrictions. The Bureau is likely to find itself a decade from now initiating costly investigations into whether the observed differential racial pricing comports with the restrictions of Reg. Z § 1026.36(d) or whether it is the result of permissible compensation structures. Without clear and effective disclosure of loan originator compensation, and significant downward pressure on creditor-paid loan originator compensation, there remain large regulatory holes through which loan originators can steer unwary consumers into disadvantageous loans.

The Bureau now contemplates further curtailment of Dodd-Frank's advances by letting creditors exclude some compensation from the points-and-fees test, despite clear statutory language to the contrary. The offset approach risks enshrining the market distortions that Dodd-Frank was enacted to prevent and undermines the remaining anti-steering protections for homeowners. That approach ignores the lessons of history and a clear congressional mandate.

B. The Additive Interpretation Most Accurately Implements Congressional Intent

1. Statutory Construction Supports the Additive Approach

As the Bureau recognizes, the Dodd-Frank Act requires creditors to count all loan originator compensation in the total points and fees. Congress explicitly added to the definition of points and fees "all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator from any source[.]"[39] This amendment ends the debate over whether creditor-paid compensation (such as yield-spread premiums) should be included in the points and fees. The definition does not merely say "compensation paid to a mortgage originator," but explicitly includes "all" compensation, whether paid by a consumer "or" a creditor. Congress further underlined this inclusive, additive approach with the words "from any source[.]"

Traditional canons of statutory interpretation require reading new language as adding something to the definition that was not previously there. Finance charges and compensation paid directly or indirectly by the consumer were already included in the statute before the amendment.[40] The Dodd-Frank amendments made three additions:

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[39] 15 USC 1602(bb)(4)(B).

[40] *See* 15 U.S.C. § 1602(bb)(4)(A) (including all items in the finance charge except interest in the points and fees calculation); 15 U.S.C. § 1602(bb)(4)(B) (including "all compensation paid to mortgage brokers" in the points and fees calculation); 15 U.S.C. § 1605(6) (including "borrower-paid mortgage broker fees, including fees paid directly to the broker or the lender (for delivery to the broker) whether such fees are paid in cash or financed" in the finance charge).

1) expanding the definition beyond broker fees to all mortgage-originator fees, including in-house loan officers;

2) including all creditor-paid mortgage loan originator compensation, whether or not it is paid ultimately by the consumers; and

3) making explicit that the compensation includes both direct and indirect payments.

Dodd-Frank also deleted the former requirement that the points and fees be payable "at or before closing."

Only the Bureau's proposed Alternative 1, the additive approach, reflects the changes Congress made to the definition of the statute. Alternative 2, in effect, vitiates the amendments and enshrines the pre-Dodd-Frank version of the statute.

Additionally, the statutory definition specifically endorses the additive approach. The first sentence of the definition contains a crucial word: "include."[41] "Include" means "to take in or comprise as a part of a whole or group."[42] The use of the word "include" means that the total points and fees contains, or is comprised of, the items listed in sub-paragraphs (A) through (G). Only the additive approach (Alternative 1) accurately reflects the definition of "include."

The additive approach pre-dates the Dodd-Frank Act. Before the enactment of Dodd-Frank, the Federal Reserve Board had already included creditor-paid broker compensation in the definition of points-and-fees. At that time, and until the Bureau issued the recent proposal, it was undisputed that creditor-paid broker compensation was counted in addition to all other points and fees included in the calculation. When enacting Dodd-Frank, Congress essentially codified the Board's version of the points-and-fees definition and added loan officer compensation to the total points and fees. Thus, Alternative 2 represents a radical departure from existing law.

Alternative 2 calls for consumer payments of upfront finance charges to offset creditor-paid originator compensation.[43] In other words, creditors would be entitled to exclude from the definition of points and fees all compensation they pay to a mortgage originator up to the amount of finance charges the consumer pays the creditor upfront. This is directly contrary to the statutory definition. The statute calls for including all mortgage originator compensation, from any source. By allowing creditors to exclude some compensation, Alternative 2 permits the opposite and reverses the statutory mandate.

2. The Bureau Lacks Authority to Modify the HOEPA Points-and-Fees Definition

The Bureau does not have exemption authority to redefine the scope of HOEPA. To adopt Alternative 2 without violating the statutory restraints on its exemption authority, the Bureau

[41] 15 U.S.C. § 1602(bb)(4).
[42] Merriam-Webster On-Line Dictionary, http://www.merriam-webster.com/dictionary/include?show=0&t=1361850221 (last visited on February 25, 2013).
[43] 78 Fed. Reg. 6622, 6670 (Jan. 30, 2013).

would have to engage in a substantial restructuring of the Qualified Mortgage rule it recently promulgated.

Although the Bureau has decided to merge HOEPA and other loans for a variety of purposes, including the points-and-fees test, it does not have exception authority with respect to HOEPA loans. The general section providing for exemption authority, 15 U.S.C. § 1604(f), has long protected HOEPA loans from the exemption authority, and Dodd-Frank did nothing to alter that prohibition.[44] The HOEPA-specific section of the statute, which permits the Bureau to exempt some mortgages from some HOEPA-prohibitions, only does so for a closed set of HOEPA prohibitions and explicitly does not permit the Bureau to modify the disclosure requirements for HOEPA loans.[45]

Nor may the Bureau shelter creditors from their failure to comply with the HOEPA disclosures. Congress did not grant the Bureau authority to modify the terms of 15 U.S.C. § 1639(n), which provides the remedy for violations of HOEPA terms. Notably, when Congress added several prohibitions for HOEPA loans in Dodd-Frank,[46] it did not expand the Bureau's authority to modify any of those prohibited practices or to exempt creditors from compliance.

Even if the Bureau has authority to substitute its judgment for Congress's in overriding the clear language of 15 U.S.C. § 1602(bb)(4)(B) for the purposes of the qualified-mortgage definition in 15 U.S.C. § 1639c(b)(2)(C), the Bureau lacks authority to change the HOEPA points-and-fees definition. At the least, if the Bureau adopts Alternative 2, the Bureau must confine that rulemaking to the qualified mortgage definition, and not impose it on HOEPA loans. That means the Bureau would have to decouple the many interconnected provisions of Regulation Z as applicable to HOEPA and non-HOEPA loans, and be required to rewrite much of the recent ATR rule.

While Congress gave the Bureau authority to waive the ban on mixed payments in 15 U.S.C. § 1639b(c)(2)(B)(ii), the Bureau lacks authority to adjust the HOEPA points-and-fees definition and has no clear authority to adjust the points-and-fees definition for the purposes of qualified mortgages.

3. Alternative 1 Will Benefit Consumers by Discouraging Transactions That Include Both Upfront Payments and Creditor-Paid Compensation

The congressional directive to include both upfront finance charges and creditor-paid compensation in the points-and-fees definition is not just a price-control measure. It also discourages "mixed payment" transactions—those that include both upfront charges and creditor-paid compensation. When a transaction is, nevertheless, structured in this way, the additive approach minimizes its impact. Because the Bureau has waived the Congressional ban on mixed payments, it is all the more important to adopt Alternative 1.

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[44] *See also* 15 U.S.C. § 1604(a) (excepting HOEPA loans from the Bureau's general authority to create new categories via regulation).

[45] *See* 15 U.S.C. § 1639(p)(1) (providing for exemptions of "specific mortgage products . . . from any or all of the prohibitions specified in subsections (c) through (i)," not including the disclosures provided for in 15 U.S.C. § 1639(a), or the prohibitions contained in 15 U.S.C. § 1639(j)-(m).

[46] *See* 15 U.S.C. § 1639(j)-(m).

The Bureau elected to waive Congress's ban on mixed fees due to lack of information. But the Bureau need not wait for more information before adopting the additive approach. Even under a worst case scenario, Alternative 1 will have much less impact on the lending industry than the ban on mixed payments. The additive approach permits mixed payments, while minimizing incentives for rent-seeking behavior on the part of creditors. In the absence of compelling empirical evidence supporting the industry's unsupported claims, the Bureau should exercise deference to Congress.

4. Alternative 1 Provides for Greater Transparency in Disclosure to Homeowners and Regulators Than Alternative 2

Alternative 1 is more transparent than Alternative 2. Transactions that include mixed payments lack transparency. The consumer cannot evaluate the impact of the creditor-paid compensation on the overall cost of the transaction. Nor, as the Bureau acknowledges, can anyone readily tell the difference between money that is deducted from upfront payments and simply passed through the creditor versus money that represents rent-seeking or deceptive pricing.[47]

Creditors are not required to pass all or any portion of upfront charges through to the loan originator. Yet, adopting Alternative 2 would mandate the fiction that all creditor-paid originator compensation is paid by the consumer upfront. In that regard, Alternative 2 is simply dishonest. Mandating this fiction will only benefit creditors that exploit it to extract more money from consumers and steal business from more honest competitors.

Additionally, the Bureau itself, along with other regulators, has an interest in transparent disclosure of loan originator compensation. In order to monitor compliance with the rules on loan originator compensation and steering, the Bureau needs to know who is paid what. Allowing offset of the loan originator fees, or exempting the compensation of in-house loan officers from inclusion in the points-and-fees test, will only make the Bureau's job of oversight and enforcement more difficult.

5. The Offset Interpretation (Alternative 2) Facilitates Over-Charging, Increases the Risk of Steering, and Violates HOEPA

Alternative 2 is an invitation to increase upfront charges and originator compensation. Its effect would be that all or most creditor payments to originators would not be treated as points and fees. Alternative 2 would make it easier to increase borrower costs without hitting the points-and-fees thresholds.

Giving creditors the ability to offer higher loan-originator compensation without exceeding the thresholds will undermine the ban on steering, because the financial incentives will encourage loan originators to evade the ban. Violations of the steering ban will be hard to detect under any circumstances. So the Bureau should adopt rules that complement the ban rather than make steering more enticing.

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[47] 78 Fed. Reg. 6622, 6639 (Jan. 30, 2013).

The examples accompanying Alternative 2 show that the offset rule would undermine the QM and HOEPA fee thresholds by permitting double the current number of points and fees, i.e., 6—rather than 3—points for a QM loan and 10—rather than 5—points for a HOEPA loan. This would occur because creditor-paid compensation would not be counted unless it exceeded the upfront charges. For example, if a loan included 3 points of prepaid finance charges, all of which would go toward the creditor's profit margin (and no consumer-paid loan originator compensation), the creditor could pay the originator an additional 3 points of compensation without exceeding the QM or HOEPA thresholds. This would directly contradict Dodd-Frank and exceeds the Bureau's exemption authority with regard to the provisions reducing the HOEPA threshold.

Alternative 2 is also flawed for one of the same reasons that the ban on mixed payments was necessary. It assumes that a one-to-one offset of loan originator fees with other settlement services is possible. But all available evidence suggests the contrary, particularly for loans near the high-cost triggers.[48] Instead, the presence of creditor-paid loan originator compensation increases the costs of other settlement services. Adoption of Alternative 2 will exacerbate the harm done by the Bureau's waiver of the statute's ban on mixed payments.

Alternative 2 would, in effect, ease the downward pressure on fees paid to affiliates imposed by Dodd-Frank by allowing creditors to offset loan originator fees against fees paid to affiliates, without regard to how inflated either fees are or whether the fees provide any benefit whatsoever for the consumer. Permitting creditors to subtract from the points-and-fees test monies the consumer pays to affiliates undercuts the restraints on affiliate pricing that were put in place under Dodd-Frank.

The Bureau cites the downward pressure on fees in order to maintain QM status as a reason in support of Alternative 2.[49] But it is the reverse. The greater concern is whether such a creditor is charging so many fees and including so much compensation in the transaction that the cost of credit is too high to justify giving the transaction the benefit of being a qualified mortgage. Congress was clearly aware of, and should be presumed to have intended, the impact of its points-and-fees rule, i.e., to either create downward pricing pressure on loan originator fees, or to make some loans fall outside the qualified mortgage definition.

Adopting Alternative 2 and eviscerating the statutory language would allow lender to cloak over-priced loans and improper originator incentives in the protective cover of the qualified-mortgage rule. One of the benefits of Alternative 1, the additive approach, is that it works to restrain both abusive fees paid to the affiliates and abusive loan originator compensation. Alternative 2 would restrain neither, but would encourage profiteering.

C. The Expressed Concerns with the Additive Approach Lack Validity

1. Double-Counting Can Be Avoided

The Bureau states that some industry commenters oppose a literal interpretation of the new points-and-fees definition because it would result in double-counting when creditors compensate loan

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48 *See generally* I.C, *supra*.

49 78 Fed. Reg. 6622, 6639 (Jan. 30, 2013).

originators with money collected upfront from consumers.[50] Under this theory, the compensation would be counted first when paid by the consumer to the creditor as a finance charge and a second time when paid by the creditor to the loan originator as compensation. This problem, however, is easily avoided by modifying creditor practices to more accurately reflect the substance of the transaction and providing, as the Bureau proposes, that fees included in the finance charge need not be added a second time to the points-and-fees calculation.[51]

When a creditor pays a loan originator with money the creditor has received from the consumer at closing, the originator compensation is—in substance—coming from the consumer. The payment is merely passing through the creditor. This payment has likely been disclosed on the HUD-1 as a finance charge payable to the creditor with no indication that the funds will be paid (in whole or part) to the loan originator. This practice is problematic for two reasons: it obscures the nature of the transaction—especially when the loan originator is a mortgage broker—and it interferes with an accurate calculation of the total points and fees in the transaction.

Instead, even under Alternative 1, creditors can continue to compensate loan originators without risking double-counting through the simple expedience of honesty and transparency and disclosing the originator compensation on the HUD-1 as a separate line-item instead of including it in the other upfront fees. The original amount of prepaid finance charges, in which the compensation would otherwise be concealed, would be disclosed as reduced by the separately disclosed amount of compensation. For example, instead of disclosing a $1000 lump sum "origination fee," $200 of which would be secretly paid to a loan originator after closing, the creditor would disclose an $800 origination fee and $200 of loan originator compensation. Everyone pays and receives the same amount of money, but the latter is more accurate, promotes consumer comprehension, and eases enforcement by the Bureau and other agencies.

This method of disclosing and compensating a loan originator can be contrasted with a transaction in which the creditor funds the compensation payment through the interest rate.[52] When the creditor pays the originator through the interest rate, the compensation does not qualify as a finance charge under the first prong of the points-and-fees definition because the definition excludes interest from that prong.[53] Therefore, the creditor would be required to count it under the second prong.[54]

When the creditor funds the originator compensation from a disclosed portion of the upfront charges paid by the consumer, the rationale for double-counting is eliminated. The double-counting problem[55] only arises when it is "extraordinarily complex and cumbersome" to tell how the originator compensation was funded or where the creditor spent money collected from the consumer and the interest rate.[56] In contrast, if the creditor discloses the portion of upfront fees designated for loan originator compensation, it will be a simple matter for an examiner to verify

50 78 Fed. Reg. 6622, 6638 (Jan. 30, 2013).
51 *See* Proposed Official Interpretations § 1026.32(b)(1)(ii)-5.i and -5.ii.
52 [see expl of funding comp on p61]
53 [1026.32(b)(1) "points and fees means . . . (i) All items included in the finance charge under s 1026.4(a) and (b), except that the following items are excluded: (A) Interest")]
54 [(ii) for comp. paid to a LO]
55 [FNcounting the money when paid by the consumer to the creditor and again when paid by the creditor to the LO]
56 78 Fed. Reg. 6622, 6639 (Jan. 30, 2013).

how much money was actually paid to the originator, where it came from, and how much the transaction cost the consumer.

If the creditor paid the loan originator from a combination of the consumer's upfront charges and money from the interest rate, the procedure would be the same. But, as a practical matter, the creditor should also be required to disclose the amount of originator compensation funded by the interest rate so the consumer can verify that the points and fees are calculated properly.

For example, a creditor might issue a HUD-1 that appears as follows:

1. Origination fee to Creditor $5000
2. Loan Originator Compensation to Creditor $2000
    - $1000 paid at closing + $1000 paid from interest

The total points and fees in this transaction would be $7000.

These improvements to Alternative 1 would heighten transparency and ease comparison shopping by consumers, one of TILA's central goals.[57] While creditors would retain the option of hiding the amount of originator compensation in upfront fees (without separately itemizing it), this practice would be discouraged by a double-counting penalty in the points-and-fees total. Price disclosure will also help market forces function more effectively by counteracting the reverse competition that drives increases in originator compensation.

2. Preserving Access to Credit Does Not Justify Weak Rules: Some Credit Terms Can Be Worse Than No Credit

The Bureau notes that the additive approach "could result in some consumers being unable to qualify for credit."[58] The question is always—what credit and at what price? Some credit does more harm than good. Indeed, the entire world is struggling to recover from the nightmare of too much credit, too improvidently extended.

The access-to-credit argument is unsupported by anything other than mere speculation and industry threats. It should not be used as a justification for adopting weak, loophole-ridden rules that appease the lending industry while exposing consumers and the economy to undue risk.

We are witnessing the greatest loss of wealth in communities of color in at least 40 years. The median wealth of white households is now 20 times that of African-American households and 18 times that of Hispanic households.[59] In 1984, by comparison, well before the surge of credit in the last decades, the ratios were 12:1 for African-Americans and 8:1 for Latinos.[60] A 2008 report concluded that "subprime borrowers of color will lose between $164 billion and $213 billion for loans taken during the past eight years," representing "the greatest loss of wealth for people of

[57] 15 U.S.C. § 1601(a).
[58] 78 Fed. Reg. 6622, 6639 (Jan. 30, 2013).
[59] Rakesh Kochhar, Richard Fry and Paul Taylor, "Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics," *Pew Research Center* (July 26, 2011) (hereafter "Wealth Gaps Rise to Record Highs"), p. 1.
[60] Wealth Gaps Rise to Record Highs, p. 29.

color in modern US history."[61] By 2011 another report determined that "African-American and Latino borrowers [were] almost twice as likely to have lost their home to foreclosure as non-Hispanic whites."[62] In some communities, these numbers are even worse. For example, in Detroit, which once had one of the highest African-American homeownership rates in the nation, more than a third of African-American consumers have lost their homes to foreclosure.[63] It will take generations to recover the wealth that has been lost.

This is not the result of income inequities.[64] This wealth was lost because borrowers of color were disproportionately targeted for high-rate, high-risk credit.[65] It is unfair lending practices—access to abusive credit, often driven by compensation incentives—that have destroyed those communities. The important rules that are the subject of this rulemaking must not undercut an unambiguous act of Congress that was designed to prevent this destruction in wealth from happening again.

The mantra of "access to credit" is often invoked to justify abusive lending practices that undermine wealth accumulation and preservation. The Bureau is not charged with preserving access to any kind of credit at any cost.

Nor should the Bureau assume that costly credit is the only available credit. Many borrowers who received costly subprime loans qualified for, but did not get, more affordable prime loans—almost half, according to one Fannie Mae report. Banks paid in-house loan originators more for inflating the interest above what borrowers' credit score qualified them for.[66] Credit scores have at best an attenuated relationship to pricing.[67] By 2006, *The Wall Street Journal* reported, a majority of all subprime mortgage borrowers were eligible for prime credit.[68] Lenders in the newest wave of subprime lending describe the credit characteristics of their borrowers as "excellent" with FICO scores above 700.[69] If lenders cannot make overpriced loans reputably and free from suit, lenders are likely to make fairly-priced and affordable loans instead.

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[61] Amaad Rivera et al., Foreclosed: State of the Dream 2008, *United for a Fair Economy* (January 15, 2008), p. vii.

[62] Lost Ground at 18.

[63] Lost Ground at 19.

[64] Lost Ground at 20 ("Racial and ethnic differences in foreclosure rates persist even after accounting for differences in borrower incomes.").

[65] See Lost Ground at 19, 21 ("In addition to receiving a higher proportion of higher-rate loans, African Americans and Latinos also were much more likely to receive loans with other risky features, such as hybrid and option ARMs and prepayment penalties. Disparities in the incidence of these features are evident across all segments of the credit spectrum . . . .").

[66] *See, e.g., Wall Street and the Financial Crisis: The Role of High Risk Home Loans: Hearing Before the Subcomm. on Investigations of S. Comm. on Homeland Security and Governmental Affairs*, 111th Cong. 2d Sess. 5 (2010) (memorandum by Sen. Carl Levin, Chair, & Sen. Tom Coburn, Ranking Minority Member) (discussing Washington Mutual's compensation of in-house loan originators; noting compensation increased the more over-priced the loan was compared to the borrower's credit score.).

[67] *See, e.g.*, Sumit Agarwal, John C. Driscoll, Xavier Gabaix, & David Laibson, The Age of Reason: Financial Decisions Over the Lifecycle 4, 16, 17 (Feb. 11, 2008), *available at* http://ssrn.com/abstract=973790 (finding that FICO scores have only small impact on APRs for home equity loans, car loans, and credit cards).

[68] Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans to a Broader Market,* Wall St. J., Dec. 3, 2007, at A1 (reporting that 61% percent of subprime borrowers in 2006 were prime eligible based on their credit score). *Cf.* Marsha J. Courchane, *The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?*, 29 J. Real Est. Res. 399, 415, 417 (2007) (reporting that, in 2004 and 2005, respectively, 17.29% and 12.15% of subprime borrowers had FICO scores of 700 or higher, well into prime territory).

[69] Paul Muolo, *Subprime Lending Starting to Attract Interest Again*, Am. Banker, July 14, 2010.

3. Encouraging No-Cost Loans Is Appropriate

The Bureau expresses concern that "creditors whose combined loan originator compensation and up-front charges would otherwise exceed the points-and-fees limits would have strong incentives to cap their up-front charges . . . and instead recover those expenses by increasing interest rates . . . ."[70] According to the Bureau, this is problematic because it "would adversely affect consumers who prefer a lower interest rate and higher upfront costs and, at the margins, could result in some consumers being unable to qualify for credit."[71]

This concern is misplaced. It is highly likely that Congress intended to encourage creditors to cap their up-front charges (or loan originator compensation). The Bureau appears to imply that this would be a negative consequence because creditors would, instead, cover their expenses or profit margin from the interest rate. The interest rate has historically been the primary way creditors recouped expenses and made a profit. The proliferation of upfront charges is a relatively modern phenomenon that accompanied deregulation and the preemption of state laws. Unbundling the cost of credit through a myriad of upfront fees may make credit look cheaper (each individual fee looks so small), but it is ultimately more expensive for homeowners.

Most homeowners would be better off if creditors capped upfront fees and recovered expenses through interest rates. The typical homeowner can effectively shop for a loan only if the fees are pushed into the interest rate. The combination of up-front fees and interest rate pricing is confusing and routinely leads to consumers being overcharged. In addition, few homeowners keep the same mortgage until maturity, so trading higher upfront costs for a lower rate is often a bad deal.

Alternative 1 is desirable in part because it would encourage no-cost loans, where all fees are pushed into the interest rate. If a creditor intends to pay the originator from the interest rate, the additive approach will be the only honest method of calculating the points and fees. To allow the compensation to be offset by the fees would conceal the fact that such a loan includes enough points and fees to exceed the threshold.

Alternative 2 would discourage no-cost loans. In a no-cost loan, all of the creditor-paid compensation will count toward the points and fees. But, under Alternative 2, if the creditor is already paying the originator's compensation, there is no downside (in terms of the points-and-fees definition) to shift the other origination costs to the consumer.

No-cost loans enhance competition by supporting consumer shopping. Nothing in the additive approach would prevent sophisticated consumers from shopping for and finding a loan with origination fees paid both in the rate and upfront. But Alternative 1 would tilt the default to where it should be for most consumers: loans with the fees in the rate, allowing homeowners without advanced economics or math degrees to evaluate realistically the comparative cost of two loans.

D. The Additive Approach Is Appropriate for Both Brokers and Retail Originators

[70] 78 Fed. Reg. 6622, 6639 (Jan. 30, 2013).
[71] 78 Fed. Reg. 6622, 6639 (Jan. 30, 2013).

1. All Originators Should Be Treated the Same

Both brokers and retail lenders plead for exceptions from the rule. Brokers plead for leniency on the grounds that they provide an important service to consumers not available from retail lenders. Brokers also argue that the compensation rules unfairly treat lender gain on sale more favorably than broker compensation. Retailers plead for leniency on the grounds that they are not as bad as brokers and do not engage in steering. Retailers also argue that, because they bear the risks of originating loans, they should receive greater compensation. Most of these claims are specious. And even if they have a grain of truth, it is greatly outweighed by the evidence of harm caused by incentive compensation practices. Moreover, none of these excuses justifies creating an uneven playing field (by giving someone an exception) or adopting a weak rule.

Nothing in the additive approach prevents compensation for retailers in exchange for their assumption of the risk of funding the loan. The profit made when a loan is sold is not reflected in the points-and-fees calculation. That profit happens after the points-and-fees measurement occurs. Only if the retailer, ex ante, decides to compensate its loan officers in expectation of a future profit is the subsequent sale of the loan implicated. But this upfront compensation to a loan officer based on the expectation of a profit from a future sale is not categorically different depending on whether the loan originator is in-house or an independent broker.

Tracking payments to loan originators may increase costs, slightly. But the only compensation that must be tracked for purposes of the points-and-fees test is that paid in connection with an individual loan. We have trouble understanding how a lender could pay a loan originator for her work on an individual loan without already tracking those costs. As a result, we are uncertain what additional costs creditors would legitimately incur in reporting those payments as part of the points-and-fees test.

The additive approach is fair to both brokers and retailers.

2. Retail Loan Officers Are Subject to the Same Temptations as Mortgage Brokers and May Be Little More Than In-House Brokers

The problem of loan originator compensation is not limited to mortgage brokers.[72] Nor does the evidence showing broker loans are more expensive justify giving retail lenders a free pass. Retail lenders, like mortgage brokerages, offer incentive pay to loan officers. While there are now strict limits on what incentive payments may be tied to, those limits will not eliminate the risk of steering.

The prohibitions on steering contained in § 1026.36(e) are not, alone, sufficient to prevent steering among affiliates. Those prohibitions will only be effective if complemented by rules that crack down on the incentives for steering. While § 1026.36(d)(3) specifically provides that loan originators cannot be paid more based on terms of the loan depending on which affiliate they sell to, the regulation and commentary permit many other forms of compensation, which any creative creditor can craft into de facto incentives to steer. At the very least, because compensation may still be tied to the amount of a loan, lenders are likely to encourage originators to steer consumers

[72] *See generally* I.B., *supra.*

to bigger loans. Sometimes this may be a matter of encouraging a consumer to borrow more. Or it may involve steering a borrower to products that permit a higher loan-to-value ratio.

In-house loan officer compensation has long been even less transparent than broker compensation. Consumers may trust loan officers less than brokers, but particularly vulnerable homeowners continue to believe that the bank must give them the best rate.[73] Unsophisticated homeowners may believe that the loan officer is paid on an hourly or salary basis, as most employees at most organizations are. Excluding in-house loan officer compensation from inclusion in the points-and-fees test perpetrates a myth that loan officers are somehow exempt from the temptations of compensation-based steering, while encouraging retail lenders to push up compensation packages for loan officers, in a form of reverse competition.

3. Exception-Ridden Rules Invite Evasion; Regulatory Supervision Is Not an Adequate Deterrent

The financial services industry has been very creative in finding innovative ways to profit from loopholes. An entrepreneurial lender looking down the list of permitted compensation in Official Interpretation § 1026.36(d)(1)-2(i) could craft different compensation structures based on volume, or performance of the loans, or legitimate business expenses. Or lenders may find that loan originators are receptive to incentives that take advantage of the weaker rules for deferred compensation plans. While we cannot predict now which incentive structure will make one product or affiliate more desirable than another to loan officers, some will certainly prove more profitable or easier to obtain. Experience has shown that if loan originators are given an incentive to act in their own best interest, they will find a way to do so. Even the most detailed rules cannot foresee and plug every conceivable loophole.

The additive approach helps limit the evolution of new forms of steering, by brokers and by in-house loan originators. It provides a safety check against potential loopholes in the Bureau's steering rule. And it promotes greater transparency in the disclosure of loan originator compensation, thus assisting the Bureau in enforcement, as well as homeowners in shopping.

There is no valid policy reason to allow in-house originators to be compensated on terms that are destructive for outside originators, particularly as in-house originator compensation is even less transparent. Adopting the additive approach will help align financial incentives with the ban on steering and with the public's best interests.

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[73] *See, e.g.,* Mortgage Foreclosure Filings in Pennsylvania: A Study by The Reinvestment Fund for the Pennsylvania Department of Banking 74 (Mar. 2005), *available at* http://www.trfund.com/policy/pa_foreclosures.htm, *citing* Fannie Mae's 2002 National Housing Survey (noting that African American and Latino borrowers are particularly likely to believe that banks are legally required to give them the best rate they qualify for).

E. There Should Be No Difference In The Treatment of Loan Originator Compensation for Open- and Closed-End Transactions

The Bureau asks whether there is a need for special or different guidance on the calculation of loan originator compensation in open-end transactions.[74] As we have previously recommended, open and closed-end mortgages should be subject to the same rules for substance and disclosure.[75] Aggressive lenders will steer borrowers toward the product with weaker rules. The abuse of fully-drawn HELOCs in place of closed-end home equity loans is one example of this phenomenon. Rules against spurious open-end credit are appropriate but largely unenforceable. Weaker rules for open-end credit create a honey pot for deceptive lenders. The rules for loan originator compensation are no exception.

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IV. The Bureau Should Carefully Restrict All Exemptions from the QM Rule

A. The Exemptions for Small Portfolio Lenders Should Be More Tightly Drawn

1. Small Portfolio Lenders Making Subprime Loans Should Not Be Entitled to a Safe Harbor

The proposed exemption for small portfolio lenders proposes both to allow an exemption from the underwriting standards of QM (because small portfolio lenders are presumed to provide more individualized and careful underwriting, and thus do not need directives from the Bureau) and to allow these creditors to charge a higher interest rate before borrowers may rebut the presumption of affordability (because small lenders may have higher initial capital costs, even if those higher initial costs are offset by lower rates of default).[76] In effect, the Bureau's proposal suggests that a lender may make an overpriced loan with impunity so long as the lender is small enough.

The Bureau notes that small portfolio lenders have offset their higher upfront costs with lower default rates.[77] Easing underwriting restrictions for small portfolio lenders who assume the risk of their own loans is reasonable, but allowing them to make abusively priced loans to homeowners and applying an unrebuttable presumption of affordability that denies homeowners recourse is not appropriate. Particularly in underserved communities, homeowners may be susceptible to abuses by small, local lenders. Indeed, historically, many HOEPA lenders have been small lenders. The Bureau should not condone abusive pricing simply because a lender is small.

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[74] 78 Fed. Reg. 6622, 6640 (Jan. 30, 2013).
[75] *See, e.g.,* National Consumer L. Ctr., et al., Comments to the Fed. Res. Board (Dec. 24, 2009), at 15.
[76] 78 Fed. Reg. 6622, 6652, 6668 (Jan. 30, 2013) (proposed 1026.43(b)(4)).
[77] 78 Fed. Reg. 6622, 6652 (Jan. 30, 2013).

2. Small Creditor Portfolio Loans Designated as Qualified Mortgages under Reg. Z 1026.43(e)(5)(i) Should Lose Their QM Status When Transferred from a Failed Bank

Proposed Reg. Z 1026.43(e)(5)(i) establishes a limited exemption from the qualified mortgage guidelines for loans made by small creditors that are held in portfolio. A loan made by such a lender loses its QM status if it is transferred to a non-exempt person less than three years after origination unless the transfer is a supervisory sale.[78] The Bureau should eliminate the exception to loss of QM status for supervisory sales from failed banks occurring less than three years after origination.

As explained in the proposed commentary, a supervisory sale is one "deemed necessary by supervisory agencies to revive troubled creditors and resolved failed creditors." Proposed OI 1026.43(e)(5)-9. It is axiomatic that a creditor may be troubled or may fail due to unsafe or unsound lending practices. The safe harbor and rebuttable presumption for qualified mortgages is granted based on the assumption that the lender has followed sound practices and the loans are affordable. The need for supervisory action strongly suggests the loans should no longer be entitled to the assumption underlying QM status. The recent foreclosure of thousands of unsustainable loans that were originated by lenders that themselves failed should be conclusive proof that troubled institutions should lose their QM exemption. If a bank is generally sound but a sale is ordered because, for example, a supervisory agency determines that the bank is holding too many mortgage assets, there would be less concern about this exception. But loans made by banks that fail within three years of origination should not receive this exception.

Supervisory agencies already have authority to protect transferees from borrower claims when necessary.[79] In addition, when a failed institution goes through bankruptcy or is taken over by a receiver, borrowers are typically authorized to make claims against the institution through an administrative or court-supervised process. This process allows the orderly transfer of assets without burdening the transferee with potential legal claims while still ensuring that anyone harmed by the failed institution has some (albeit limited) opportunity for legal redress. The Bureau's proposal would eliminate that opportunity.

Lending institutions often fail because poor underwriting practices lead to high loan default rates. Loans made less than three years before the lender's failure are likely to have been subject to those poor practices. Such loans are not entitled to qualified mortgage status.

B. Restrictions on Nonprofit Lending Are Necessary To Prevent Abuse

While easing the qualified-mortgage standards for nonprofit lenders may be appropriate, restrictions on nonprofit lending are necessary to prevent abuse. As the Bureau recognizes, obtaining and maintaining an IRS 501(c)(3) certification does not require any oversight of the organization’s lending practices or foreclosure rates.[80]

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78 Proposed Reg. Z 1026.43(e)(5)(ii)(A), (C).
79 National Consumer Law Center, Mortgage Lending § Ch. 11 (2012) (discussing the FDIC's role in bank failures).
80 78 Fed. Reg. 6622, 6644 (Jan. 30, 2013).

There have been countless examples of abusive practices by organizations with IRS tax-exempt status, many involving credit or lending practices.[81] To take one example, a company on the internet is currently advertising "non-profit payday loans."[82] The Bureau also recognizes that a nonprofit may be able to evade detection by the IRS of conduct that violates its status for many months. The Housing and Economic Recovery Act of 2008 revoked HUD's seller-funded down-payment assistance programs for FHA loans in part because of concerns about abuse, even though those funds were funneled through nonprofits. Nonprofit status by itself is no guarantee against abusive lending.

Rather than giving immunity to such conduct, the Bureau should only provide a rebuttable presumption of compliance. In addition, the rule should only apply to "bona fide" nonprofits. Adding the "bona fide" qualifier would give injured consumers the opportunity to prove that an entity does not comply with the requirements of its tax exempt status. It would be easy for a small-time scammer to qualify for non-profit status under the guise of helping homeowners avoid foreclosure or renovating and selling affordable housing and then to invoke the protections of this rule for abusive mortgages.

In addition, because the Bureau's rule essentially immunizes nonprofit lenders from suit by homeowners, regardless of how faulty the underwriting was or how mercenary the motive, the Bureau should provide that adoption of nonprofit status in order to evade the requirements of the QM rule is a prohibited practice and strips the entity of any presumption of compliance with the qualified mortgage standards. Otherwise, the temptation for the small, high-cost lenders who prey on many underserved communities to set up front nonprofits will be even stronger.

C. Exempting Refinancings from the Ability-to-Repay Rule is Counterproductive and Dangerous

The premise behind the proposed refinancing exemptions from the ability-to-repay requirements[83] is two-fold: first, that the access to the credit provided by these refinancings is so valuable that the refinancing creditor need not evaluate the consumer's ability to afford the new loan; and second, that sufficiently strict underwriting criteria are already imposed.[84]

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[81] U.S. Attorney, E.D. Pa., Press release, Owner of Non-Profit Sentenced in Loan Fraud Scheme (Sept. 30, 2010), available at http://www.fbi.gov/philadelphia/press-releases/2010/ph093010a.htm; Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams (Apr. 6, 2009), available at http://www.ftc.gov/opa/2009/04/hud.shtm; Fed. Trade Comm'n, Press Release, FTC: Bogus "Nonprofit" Debt Negotiation Companies Misled Consumers in Financial Trouble and Violated Do Not Call Registry (May 5, 2004), available at http://www.ftc.gov/opa/2004/05/ncc.shtm; FTC Testifies about Credit Counseling Abuses (Mar. 24, 2004) ("Although credit counseling can provide financially distressed consumers with valuable assistance, according to the Federal Trade Commission, some firms may be misleading consumers about who they are, what they do, or how much they charge."), available at http://www.ftc.gov/opa/2004/03/credittestimony.shtm; FTC, IRS, and State Regulators Urge Care When Seeking Help from Credit Counseling Organizations (Oct. 14, 2003) ("Federal and state regulators are concerned that some credit counseling organizations using questionable practices may seek tax-exempt status in order to circumvent state and federal consumer protection laws"), available at http://www.ftc.gov/opa/2003/10/ftcirs.shtm.

[82] Non Profit Payday Loans Ohio, http://loan247.s3.amazonaws.com/non-profit-payday-loans-ohio.html (last viewed Feb. 23, 2013).

[83] *See* proposed Reg. Z § 1026.43(a)(3)(vi)-(viii).

[84] 78 Fed. Reg. 6622, 6646-6650 (Jan. 30, 2013).

Part of the root cause of the recent housing meltdown was repeated refinancing of the home, sucking out home equity each time. Each refinancing of a home loan increased the loan-to-equity ratio, until the equity was completely used up.[85] Typically the predator used inflated, made-up income to support loans that were not affordable and could never be repaid, except by either refinancing the loan—depleting more equity—or through foreclosure. Each loan generally secured more debt and was less affordable.[86]

These serial refinancings were often not truly voluntary but, instead, were temporary measures that delayed foreclosure or were suggested by a loan originator looking for more business. Refinancings can be a lucrative source of business for loan originators, who gin up the loan amount, extracting ever more equity while making the loan increasingly unaffordable for the homeowner. We have represented homeowners who were completely unaware of multiple refinancings on their homes before the final loan led inexorably to foreclosure.

A pending lawsuit in federal court in Chicago involving an FHA refinance illustrates the limitations of relying on existing government regulations to ensure affordability.[87] In this case, the elderly African-American homeowner alleges that her FHA streamline refinance loan was not affordable, as the payments require 90% of her income. The defendant lender has claimed that it was not required to evaluate affordability because, under the FHA Streamline program, underwriting for affordability was not required. VA streamlined refinances are also available without any proof of income or appraisal, with similar predictable and dire results for homeowners.

Refinancing a bad loan with another loan that is not affordable will not help homeowners. It uses up available equity, it causes stress, and it misleads the homeowner to believe she might be able to save the family home from foreclosure even when the new loan is not sustainable. Kicking the can down the road, which is all these refinancing do, benefits no one ultimately and makes a travesty of ability-to-repay rules. Nor have any of the governmental actors to date adequately protected borrowers from such predatory refinancings. Lenders that make such rules should not be given blanket immunity from suit.

"No-doc" loans have been proven dangerous—to borrowers and safety and soundness. It is not difficult to determine a borrower's ability to repay a loan. The Bureau's ability-to-repay rules are straightforward and streamlined, and should become the industry standard for all loans, whether purchase money or refinancings. There should be no exceptions from the requirement to make this critical evaluation, even when refinancing out of bad loans.

We have no objection to exempting loan modifications from the ability-to-repay standards. As the Bureau notes, loan modifications, as opposed to refinancings, are already exempt from TILA and the Dodd-Frank ability-to-repay requirements.[88] But the Emergency Economic Stabilization Act

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[85] Nationally, between 1989 and 2004, homeowners increased their home-secured debt by over 90% , while their home equity only increased by slightly less than 20%. Fed. Res. Bull. Jan. 2000, Jan. 2003, Feb. 2006 (using data from the Survey of Consumer Finances).

[86] *See generally* United States Dep't of the Treasury & United States Dep't of Hous. & Urban Dev., Joint Report on Recommendations to Curb Predatory Mortgage Lending, Ch. 3, *available at* www.huduser.org/Publications/pdf/treasrpt.pdf.

[87] Haymer v. Countrywide Bank, FSB, *et al.*, U.S. District Court for the Northern District of Illinois, E.D., No. 10 C V 5910.

[88] 78 Fed. Reg. 6622, 6647 (Jan. 30, 2013).

(EESA) rules provide no meaningful underwriting guidance. The Bureau should not encourage lenders to ignore underwriting for EESA refinances.

Nor should FHA, VA, and RHS loans be exempted from ability-to-repay rules pending the relevant agencies' issuance of their own ability-to-repay rules. The agencies have nearly a year before the ability-to-repay rules go into effect; that is ample time for them to issue their own rules under Dodd-Frank. Providing a blanket exemption for these government-guaranteed loans in the absence of agency-specific rulemaking endangers the most vulnerable homeowners who receive these loans and removes incentives for the relevant agencies to act promptly.

In exempting refinance loans eligible for purchase by the GSEs, the Bureau is excluding a huge portion of the market from ability-to-repay standards. The FHFA guidelines, unlike the Bureau's regulations, are not subject to notice and comment, are difficult for consumers to locate and understand, and are not privately enforceable. However good the FHFA standards may be, homeowners have no redress if the standards are violated.

We have seen numerous examples of abusive refinancings under all government-programs; neither the EESA programs nor the FHA, RHS, VA guidelines, nor the Fannie Mae and Freddie Mac seller/servicer guides currently contain adequate assurances of ability-to-repay. Even if they did, the rules under these programs are frequently adjusted, are not always subject to notice and comment, and do not receive the same public scrutiny and debate as the Bureau's ability-to-repay rules. The Bureau should establish clear and uniform standards for all creditors, without exempting refinancings.

V. The Rules for Determining when a Manufactured-Home Retail Employee Is a Loan Originator Need Clarification

A. Overview

The Bureau has solicited comments on whether additional guidance is required for the final loan originator compensation rule recently issued. We believe more guidance is particularly needed for implementation of the exemption for employees of retail manufactured-home sellers..

The final rule governing when employees of manufactured-home retailers meet the definition of "loan originator" is too vague and confusing to be implemented. Under the Consumer Financial Protection Bureau's new rule on loan originators (effective January 10, 2014) a manufactured-home (MH) retailer is considered a loan originator when it meets the definition in Regulation Z, 12 C.F.R. § 1026.36(a)(1)(i). The definition excludes "[a]n employee of a manufactured home retailer who does not take a consumer credit application, offer or negotiate credit terms available from a creditor, or advise a consumer on credit terms . . . available from a creditor."[89] A loan originator may be a natural person (an "individual loan originator") or an artificial entity (a "loan originator organization").[90] A table-funded lender is both a creditor and a loan originator organization.

89 Reg. Z 1026.36(a)(1)(i)(B) (effective Jan. 10, 2014).
90 Reg. Z 1026.36(a)(1)(ii)-(iii) (effective Jan. 10, 2014).

B. The Bureau Should Clarify Who Is Eligible for the Exemption

The exemption for MH retailers applies only to "an employee." There is no definition of "employee" but the ordinary interpretation of the word implies that employees are individual loan originators. That would mean that only individual employees of MH retailers are eligible for the exemption (such as salesmen) and that the exemption may not be applied to an MH dealership. This leaves unanswered the question of whether natural persons who are both owners and employees of a retailer would be eligible for the employee exemption. The Bureau should clarify that such persons are not eligible for the exemption. Such companies are the ones most likely to fly under the radar. They will never be audited by the Bureau and states lack the resources to police them.

C. The Bureau Should Clarify What Activities Are Exempt

TILA, 15 U.S.C. § 1602(cc) defines a "mortgage originator" (the equivalent of "loan originator" in Regulation Z) as a person who, for compensation:

1) takes an application;
2) "assists a consumer in obtaining or applying" for a loan; or
3) offers or negotiates loan terms.

According to the statute, "assist[ing] a consumer in obtaining or applying" for a loan includes, but is not limited to, "advising on [loan terms], preparing residential mortgage loan packages, or collecting information on behalf of a consumer[.]" In the statute, MH retailer employees are exempt if they do not:

1) take an application;
2) offer or negotiate loan terms; or
3) advise consumers on loan terms.

Regulation Z[91] defines loan originator as someone who, for compensation:

1) takes an application;
2) assists a consumer in obtaining or applying for a loan;
3) offers or negotiates a loan;
4) arranges a loan; or
5) otherwise obtains or makes an extension of consumer credit for another person.

Regulation Z's exemption for MH employees is the same as found in the statute.

Both the statutory and regulatory provisions creating the MH retailer exemption are difficult to understand because the terminology is vague and the words used in the definition do not fully match the words of the exemption. The statutory and regulatory definitions, including the exemptions, clearly overlap regarding taking applications, offering or negotiating loan terms, and giving consumers advice on terms. A person doing any of these is a loan originator, even if the person is an employee of a MH retailer. Lining up the rest of the definition with the exemption

[91] Reg. Z § 1026.36(a)(1)(i) (effective Jan. 10, 2014).

shows that an employee can assist a consumer or arrange a loan without being considered a loan originator so long as the employee neither gives advice nor makes a referral. But applying some of these terms to the daily operations of a retailer is likely to be difficult in practice.

The Bureau's guidance on arranging and assisting is somewhat muddy. Arranging and assisting are in the definition of loan originator but are not in the list of things an exempt retailer cannot do. The Bureau said it believes the concept of "arranging" includes "assisting."[92] But, while the MH-employee exemption does not explicitly say MH employees will be loan originators if they do either,[93] the Bureau elsewhere says "assisting" includes making referrals.[94] And an MH employee who makes referrals for compensation will be a loan originator.[95] This is one of the more confusing points of the Bureau's notice.[96] Nevertheless, despite the confusion about definitions, it appears clear that a MH employee will be considered a loan originator if, for compensation, she makes a referral or advises a consumer on loan terms.[97] This should be confirmed and clarified in the commentary.

The supplementary information accompanying the rule says that "assisting" includes preparing loan packages (such as credit applications or pre-approval applications and supporting documents), collecting information on behalf of consumers,[98] and filling out applications.[99] "Collecting information on behalf of consumers" presumably refers to collecting information from third-parties, such as requesting verification of income from the consumer's employer. But does it also include obtaining credit reports? The Bureau should elaborate on the meaning of "collecting information on behalf of consumers" and provide examples.

The scope of the term "assisting" is especially confusing. It sounds as though MH retailer employees are not loan originators when they assist the homebuyer by preparing loan packages (such as credit applications or pre-approval applications and supporting documents) or collect information on behalf of consumers for compensation. But MH retailer employees will be loan originators if they fill out applications for consumers for compensation. The Bureau did not explain the difference between preparing a loan package and filling out an application.

In order for MH retailers to implement the rules on loan originator compensation, they will need to give their employees a clear list of what they can and cannot do or say to customers. The final rule includes some clear guidance and examples but not enough. We encourage the Bureau to issue

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92 *Id.* at 80.

93 *See id.* at 94 (noting the exclusion permits MH retail employees to assist consumers in obtaining or applying for credit).

94 *Id.* at 76 n.62.

95 *See id.* at 75 (saying making referrals is a form of "taking" an application, which makes an MH employee a loan originator).

96 *Compare id.* at 76 n.62 (saying "The Bureau . . . believes that referral activities are encompassed within the language 'assists a consumer in obtaining or applying to obtain a residential mortgage loan' in TILA section 103(cc)(2).") *with id.* at 94 (saying "The one core activity that the exclusion permits manufactured housing retail employees to perform without becoming loan originators, '[a]ssisting a consumer in obtaining or applying to obtain' credit, has a statutorily defined meaning that does not include referring consumers to a creditor.").

97 *Id.* at 93, 94. *See also id.* at 76 n.62 (saying "advise" includes referrals).

98 Presumably this refers to collecting information from third-parties, such as requesting verification of income from the consumer's employer. The Bureau, however, did not elaborate on "collecting information on behalf of consumers."

99 LO Notice. at 82; 15 U.S.C. § 1062(cc)(4).

additional commentary with specific examples and instructions. At a minimum, the Bureau should more clearly state that employees who make referrals for compensation are considered loan originators—whether the compensation is paid to the employee or the employer. Referrals, including giving someone a blank loan application from a specific lender or submitting an application to a particular lender are one of the most likely forms of loan originator activity.