



FEDERAL REGISTER

Vol. 77

Friday,

No. 174

September 7, 2012

Part II

Bureau of Consumer Financial Protection

12 CFR Part 1026

Truth in Lending Act (Regulation Z); Loan Originator Compensation;
Proposed Rule

BUREAU OF CONSUMER FINANCIAL PROTECTION**12 CFR Part 1026**

[Docket No. CFPB–2012–0037]

RIN 3170–AA13

Truth in Lending Act (Regulation Z); Loan Originator Compensation**AGENCY:** Bureau of Consumer Financial Protection.**ACTION:** Proposed rule with request for public comment.

SUMMARY: The Bureau of Consumer Financial Protection is publishing for public comment a proposed rule amending Regulation Z (Truth in Lending) to implement amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The proposal would implement statutory changes made by the Dodd-Frank Act to Regulation Z's current loan originator compensation provisions, including a new additional restriction on the imposition of any upfront discount points, origination points, or fees on consumers under certain circumstances. In addition, the proposal implements additional requirements imposed by the Dodd-Frank Act concerning proper qualification and registration or licensing for loan originators. The proposal also implements Dodd-Frank Act restrictions on mandatory arbitration and the financing of certain credit insurance premiums. Finally, the proposal provides additional guidance and clarification under the existing regulation's provisions restricting loan originator compensation practices, including guidance on the application of those provisions to certain profit-sharing plans and the appropriate analysis of payments to loan originators based on factors that are not terms but that may act as proxies for a transaction's terms.

DATES: Comments must be received on or before October 16, 2012, except for comments on the Paperwork Reduction Act analysis in part IX of this document, which must be received on or before November 6, 2012.

ADDRESSES: You may submit comments, identified by Docket No. CFPB–2012–0037 or RIN 3170–AA13, by any of the following methods:

- *Electronic:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *Mail/Hand Delivery/Courier:* Monica Jackson, Office of the Executive Secretary, Consumer Financial

Protection Bureau, 1700 G Street NW., Washington, DC 20552.

Instructions: All submissions should include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. Because paper mail in the Washington, DC area and at the Bureau is subject to delay, commenters are encouraged to submit comments electronically. In general, all comments received will be posted without change to <http://www.regulations.gov>. In addition, comments will be available for public inspection and copying at 1700 G Street NW., Washington, DC 20552, on official business days between the hours of 10 a.m. and 5 p.m. Eastern Time. You can make an appointment to inspect the documents by telephoning (202) 435–7275.

All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Sensitive personal information, such as account numbers or Social Security numbers, should not be included. Comments will not be edited to remove any identifying or contact information.

FOR FURTHER INFORMATION CONTACT:

Daniel C. Brown and Michael G. Silver, Counsels; Krista P. Ayoub and R. Colgate Selden, Senior Counsels; Paul Mondor, Senior Counsel & Special Advisor; Charles Honig, Managing Counsel; Office of Regulations, at (202) 435–7700.

SUPPLEMENTARY INFORMATION:**I. Summary of the Proposed Rule***A. Background*

The mortgage market crisis focused attention on the critical role that loan officers and mortgage brokers play in the loan origination process. Because consumers generally take out only a few home loans over the course of their lives, they often rely heavily on loan officers and brokers to guide them. But prior to the crisis, training and qualification standards for loan originators varied widely, and compensation was frequently structured to give loan originators strong incentives to steer consumers into more expensive loans. Often, consumers paid loan originators an upfront fee without realizing that their creditors also were paying the loan originators commissions that increased with the price of the loan.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)¹ expanded on previous efforts by lawmakers and regulators to strengthen loan originator qualification

requirements and regulate industry compensation practices. The Bureau is proposing new rules to implement the Dodd-Frank Act requirements, as well as to revise and clarify existing regulations and guidance on loan originator compensation.

The Bureau is also proposing rules to implement a new Dodd-Frank Act requirement that appears to be designed to address broader consumer confusion about the relationship between certain upfront charges and loan interest rates. Specifically, for mortgage loans in which a brokerage firm or creditor pays a loan originator a transaction-specific commission, the Dodd-Frank Act would ban the imposition on consumers of discount points, origination points, or other upfront origination fees that are retained by the creditor, broker, or an affiliate of either. Although bona fide upfront payments to independent appraisers or other third parties would still be permitted, the Act would require creditors in the vast majority of transactions in today's market to restructure their current pricing practices.

However, the Bureau is proposing to use its exception authority under the Dodd-Frank Act to allow creditors to continue making available loans with points and/or fees, so long as they also make available a comparable, alternative loan, as described below. The Bureau believes this approach would benefit consumers and industry alike. Making both options available would make it easier for consumers to evaluate different pricing options, while preserving their ability to make some upfront payments if they want to reduce their periodic payments over time. And the proposed approach would promote stability in the mortgage market, which would otherwise face radical restructuring of its existing pricing structures and practices to comply with the new Dodd-Frank Act requirement.

B. Restriction on Upfront Points and Fees

The proposed rule would generally require that, before a creditor or mortgage broker may impose upfront points and/or fees on a consumer in a closed-end mortgage transaction, the creditor must make available to the consumer a comparable, alternative loan with no upfront discount points, origination points, or origination fees that are retained by the creditor, broker, or an affiliate of either (a “zero-zero alternative”). The requirement would not be triggered by charges that are passed on to independent third parties that are not affiliated with the creditor or mortgage broker. The requirement

¹Public Law 111–203, 124 Stat. 1376.

would not apply where the consumer is unlikely to qualify for the zero-zero alternative.

In transactions that do not involve a mortgage broker, the proposed rule would provide a safe harbor if, any time prior to application that the creditor provides a consumer an individualized quote for a loan that includes upfront points and/or fees, the creditor also provides a quote for a zero-zero alternative. In transactions that involve mortgage brokers, the proposed rule would provide a safe harbor under which creditors provide mortgage brokers with the pricing for all of their zero-zero alternatives. Mortgage brokers then would provide quotes to consumers for the zero-zero alternatives when presenting different loan options to consumers.

The Bureau is seeking comment on a number of related issues, including:

- Whether the Bureau should adopt as proposed a “bona fide” requirement to ensure that consumers receive value in return for paying upfront points and/or fees and, if so, the relative merits of several alternatives on the details of such a requirement;
- Whether additional adjustments to the proposal concerning the treatment of affiliate fees would make it easier for consumers to compare offers between two or more creditors;
- Whether to take a different approach concerning situations in which a consumer does not qualify for the zero-zero alternative; and
- Whether to require information about zero-zero alternatives to be provided not just in connection with informal quotes, but also in advertising and at the time that consumers are provided disclosures within three days after application.

C. Restrictions on Loan Originator Compensation

The proposal would adjust existing rules governing compensation to loan officers and mortgage brokers in connection with closed-end mortgage transactions to account for the Dodd-Frank Act and to provide greater clarity and flexibility. Specifically, the proposal would:

- Continue the general ban on paying or receiving commissions or other loan originator compensation based on the terms of the transaction (other than loan amount), with some refinements:
 - The proposal would allow reductions in loan originator compensation to cover unanticipated increases in closing costs from non-affiliated third parties under certain circumstances.

- The proposal would clarify when a factor used as a basis for compensation is prohibited as a “proxy” for a transaction term.

- Clarify and revise restrictions on pooled compensation, profit-sharing, and bonus plans for loan originators, depending on the potential incentives to steer consumers to different transaction terms.

- The proposal would permit employers to make contributions from general profits derived from mortgage activity to 401(k) plans, employee stock plans, and other “qualified plans” under tax and employment law.

- The proposal would permit employers to pay bonuses or make contributions to non-qualified profit-sharing or retirement plans from general profits derived from mortgage activity if either (1) the loan originator affected has originated five or fewer mortgage transactions during the last 12 months; or (2) the company’s mortgage business revenues are limited. The Bureau is proposing two alternatives, 25 percent or 50 percent of total revenues, as the applicable test.

- Even though contributions and bonuses could be funded from general mortgage profits, the amounts of such contributions and bonuses could not be based on the terms of the transactions that the individual had originated.

- Continue the general ban on loan originators being compensated by both consumers and other parties, with some refinements:

- The proposal would allow mortgage brokerage firms that are paid by the consumer to pay their individual brokers a commission, so long as the commission is not based on the terms of the transaction.

- The proposal would clarify that certain funds contributed toward closing costs by sellers, home builders, home-improvement contractors, or similar parties, when used to compensate a loan originator, are considered payments made directly to the loan originator by the consumer.

D. Loan Originator Qualification Requirements

The proposal would implement a Dodd-Frank Act provision requiring both individual loan originators and their employers to be “qualified” and to include their license or registration numbers on certain specified loan documents.

- Where a loan originator is not already required to be licensed under the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act), the proposal would require his or her employer to ensure that the loan

originator meets character, fitness, and criminal background check standards that are equivalent to SAFE Act requirements and receives training commensurate with the loan originator’s duties.

- Employers would be required to ensure that their loan originator employees are licensed or registered under the SAFE Act where applicable.
- Employers and the individual loan originators that are primarily responsible for a particular transaction would be required to list their license or registration numbers on certain key loan documents.

E. Other Provisions

The proposal would implement certain other Dodd-Frank Act requirements applicable to both closed-end and open-end mortgage credit:

- The proposal would ban general agreements requiring consumers to submit any disputes that may arise to mandatory arbitration rather than filing suit in court.

- The proposal would generally ban the financing of premiums for credit insurance.

- In the preamble below, the Bureau describes rule text that may be included in the final rule to implement a Dodd-Frank Act requirement that the Bureau require depository institutions to establish and maintain procedures to assure and monitor compliance with many of the requirements described above and the registration procedures established under the SAFE Act.

II. Background

A. The Mortgage Market

Overview of the Market and the Mortgage Crisis

The mortgage market is the single largest market for consumer financial products and services in the United States, with approximately \$10.3 trillion in loans outstanding.² During the last decade, the market went through an unprecedented cycle of expansion and contraction. So many other parts of the American financial system were drawn into mortgage-related activities that, when the bubble collapsed in 2008, it sparked the most severe recession in the United States since the Great Depression.

The expansion in the market was driven, in part, by an era of low interest rates and rising house prices. Interest rates dropped significantly—by more than 20 percent—from 2000 through

² 2 Inside Mortg. Fin., The 2012 Mortgage Market Statistical Annual 7 (2012).

2003.³ Housing prices increased dramatically—about 152 percent—between 1997 and 2006.⁴ Driven by the decrease in interest rates and the increase in housing prices, the volume of refinancings was increasing, from about 2.5 million loans in 2000 to more than 15 million in 2003.⁵

Growth in the mortgage loan market was particularly pronounced in what are known as “subprime” and “Alt-A” products. Subprime products were sold primarily to borrowers with poor or no credit history, although there is evidence that some borrowers who would have qualified for “prime” loans were steered into subprime loans as well.⁶ The Alt-A category of loans permitted borrowers to take out mortgage loans while providing little or no documentation of income or other evidence of repayment ability. Because these loans involved additional risk, they were typically more expensive to borrowers than “prime” mortgages, although many of them had very low introductory interest rates. In 2003, subprime and Alt-A origination volume was about \$400 billion; in 2006, it had reached \$830 billion.⁷

So long as housing prices were continuing to increase, it was relatively easy for borrowers to refinance their loans to avoid interest rate resets and other adjustments. When housing prices began to decline in 2005, refinancing became more difficult and delinquency rates on these subprime and Alt-A products increased dramatically.⁸ The

private securitization-backed subprime and Alt-A mortgage market ground to a halt in 2007 in the face of these rising delinquencies. Fannie Mae and Freddie Mac, which supported the mainstream mortgage market, experienced heavy losses and were placed in conservatorship by the Federal government in 2008.

Four years later, the United States continues to grapple with the fallout. Home prices are down 35 percent from the peak nationally, as the national market appears at or near its bottom.⁹ Mortgage markets continue to rely on extraordinary U.S. government support, and distressed homeownership and foreclosure rates remain at unprecedented levels.¹⁰

Nevertheless, even with the economic downturn, approximately \$1.28 trillion in mortgage loans were originated in 2011.¹¹ The overwhelming majority of homebuyers continue to use mortgage loans to finance at least some of the purchase price of their property. In 2011, 93 percent of all new home purchases were financed with a mortgage loan.¹² Purchase loans and refinancings together produced 6.3 million new first-lien mortgage loan originations in 2011.¹³ Home equity loans and lines of credit resulted in an additional 1.3 million mortgage loan originations in 2011.¹⁴

The Mortgage Origination Process and Origination Channels

Consumers must go through a mortgage origination process to obtain a

mortgage loan. There are many actors involved in a mortgage origination. In addition to the creditor and the consumer, a transaction may involve a mortgage broker, settlement agent, appraiser, multiple insurance providers, local government clerks and tax offices, and others. Purchase money loans involve additional parties such as sellers and real estate agents. These third parties typically charge fees or commissions for the services they provide.

Application. To obtain a mortgage loan, consumers must first apply through a loan originator. There are three different “channels” for mortgage loan origination in the current market:

- **Retail:** The consumer deals with a loan officer that works directly for the mortgage creditor, such as a bank, credit union, or specialized mortgage finance company. The creditor typically operates a network of branches, but may also communicate with consumers through mail and the Internet. The entire origination transaction is conducted within the corporate structure of the creditor, and the loan is closed using funds supplied by the creditor. Depending on the type of creditor, the creditor may hold the loan in its portfolio or sell the loan to investors on the secondary market, as discussed further below.

- **Wholesale:** The consumer deals with an independent mortgage broker, which may be an individual or a mortgage brokerage firm. The broker may seek offers from many different creditors, and then acts as a liaison between the consumer and whichever creditor ultimately makes the loan. At closing, the loan is funded using the creditor’s funds and the mortgage note is written in the creditor’s name.¹⁵ Again, the creditor may hold the loan in its portfolio or sell the loan on the secondary market.

- **Correspondent:** The consumer deals with a loan officer that works directly for a “correspondent lender” that does not deal directly with the secondary market. At closing, the correspondent lender closes the loans using its own funds, but then immediately sells the loan to an “acquiring creditor,” which in turn either holds the loan in portfolio or sells it on the secondary market.

Both loan officers and mortgage brokers generally help consumers determine what kind of loan best suits their needs, and will take their

³ See U.S. Dep’t of Hous. & Urban Dev., *An Analysis of Mortgage Refinancing, 2001–2003*, at 2 (2004), available at: www.huduser.org/Publications/pdf/MortgageRefinance03.pdf; Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 Fed. Res. Bank of St. Louis Rev. 31, 48 (2006), available at: <http://research.stlouisfed.org/publications/review/article/5019>.

⁴ U.S. Fin. Crisis Inquiry Comm’n, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* 156 (Official Gov’t ed. 2011) (“FCIC Report”), available at: <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

⁵ *An Analysis of Mortgage Refinancing, 2001–2003*, at 1.

⁶ The Federal Reserve Board on July 18, 2011 issued a consent cease and desist order and assessed an \$85 million civil money penalty against Wells Fargo & Company of San Francisco, a registered bank holding company, and Wells Fargo Financial, Inc., of Des Moines. The order addresses allegations that Wells Fargo Financial employees steered potential prime borrowers into more costly subprime loans and separately falsified income information in mortgage applications. In addition to the civil money penalty, the order requires that Wells Fargo compensate affected borrowers. See <http://www.federalreserve.gov/newsevents/press/enforcement/20110720a.htm>.

⁷ Inside Mortg. Fin., *The 2011 Mortgage Market Statistical Annual* (2011).

⁸ FCIC Report at 215–217.

⁹ *Standard & Poors/Case-Shiller 20-City Composite*, Bloomberg, LP, available at: <http://www.bloomberg.com> (data service accessible only through paid subscription).

¹⁰ PowerPoint Presentation, Lender Processing Servs., *LPS Mortgage Monitor: May 2012 Mortgage Performance Observations, Data as of April 2012 Month End*, at 3, 11 (May 2012), available at: <http://www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/Pages/Mortgage-Monitor.aspx>.

¹¹ *Credit Forecast 2012*, Moody’s Analytics (2012), available at, <http://www.economy.com/default.asp> (reflects first-lien mortgage loans) (data service accessible only through paid subscription).

¹² 1 Inside Mortg. Fin., *The 2012 Mortgage Market Statistical Annual 12* (2012).

¹³ *Credit Forecast 2012*. The proportion of loans that are for purchases as opposed to refinancings varies with the interest rate environment. In 2011, refinance transactions comprised 65 percent of the market, and purchase money mortgage loans comprised 35 percent, by dollar volume. 1 Inside Mortg. Fin., *The 2012 Mortgage Market Statistical Annual 17* (2012). Historically the distribution has been more even. In 2000, refinancings accounted for 44 percent of the market as measured by dollar volume, while purchase money mortgage loans comprised 56 percent, and in 2005 the two types of mortgage loan were split evenly. *Id.*

¹⁴ *Credit Forecast* (2012). Using a home equity loan or line of credit, a homeowner uses home equity as collateral for a loan. The loan proceeds can be used, for example, to pay for home improvements or to pay off other debts.

¹⁵ In some cases, mortgage brokers use a process called “table funding,” in which the wholesale creditor provides the funds to the settlement, but the loan is closed in the broker’s name. The broker simultaneously assigns the closed loan to the creditor.

completed loan applications for submission to the creditor's loan underwriter. The application includes consumer credit and income information, along with information about the home to be purchased. Consumers can work with multiple loan originators to compare the loan offers that loan originators may obtain on their behalf from creditors. Once the consumer has decided to move forward with a loan, the loan originator may request additional information or documents from the consumer to support the information in the application and obtain an appraisal of the property.

Underwriting. The creditor's loan underwriter uses the application and additional information to confirm initial information provided by the consumer. The underwriter will assess whether the creditor should take on the risk of making the mortgage loan. To make this decision, the underwriter considers whether the consumer can repay the loan and whether the home is worth enough to serve as collateral for the loan. If the underwriter finds that the consumer and the home qualify, the underwriter will approve the consumer's mortgage application.

Closing. After being approved for a mortgage loan, completing any closing requirements, and receiving necessary disclosures, the consumer can close on the loan. Multiple parties participate at closing, including the consumer, the creditor, and the settlement agent.

Loan Pricing and Disposition of Closed Loans

Mortgage loan pricing is an extremely complex process that involves a series of trade-offs for both the consumer and the creditor between upfront and long-term payments. Some of the costs that borrowers pay to close the loan—such as third-party appraisal fees, title insurance, taxes, etc.—are independent of the other terms of the loan. But costs that are paid to the creditor, broker, or affiliates of either company often vary in connection with the interest rate because the consumer can choose whether to pay more money up front (through discount points, origination points, or origination fees) or over time (through the interest rate, which drives monthly payments). Borrowers face a complex set of decisions around whether to pay upfront charges to reduce the interest rate they would otherwise pay and, if so, how much to pay in such charges to receive a specific rate reduction.

Thus, from the consumer's perspective, loan pricing depends on several elements:

- **Loan terms.** The loan terms affect how the loan is to be repaid, including the type of loan “product,”¹⁶ the interest rate, the payment amount, and the length of the loan term.

- **Discount points and cash rebates.** Discount points are paid by consumers to the creditor to purchase a lower interest rate. Conversely, creditors may offer consumers a cash rebate at closing which can help cover upfront closing costs in exchange for paying a higher rate over the life of the loan. Both discount points and creditor rebates involve an exchange of cash now (in the form of a payment or credit at closing) for cash over time (in the form of a reduced or increased interest rate).

- **Origination points or fees.** Creditors and/or loan originators also sometimes charge origination points or fees, which are typically presented as charges to apply for the loan. Origination fees can take a number of forms: A flat dollar amount, a percentage of the loan amount (*i.e.*, an “origination point”), or a combination of the two. Origination points or fees may also be framed as a single lump sum or as several different fees (*e.g.*, application fee, underwriting fee, document preparation fee).

- **Closing costs.** Closing costs are the additional upfront costs of completing a mortgage transaction, including appraisal fees, title insurance, recording fees, taxes, and homeowner's insurance, for example. These closing costs, as distinct from upfront discount points and origination charges, often are paid to third parties other than the creditor or loan originator.

In practice, both discount points and origination points or fees are revenue to the lender and/or loan originator, and that revenue is fungible. The existence of two types of fees and the many names lenders use for origination fees—some of which may appear to be more negotiable than others—has the potential to confuse consumers.

Determining the appropriate trade-off between payments now and payments later requires a consumer to have a clear sense of how long he or she expects to stay in the home and in the particular loan. If the consumer plans to stay in the home for a number of years without refinancing, paying points to obtain a lower rate may make sense because the consumer will save more in monthly

payments than he or she pays up front in discount points. If the consumer expects to move or refinance within a few years, however, then agreeing to pay a higher rate on the loan to reduce out of pocket expenses at closing may make sense because the consumer will save more up front than he or she will pay in increased monthly payments before moving or refinancing. There is a breakeven moment in time where the present value of a reduction/increase to the rate just equals the corresponding upfront points/credits. If the consumer moves or refinances earlier (in the case of discount points) or later (in the case of creditor rebates) than the breakeven moment, then the consumer will lose money compared to a consumer that neither paid discount points nor received creditor rebates.

The creditor's assessment of pricing—and in particular what different combinations of points, fees, and interest rates it is willing to offer particular consumers—is also driven by the trade-off between upfront and long-term payments. Creditors in general would prefer to receive as much money as possible up front, because having to wait for payments to come in over the life of the loan increases the level of risk. If consumers ultimately pay off a loan earlier than expected or cannot pay off a loan due to financial distress, the creditors will not earn the overall expected return on the loan.

One mechanism that has developed to manage this risk is the creation of the secondary market, which allows creditors to sell off their loans to investors, recoup the capital they have invested in the loans and recycle that capital into new loans. The investors then benefit from the payment streams over time, as well as bearing the risk of early payment or default. And the creditor can go on to make additional money from additional loans. Thus, although some banks and credit unions hold some loans in portfolio over time, many creditors prefer not to hold loans until maturity.¹⁷

When a creditor sells a loan into the secondary market, the creditor is exchanging an asset (the loan) that

¹⁶ The meaning of loan “product” is not firmly established and varies with the person using the term, but it generally refers to various combinations of features such as the type of interest rate and the form of amortization. Feature distinctions often thought of as distinct “loan products” include, for example, fixed rate versus adjustable rate loans and fully amortizing versus interest-only or negatively amortizing loans.

¹⁷ For companies that are affiliated with securitizers, the processing fees involved in creating investment vehicles on the secondary market can itself become a distinct revenue stream. Although the secondary market was originally created by government-sponsored enterprises Fannie Mae and Freddie Mac to provide liquidity for the mortgage market, over time, Wall Street companies began packaging mortgage loans into private-label mortgage-backed securities. Subprime and Alt-A loans, in particular, were often sold into private-label securities. During the boom, a number of large creditors started securitizing the loans themselves in-house, thereby capturing the final piece of the loan's value.

produces regular cash flows (principal and interest) for an upfront cash payment from the buyer.¹⁸ That upfront cash payment represents the buyer's present valuation of the loan's future cash flows, using assumptions about the rate of prepayments due to moves and refinancings, the rate of expected defaults, the rate of return relative to other investments, and other factors. Secondary market buyers assume considerable risk in determining the price they are willing to pay for a loan. If, for example, loans prepay faster than expected or default at higher rates than expected, the investor will receive a lower return than expected. Conversely, if loans prepay more slowly than expected, or default at lower rates than expected, the investor will earn a higher return over time than expected.¹⁹

Secondary market mortgage prices are typically quoted as a multiple of the principal loan amount and are specific to a given interest rate. For illustrative purposes, at some point in time, a loan with an interest rate of 3.5 percent might earn 102.5 in the secondary market. This means that for every \$100 in initial loan principal amount, the secondary market buyer will pay \$102.50. Of that amount, \$100 is to cover the principal amount and \$2.50 is revenue to the creditor in exchange for the rights to the future interest payments on the loan.²⁰ The secondary market price of a loan increases or decreases along with the loan's interest rate, but the relationship is not typically linear. In other words, using the above example at the same point in time, loans with interest rates higher than 3.5 percent will typically earn more than 102.5, and loans with interest rates less than 3.5 percent will typically earn less than 102.5. However, each subsequent 0.125 percent increment in interest rate above or below 3.5 percent may not be associated with the same size increment in secondary market price.²¹

¹⁸ For simplicity, this discussion assumes that the secondary market buyer is a person other than the creditor, such as Fannie Mae, Freddie Mac, or a Wall Street investment bank. In practice, during the mortgage boom, some creditors securitized their own loans. In this case, the secondary market price for the loans was effectively determined by the price investors were willing to pay for the subsequent securities.

¹⁹ For simplicity, these examples do not take into account the use of various risk mitigation techniques, such as risk-sharing counterparties and loan level mortgage or other security credit enhancements.

²⁰ The creditor's profit is equal to secondary market revenue plus origination fees collected by the creditor (if any) plus value of the mortgage servicing rights (MSRs) less origination expenses.

²¹ Susan E. Woodward, Urb. Inst., *A Study of Closing Costs for FHA Mortgages* 10–11 (U.S. Dep't of Hous. & Urban Dev. 2008), available at: http://www.huduser.org/publications/pdf/FHA_closing_cost.pdf.

In some cases, secondary market prices can actually be less than the principal amount of the loan. A price of 98.75, for example, means that for every \$100 in principal, the selling creditor receives only \$98.75. This represents a loss of \$1.25 per \$100 of principal just on the sale of the loan, before the creditor takes its expenses into account. This usually happens when the interest rate on the loan is below prevailing interest rates. But so long as discount points or other origination charges can cover the shortfall, the creditor will still make its expected return on the loan. The same style of pricing is used when correspondent lenders sell loans to acquiring creditors.

Discount points are also valuable to creditors (and secondary market investors) for another reason: Because payment of discount points signals the consumer's expectations about how long he or she expects to stay in the loan, they make prepayment risk easier to predict. The more discount points a consumer pays, the longer the consumer likely expects to keep the loan in place. This fact mitigates a creditor's or investor's uncertainty about how long interest payments can be expected to continue, which facilitates assigning a present value to the loan's yield and, therefore, setting the loan's price.

Loan Originator Compensation

Prior to 2010, compensation for individual loan officers and mortgage brokers was also often calculated and paid as a premium above every \$100 in principal. This was typically called a "yield spread premium." The loan originator might keep the entire yield spread premium as a commission, or he or she might provide some of the yield spread premium to the borrower as a credit against closing costs.²²

While this system was in place, it was common for loan originator commissions to mirror secondary market pricing closely. The "price" that the creditor quoted to its brokers and loan officers was somewhat lower than the price that the creditor expected to receive from the secondary market—the creditor kept the difference as corporate revenue. However, the underlying mechanics of the secondary market flowed through to the loan originator's compensation. The higher the interest rate on the loan or the more in upfront charges the consumer pays to the

www.huduser.org/publications/pdf/FHA_closing_cost.pdf.

²² Mortgage brokers, and some retail loan officers, were compensated in this fashion. Some retail loan officers may have been paid a salary with a bonus for loan volume, rather than yield spread premium-based commissions.

creditor (or both), the greater the yield spread premium available to the loan originator. This created a situation in which the loan originator had a financial incentive to steer consumers into the highest interest rate possible or to impose on the consumer additional upfront charges payable to the creditor.

In a perfectly competitive and transparent market, competition would ensure that this incentive would be countered by the need to compete with other loan originators to offer attractive loan terms to consumers. However, the mortgage origination market is neither always perfectly competitive nor always transparent, and consumers (who take out a mortgage only a few times in their lives) may be uninformed about how prices work and what terms they can expect.²³ Moreover, prior to 2010, mortgage brokers were free to charge consumers directly for additional origination points or fees, which were generally described as compensating for the time and expense of working with the consumer to submit the loan application. This compensation structure was problematic both because the loan originator had an incentive to steer borrowers into less favorable pricing terms and because the consumer may have paid origination fees to the loan originator believing that the loan originator was working for the borrower, without knowing that the loan originator was receiving compensation from the creditor as well.

The 2010 Loan Originator Final Rule

In the aftermath of the mortgage crisis, regulators and lawmakers began focusing on concerns about the steering of consumers into less favorable loan terms than those for which they otherwise qualified. Both the Board of Governors of the Federal Reserve System (Board) and the Department of Housing and Urban Development (HUD) had explored the use of disclosures to inform consumers about loan originator compensation practices. HUD did adopt a new disclosure regime under the Real Estate Settlement Procedures Act (RESPA), in a 2008 final rule, which addressed among other matters the

²³ James Lacko and Janis Pappalardo, *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms*, Federal Trade Commission, p. 26 (June 2007), available at: <http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf>, Brian K. Bucks and Karen M. Pence, *Do Borrowers Know their Mortgage Terms?*, J. of Urban Econ. (2008), available at: http://works.bepress.com/karen_pence/ 5, Hall and Woodward, *Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory and Mortgage-Market Evidence* (2012), available at: <http://www.stanford.edu/~rehall/DiagnosingConsumerConfusionJune2012>.

disclosure of mortgage broker compensation.²⁴ The Board, on the other hand, first proposed a disclosure-based approach to addressing concerns with mortgage broker compensation.²⁵ The Board later determined, however, that the proposed approach presented a significant risk of misleading consumers regarding both the relative costs of brokers and creditors and the role of brokers in their transactions and, consequently, withdrew that aspect of the 2008 proposal as part of its 2008 Home Ownership and Equity Protection Act (HOEPA) Final Rule.²⁶

The Board in 2009 proposed new rules addressing in a more substantive fashion loan originator compensation practices.²⁷ Although this proposal was prior to the enactment of the Dodd-Frank Act, Congress subsequently codified significant elements of the Board's proposal.²⁸ Specifically, the Board's new proposal prohibited the payment and receipt of loan originator compensation based on transaction terms or conditions, and banned the receipt by a loan originator of compensation on a particular transaction from both the consumer and any other person; the Dodd-Frank Act substantially paralleled both of these provisions. The Board therefore decided in 2010 to finalize those rules, while acknowledging that some adjustments would need to be made to account for the statutory language.²⁹ The Board's 2010 Loan Originator Final Rule took effect in April of 2011.

Most notably, the Board's 2010 Loan Originator Final Rule substantially restricted the use of yield spread premiums. Under the current regulations, creditors may not base a loan originator's compensation on the transaction's terms or conditions, other than the mortgage loan amount. In addition, the rule prohibits "dual compensation," in which a loan originator is paid compensation by both the consumer and the creditor (or any other person).³⁰ The existing rules, however, do not address broader consumer confusion regarding the relationship between loan originator

compensation and general trade-offs between points, fees, and interest rates.

B. TILA and Regulation Z

Congress enacted the Truth in Lending Act (TILA) based on findings that the informed use of credit resulting from consumers' awareness of the cost of credit would enhance economic stability and would strengthen competition among consumer credit providers. 15 U.S.C. 1601(a). One of the purposes of TILA is to provide meaningful disclosure of credit terms to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit. *Id.* TILA's disclosures differ depending on whether credit is an open-end (revolving) plan or a closed-end (installment) loan. TILA also contains procedural and substantive protections for consumers. TILA is implemented by the Bureau's Regulation Z, 12 CFR part 1026, though historically the Board's Regulation Z, 12 CFR part 226, has implemented TILA.³¹

On August 26, 2009, as discussed above, the Board published proposed amendments to Regulation Z to include new limits on loan originator compensation for all closed-end mortgages (Board's 2009 Loan Originator Proposal). 74 FR 43232 (Aug. 26, 2009). The Board considered, among other changes, prohibiting certain payments to a mortgage broker or loan officer based on the transaction's terms or conditions, prohibiting dual compensation as described above, and prohibiting a mortgage broker or loan officer from "steering" consumers to transactions not in their interest, to increase mortgage broker or loan officer compensation. The Board issued the 2009 Loan Originator Proposal using its authority to prohibit acts or practices in the mortgage market that the Board found to be unfair, deceptive, or (in the case of refinancings) abusive under TILA section 129(I)(2) (now redesignated as TILA section 129(p)(2), 15 U.S.C. 1639(p)(2)).

On September 24, 2010, the Board issued the 2010 Loan Originator Final Rule, which finalized the 2009 Loan Originator Proposal and included the above prohibitions. 75 FR 58509 (Sept. 24, 2010). The Board acknowledged, however, that further rulemaking would be required to address certain issues and adjustments made by the Dodd-Frank Act, which was signed on July 21,

2010.³² Public Law 111-203, 124 Stat. 1376.

C. The SAFE Act

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) generally prohibits an individual from engaging in the business of a loan originator without first obtaining, and maintaining annually, a unique identifier from the Nationwide Mortgage Licensing System and Registry (NMLSR) and either a registration as a registered loan originator or a license and registration as a State-licensed loan originator. 12 U.S.C. 5103. Loan originators who are employees of depository institutions are generally subject to the registration requirement, which is implemented by the Bureau's Regulation G, 12 CFR part 1007. Other loan originators are generally subject to the State licensing requirement, which is implemented by the Bureau's Regulation H, 12 CFR part 1008, and by State law.

D. The Dodd-Frank Act

Effective July 21, 2011, the Dodd-Frank Act transferred rulemaking authority for TILA and the SAFE Act, among other laws, to the Bureau.³³ See sections 1061 and 1100A of the Dodd-Frank Act. In addition, the Dodd-Frank Act added section 129B to TILA, which

³² As the Board explained: "The Board has decided to issue this final rule on loan originator compensation and steering, even though a subsequent rulemaking will be necessary to implement Section 129B(c). The Board believes that Congress was aware of the Board's proposal and that in enacting TILA Section 129B(c), Congress sought to codify the Board's proposed prohibitions while expanding them in some respects and making other adjustments. The Board further believes that it can best effectuate the legislative purpose of the [Dodd-Frank Act] by finalizing its proposal relating to loan origination compensation and steering at this time. Allowing enactment of TILA Section 129B(c) to delay final action on the Board's prior regulatory proposal would have the opposite effect intended by the legislation by allowing the continuation of the practices that Congress sought to prohibit." 75 FR 58509 (Sept. 24, 2010).

³³ Section 1029 of the Dodd-Frank Act excludes from this transfer of authority, subject to certain exceptions, any rulemaking authority over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both. 12 U.S.C. 5519. Pursuant to the Dodd-Frank Act and TILA, as amended, the Bureau published for public comment an interim final rule establishing a new Regulation Z, 12 CFR part 1026, implementing TILA (except with respect to persons excluded from the Bureau's rulemaking authority by section 1029 of the Dodd-Frank Act). 76 FR 79768 (Dec. 22, 2011). Similarly, the Bureau's Regulations G and H are recodifications of predecessor agencies' regulations implementing the SAFE Act. 76 FR 78483 (Dec. 19, 2011). The Bureau's Regulations G, H, and Z took effect on December 30, 2011. These rules did not impose any new substantive obligations but did make certain technical, conforming, and stylistic changes to reflect the transfer of authority and certain other changes made by the Dodd-Frank Act.

²⁴ 73 FR 68204, 68222-27 (Nov. 17, 2008).

²⁵ See 73 FR 1672, 1698-1700 (Jan. 9, 2008).

²⁶ 73 FR 44522, 44564 (Jul. 30, 2008). The Board indicated that it would continue to explore available options to address potential unfairness associated with loan originator compensation practices. *Id.* at 44565.

²⁷ 74 FR 43232, 43279-286 (Aug. 26, 2009).

²⁸ Sections 1402 and 1403 of the Dodd-Frank Act, codified at 15 U.S.C. 1639b.

²⁹ 75 FR 58509 (Sept. 24, 2010) (2010 Loan Originator Final Rule).

³⁰ See generally 12 CFR 226.36(d). The CFPB restated this rule at 12 CFR 1026.36(d). 76 FR 79768 (Dec. 22, 2011).

³¹ The Board's rule remains applicable to certain motor vehicle dealers. See section 1029 of the Dodd-Frank, 12 U.S.C. 5519.

imposes two new duties on mortgage originators. The first such duty is to be “qualified” and (where applicable) registered and licensed in accordance with the SAFE Act and other applicable State or Federal law. The second new duty of mortgage originators is to include on all loan documents the originator’s identifier number from the NMLSR. See section 1402 of the Dodd-Frank Act.

In addition, the Dodd-Frank Act generally codified, but in some cases imposed new or different requirements than, the Board’s 2009 Loan Originator Proposal. Shortly after the legislation, the Board adopted the 2010 Loan Originator Final Rule, which prohibits loan originator compensation based on transactions’ terms or conditions and compensation from both the consumer and another person, as discussed above. Those regulatory provisions were consistent with some aspects of the Dodd-Frank Act. In addition, the Dodd-Frank Act generally prohibits any person from requiring consumers to pay any upfront discount points, origination points, or fees, however denominated, where a mortgage originator is being paid transaction-specific compensation by any person other than the consumer (subject to the Bureau’s express authority to make an exemption from the prohibition of such upfront charges if the Bureau finds such an exemption to be in the interest of consumers and the public). See section 1403 of the Dodd-Frank Act. Finally, the Dodd-Frank Act also added new restrictions on the financing of single-premium credit insurance and mandatory arbitration agreements. See section 1414 of the Dodd-Frank Act.

E. Other Rulemakings

In addition to this proposal, the Bureau currently is engaged in six other rulemakings relating to mortgage credit to implement requirements of the Dodd-Frank Act:

- *TILA-RESPA Integration*: On July 9, 2012, the Bureau published a proposed rule and proposed integrated forms combining the TILA mortgage loan disclosures with the Good Faith Estimate (GFE) and settlement statement required under the Real Estate Settlement Procedures Act (RESPA), pursuant to Dodd-Frank Act section 1032(f) and sections 4(a) of RESPA and 105(b) of TILA, as amended by Dodd-Frank Act sections 1098 and 1100A, respectively. 12 U.S.C. 2603(a); 15 U.S.C. 1604(b). The public has until November 6, 2012 to review and provide comments on most of this proposal, except that comments are due

by September 7, 2012 for specific portions of the proposal.

- *HOEPA*: The Bureau proposed on July 9, 2012 to implement Dodd-Frank Act requirements expanding protections for “high-cost” mortgage loans under the Home Ownership and Equity Protection Act (HOEPA), pursuant to TILA sections 103(bb) and 129, as amended by Dodd-Frank Act sections 1431 through 1433. 15 U.S.C. 1602(bb) and 1639. The public has until September 7, 2012 to review and provide comment on this proposal, except comments on the Paperwork Reduction Act.

- *Servicing*: The Bureau proposed on August 9, 2012 to implement Dodd-Frank Act requirements regarding force-placed insurance, error resolution, and payment crediting, as well as forms for mortgage loan periodic statements and “hybrid” adjustable-rate mortgage reset disclosures, pursuant to sections 6 of RESPA and 128, 128A, 129F, and 129G of TILA, as amended or established by Dodd-Frank Act sections 1418, 1420, 1463, and 1464. 12 U.S.C. 2605; 15 U.S.C. 1638, 1638a, 1639f, and 1639g. The Bureau also proposed rules on reasonable information management, early intervention for delinquent consumers, continuity of contact, and loss mitigation, pursuant to the Bureau’s authority to carry out the consumer protection purposes of RESPA in section 6 of RESPA, as amended by Dodd-Frank Act section 1463. 12 U.S.C. 2605. The public has until October 9, 2012 to review and provide comment on these proposals, except comments on the Paperwork Reduction Act.

- *Appraisals*: The Bureau, jointly with Federal prudential regulators and other Federal agencies, on August 15, 2012 issued a proposal to implement Dodd-Frank Act requirements concerning appraisals for higher-risk mortgages, appraisal management companies, and automated valuation models, pursuant to TILA section 129H as established by Dodd-Frank Act section 1471, 15 U.S.C. 1639h, and sections 1124 and 1125 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) as established by Dodd-Frank Act sections 1473(f), 12 U.S.C. 3353, and 1473(q), 12 U.S.C. 3354, respectively. In addition, the Bureau on the same date issued rules to implement section 701(e) of the Equal Credit Opportunity Act (ECOA), as amended by Dodd-Frank Act section 1474, to require that creditors provide applicants with a free copy of written appraisals and valuations developed in connection with applications for loans secured by a first lien on a dwelling. 15 U.S.C. 1691(e).

- *Ability to Repay*: The Bureau is in the process of finalizing a proposal issued by the Board to implement provisions of the Dodd-Frank Act requiring creditors to determine that a consumer can repay a mortgage loan and establishing standards for compliance, such as by making a “qualified mortgage,” pursuant to TILA section 129C as established by Dodd-Frank Act sections 1411 and 1412. 15 U.S.C. 1639c.

- *Escrows*: The Bureau is in the process of finalizing a proposal issued by the Board to implement provisions of the Dodd-Frank Act requiring certain escrow account disclosures and exempting from the higher-priced mortgage loan escrow requirement loans made by certain small creditors, among other provisions, pursuant to TILA section 129D as established by Dodd-Frank Act sections 1461 and 1462. 15 U.S.C. 1639d.

With the exception of the TILA-RESPA Integration Proposal, the Dodd-Frank Act requirements will take effect on January 21, 2013 unless final rules implementing those requirements are issued on or before that date and provide for a different effective date.

The Bureau regards the foregoing rulemakings as components of a single, comprehensive undertaking; each of them affects aspects of the mortgage industry and its regulation that intersect with one or more of the others. Accordingly, the Bureau is coordinating carefully the development of the proposals and final rules identified above. Each rulemaking will adopt new regulatory provisions to implement the various Dodd-Frank Act mandates described above. In addition, each of them may include other provisions the Bureau considers necessary or appropriate to ensure that the overall undertaking is accomplished efficiently and that it ultimately yields a comprehensive regulatory scheme for mortgage credit that achieves the statutory purposes set forth by Congress, while avoiding unnecessary burdens on industry.

Thus, the Bureau intends that the rulemakings listed above function collectively as a whole. In this context, each rulemaking may raise concerns that might appear unaddressed if that rulemaking were viewed in isolation. The Bureau intends, however, to address issues raised by its mortgage rulemakings through whichever rulemaking is most appropriate, in the Bureau’s judgment, for addressing each specific issue. In some cases, the Bureau expects that one rulemaking may raise an issue and yet may not be the rulemaking that is most appropriate for

addressing that issue. For example, the proposed requirement to include NMLS IDs on loan documents, discussed in Part V under § 1026.36(g), below, also is proposed to be addressed in part by the TILA-RESPA Integration Proposal.

III. Outreach Conducted for This Rulemaking

A. Early Stakeholder Outreach & Feedback on Existing Rules

The Bureau conducted extensive outreach in developing the provisions in this proposed rule. Bureau staff met with and held in-depth conference calls with large and small bank and non-bank mortgage creditors, mortgage brokers, trade associations, secondary market participants, consumer groups, non-profit organizations, and State regulators. Discussions covered existing business models and compensation practices and the impact of the existing Loan Originator Rule. They also covered the Dodd-Frank Act provisions and the impact on consumers, loan originators, lenders, and secondary market participants of various options for implementing the statutory provisions. The Bureau developed several of the proposed clarifications of existing regulatory requirements in response to compliance inquiries and with input from industry participants.

B. Small Business Review Panel

In May 2012, the Bureau convened a Small Business Review Panel with the Chief Counsel for Advocacy of the Small Business Administration (SBA) and the Administrator of the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB).³⁴ As part of this process, the Bureau prepared an outline of the proposals then under consideration and the alternatives considered (Small Business Review Panel Outline), which the Bureau posted on its Web site for review by the general public as well as the small entities participating in the panel process.³⁵ The Small Business Review Panel gathered information from representatives of small creditors, mortgage brokers, and not-for-profit organizations and made findings and

recommendations regarding the potential compliance costs and other impacts of the proposed rule on those entities. These findings and recommendations are set forth in the Small Business Review Panel Report, which will be made part of the administrative record in this rulemaking.³⁶ The Bureau has carefully considered these findings and recommendations in preparing this proposal and has addressed certain specific ones below.

In addition, the Bureau held roundtable meetings with other Federal banking and housing regulators, consumer advocacy groups, and industry representatives regarding the Small Business Review Panel Outline. At the Bureau's request, many of the participants provided feedback, which the Bureau has considered in preparing this proposal.

IV. Legal Authority

The Bureau is issuing this proposed rule pursuant to its authority under TILA and the Dodd-Frank Act. On July 21, 2011, section 1061 of the Dodd-Frank Act transferred to the Bureau the "consumer financial protection functions" previously vested in certain other Federal agencies, including the Board. The term "consumer financial protection function" is defined to include "all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines." 12 U.S.C. 5581(a)(1). TILA and title X of the Dodd-Frank Act are Federal consumer financial laws. Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining "Federal consumer financial law" to include the "enumerated consumer laws" and the provisions of title X of the Dodd-Frank Act); Dodd-Frank Act section 1002(12), 12 U.S.C. 5481(12) (defining "enumerated consumer laws" to include TILA). Accordingly, the Bureau has authority to issue regulations pursuant to TILA, as well as title X of the Dodd-Frank Act.

A. The Truth in Lending Act

TILA Section 105(a)

As amended by the Dodd-Frank Act, TILA section 105(a), 15 U.S.C. 1604(a), directs the Bureau to prescribe regulations to carry out the purposes of TILA, and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. The purpose of TILA is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." TILA section 102(a); 15 U.S.C. 1601(a). These stated purposes are tied to Congress's finding that "economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit." TILA section 102(a). Thus, strengthened competition among financial institutions is a goal of TILA, achieved through the effectuation of TILA's purposes. In addition, TILA section 129B(a)(2) establishes a purpose of TILA sections 129B and 129C to "assure consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive." 15 U.S.C. 1639b(a)(2).

Historically, TILA section 105(a) has served as a broad source of authority for rules that promote the informed use of credit through required disclosures and substantive regulation of certain practices. However, Dodd-Frank Act section 1100A clarified the Bureau's section 105(a) authority by amending that section to provide express authority to prescribe regulations that contain "additional requirements" that the Bureau finds are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. This amendment clarified the authority to exercise TILA section 105(a) to prescribe requirements beyond those specifically listed in the statute that meet the standards outlined in section 105(a). The Dodd-Frank Act also clarified the Bureau's rulemaking authority over certain high-cost mortgages pursuant to section 105(a). As

³⁴ The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) requires the Bureau to convene a Small Business Review Panel before proposing a rule that may have a substantial economic impact on a significant number of small entities. See Public Law 104-121, tit. II, 110 Stat. 847, 857 (1996) (as amended by Pub. L. 110-28, section 8302 (2007)).

³⁵ U.S. Consumer Fin. Prot. Bureau, *Outline of Proposals Under Consideration and Alternatives Considered* (May 9, 2012), available at: http://files.consumerfinance.gov/f/201205_cfpb_MLO_SBREFA_Outline_of_Proposals.pdf.

³⁶ U.S. Consumer Fin. Prot. Bureau, U.S. Small Bus. Admin., and U.S. Office of Mgmt. and Budget, *Final Report of the Small Business Review Panel on CFPB's Proposals Under Consideration for Residential Mortgage Loan Origination Standards Rulemaking* (July 11, 2012) (Small Business Review Panel Final Report), available at: http://files.consumerfinance.gov/f/201208_cfpb_LO_comp_SBREFA.pdf.

amended by the Dodd-Frank Act, the Bureau's TILA section 105(a) authority to make adjustments and exceptions to the requirements of TILA applies to all transactions subject to TILA, except with respect to the substantive protections of TILA section 129, 15 U.S.C. 1639,³⁷ which apply to the high-cost mortgages referred to in TILA section 103(bb), 15 U.S.C. 1602(bb).

For the reasons discussed in this notice, the Bureau is proposing regulations to carry out TILA's purposes and is proposing such additional requirements, adjustments, and exceptions as, in the Bureau's judgment, are necessary and proper to carry out the purposes of TILA, prevent circumvention or evasion thereof, or to facilitate compliance. In developing these aspects of the proposal pursuant to its authority under TILA section 105(a), the Bureau has considered the purposes of TILA, including ensuring meaningful disclosures, facilitating consumers' ability to compare credit terms, and helping consumers avoid the uninformed use of credit, as well as ensuring consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deception or abusive. In developing this proposal and using its authority under TILA section 105(a), the Bureau also has considered the findings of TILA, including strengthening competition among financial institutions and promoting economic stabilization.

TILA Section 129B(c)

Dodd-Frank Act section 1403 amended TILA section 129B by imposing two limitations on loan originator compensation to reduce or eliminate steering incentives for residential mortgage loans.³⁸ 15 U.S.C.

³⁷ TILA section 129 contains requirements for certain high-cost mortgages, established by the Home Ownership and Equity Protection Act (HOEPA), which are commonly called HOEPA loans.

³⁸ Section 1403 of the Dodd-Frank Act also added new TILA section 129B(c)(3), which requires the Bureau to prescribe regulations to prohibit certain kinds of steering, abusive or unfair lending practices, mischaracterization of credit histories or appraisals, and discouraging consumers from shopping with other mortgage originators. 15 U.S.C. 1639b(c)(3). This proposed rule does not address those provisions. Because they are structured as a requirement that the Bureau prescribe regulations establishing the substantive prohibitions, notwithstanding Dodd-Frank Act section 1400(c)(3), 15 U.S.C. 1601 note, the Bureau believes that the substantive prohibitions cannot take effect until the regulations establishing them have been prescribed and taken effect. The Bureau intends to prescribe such regulations in a future rulemaking. Until such time, no obligations are imposed on mortgage originators or other persons under TILA section 129B(c)(3).

1639b(c). First, it generally prohibits loan originators from receiving compensation for any residential mortgage loan that varies based on the terms of the loan, other than the amount of the principal. Second, TILA section 129B generally allows only consumers to compensate loan originators, though an exception permits other persons to pay "an origination fee or charge" to a loan originator, but only if two conditions are met: (1) The loan originator does not receive any compensation directly from a consumer; and (2) the consumer does not make an upfront payment of discount points, origination points, or fees (other than bona fide third party fees that are not retained by the creditor, the loan originator, or the affiliates of either). The Bureau has authority to prescribe regulations to prohibit the above practices. In addition, TILA section 129B(c)(2)(B)(ii) authorizes the Bureau to create exemptions from the exception's second prerequisite, that the consumer must not make any upfront payments of points or fees, where the Bureau determines that doing so "is in the interest of consumers and in the public interest."

TILA Section 129(p)(2)

HOEPA amended TILA by adding, in new section 129, a broad mandate to prohibit certain acts and practices in the mortgage industry. In particular, TILA section 129(p)(2), as re-designated by Dodd-Frank Act section 1433(a), requires the Bureau to prohibit, by regulation or order, acts or practices in connection with mortgage loans that the Bureau finds to be unfair, deceptive, or designed to evade the provisions of HOEPA. 15 U.S.C. 1639(p)(2). Likewise, TILA requires the Bureau to prohibit, by regulation or order, acts or practices in connection with the refinancing of mortgage loans that the Bureau finds to be associated with abusive lending practices, or that are otherwise not in the interest of the consumer. *Id.*

The authority granted to the Bureau under TILA section 129(p)(2) is broad. It reaches mortgage loans with rates and fees that do not meet HOEPA's rate or fee trigger in TILA section 103(bb), 15 U.S.C. 1602(bb), as well as mortgage loans not covered under that section. TILA section 129(p)(2) is not limited to acts or practices by creditors, or to loan terms or lending practices.

TILA Section 129B(e)

Dodd-Frank Act section 1405(a) amended TILA to add new section 129B(e), 15 U.S.C. 1639b(e). That section provides for the Bureau to prohibit or condition terms, acts, or

practices relating to residential mortgage loans on a variety of bases, including when the Bureau finds the terms, acts, or practices are not in the interest of the consumer. In developing proposed rules under TILA section 129B(e), the Bureau has considered all of the bases for its authority set forth in that section.

TILA Section 129C(d)

Dodd-Frank Act section 1414(d) amended TILA to add new section 129C(d), 15 U.S.C. 1639c(d). That section prohibits the financing of certain single-premium credit insurance products. As discussed more fully in the section-by-section analysis below, the Bureau is proposing to implement this prohibition in new § 1026.36(i).

TILA Section 129C(e)

Dodd-Frank Act section 1414(e) amended TILA to add new section 129C(e), 15 U.S.C. 1639c(e). That section restricts mandatory arbitration agreements in residential mortgage loan transactions. As discussed more fully in the section-by-section analysis below, the Bureau is proposing to implement these restrictions in new § 1026.36(h).

B. The Dodd-Frank Act

Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof[.]" 12 U.S.C. 5512(b)(1). Section 1022(b)(2) of the Dodd-Frank Act prescribes certain standards for rulemaking that the Bureau must follow in exercising its authority under section 1022(b)(1). 12 U.S.C. 5512(b)(2). As discussed above, TILA and title X of the Dodd-Frank Act are Federal consumer financial laws. Accordingly, the Bureau proposes to exercise its authority under Dodd-Frank Act section 1022(b) to prescribe rules under TILA that carry out the purposes and prevent evasion of TILA. *See* part VI for a discussion of the Bureau's analysis and consultation pursuant to the standards for rulemaking under Dodd-Frank Act section 1022(b)(2).

V. Section-by-Section Analysis

This proposal implements new TILA sections 129B(b)(1), (c)(1), and (c)(2) and 129C(d) and (e), as added by sections 1402, 1403, 1414(d) and (e) of the Dodd-Frank Act.³⁹ As discussed in more detail in the section-by-section analysis to proposed § 1026.36(f) and (g), TILA

³⁹ As discussed in Part VI.B, below, the final rule under this proposal also may implement new TILA section 129B(b)(2).

section 129B(b)(1) requires each mortgage originator to be qualified and include unique identification numbers on loan documents. As discussed in more detail in the section-by-section analysis to proposed § 1026.36(d)(1) and (2), TILA section 129B(c)(1) and (2) prohibits “mortgage originators” in “residential mortgage loans” from receiving compensation that varies based on loan terms and from receiving origination charges or fees from persons other than the consumer except in certain circumstances. Additionally, as discussed in more detail in the section-by-section analysis to proposed § 1026.36(i), TILA section 129C(d) creates prohibitions on single-premium credit insurance. Finally, as discussed in the section-by-section analysis to proposed § 1026.36(h), TILA section 129C(e) provides restrictions on mandatory arbitration agreements.

Section 1026.25 Record Retention

Current § 1026.25 requires creditors to retain evidence of compliance with Regulation Z. The Bureau proposes to add § 1026.25(c)(2) and (3) to establish record retention requirements for compliance with § 1026.36(d). Proposed § 1026.25(c)(2): (1) Extends the time period for retention by creditors of compensation-related records from two years to three years; (2) requires loan originator organizations (*i.e.*, generally, mortgage broker companies) to maintain certain compensation-related records for three years; and (3) clarifies the types of compensation-related records that are required to be maintained under the rule. Proposed § 1026.25(c)(3) requires creditors to maintain records evidencing compliance with the requirements related to discount points and origination points or fees set forth in proposed § 1026.36(d)(2)(ii); it also extends the two-year requirement to three years.

25(a) General Rule

Current comment 25(a)–5 clarifies the nature of the record retention requirements under § 1026.25 as applied to Regulation Z’s loan originator compensation provisions. The comment provides that for each transaction subject to the loan originator compensation provisions in § 1026.36(d)(1), a creditor should maintain records of the compensation it provided to the loan originator for the transaction as well as the compensation agreement in effect on the date the interest rate was set for the transaction. The comment also states that where a loan originator is a mortgage broker, a disclosure of compensation or other broker agreement required by applicable

State law that complies with § 1026.25 would be presumed to be a record of the amount actually paid to the loan originator in connection with the transaction.

The Bureau is proposing new § 1026.25(c)(2), which sets forth certain new record retention requirements for loan originators as discussed below. New comments 25(c)(2)–1 and –2 are being proposed to accompany proposed § 1026.25(c)(2), and those comments incorporate substantially the same guidance as existing comment 25(a)–5. Therefore, the Bureau proposes to delete existing comment 25(a)–5.

25(c) Records Related to Certain Requirements for Mortgage Loans 25(c)(2) Records Related to Requirements for Loan Originator Compensation Retention of Records for Three Years

TILA does not contain requirements to retain specific records, but § 1026.25 requires creditors to retain evidence of compliance with TILA for two years after the date disclosures are required to be made or action is required to be taken. Section 1404 of the Dodd-Frank Act amended TILA section 129B to provide a cause of action against any mortgage originator for failure to comply with the requirements of TILA section 129B and any of its implementing regulations. 15 U.S.C. 1639b(d). Section 1416(b) of the Dodd-Frank Act amended section 130(e) of TILA to extend the statute of limitations for a civil action alleging a violation of TILA section 129B (along with sections 129 and 129C) to three years beginning on the date of the occurrence of the violation.⁴⁰ 15 U.S.C. 1639b(d), 1640(e). In view of the statutory changes to TILA, the provisions of current § 1026.25, which require a two-year record retention period, do not reflect all applicable statutes of limitations for causes of action brought under TILA. Moreover, the record retention provisions in § 1026.25 currently are limited to creditors, whereas TILA section 129B(e), as added by the Dodd-Frank Act, covers all loan originators and not solely creditors.

Consequently, the Bureau proposes § 1026.25(c)(2), which makes two changes to the current record retention provisions. First, a creditor must maintain records sufficient to evidence the compensation it pays to a loan

originator organization or the creditor’s individual loan originators, and the governing compensation agreement, for three years after the date of payment. Second, a loan originator organization must maintain for three years records of the compensation (1) it receives from a creditor, a consumer, or another person, and (2) it pays to its individual loan originators. The loan originator organization must maintain records sufficient to evidence the compensation agreement that governs those receipts or payments, for three years after the date of the receipts or payments. The Bureau proposes these changes pursuant to its authority under section 105(a) of TILA to prevent circumvention or evasion of TILA by requiring records that can be used to establish compliance. The Bureau believes these proposed modifications will ensure records associated with loan originator compensation are retained for a time period commensurate with the statute of limitations for causes of action under TILA section 130 and are readily available for examination, which is necessary to prevent circumvention of and to facilitate compliance with TILA.

However, the Bureau invites public comment on whether a record retention period of five years, rather than three years, would be appropriate. The Bureau believes that relevant actions and compensation practices that must be evidenced in retained records may in some cases occur prior to the beginning of the three-year period of enforceability that applies to a particular transaction. In addition, the running of the three-year period may be tolled (*i.e.*, paused) under some circumstances, resulting in a period of enforceability that ends more than three years following an occurrence of a violation of applicable requirements. Accordingly, a record retention period that is longer than three years may help ensure that consumers are able to avail themselves of TILA protections while imposing minimal incremental burden on creditors and loan originators. The Bureau notes that many State and local laws related to transactions involving real property may require a record retention period, or may depend on the information being available, for five years. Additionally, a five-year record retention period is consistent with provisions in the Bureau’s TILA–RESPA Integration Proposal.

The Bureau believes that it is necessary to extend the record retention requirements to loan originator organizations, thus requiring both creditors and loan originator organizations to retain evidence of compliance with the requirements of

⁴⁰ Prior to the Dodd-Frank Act amendment, TILA section 130(e) provided for a one year statute of limitations for civil actions to enforce TILA provisions. A civil action to enforce certain TILA provisions (including section 129B) brought by a State attorney general has a three year statute of limitations.

§ 1026.36(d)(1) for three years. Although creditors may retain some of the records needed to demonstrate compliance with TILA section 129B and its implementing regulations, in some circumstances, the records may be available solely from the loan originator organization. For example, if a creditor pays a loan originator organization a fee for arranging a loan and the loan originator organization in turn allocates a portion of that fee to the individual loan originator as a commission, the creditor may not possess a copy of the commission agreement setting forth the arrangement between the loan originator organization and the individual loan originator or any record of the payment of the commission. The Bureau believes that applying this proposed requirement to both creditors and loan originator organizations will prevent circumvention of and facilitate compliance with TILA, as amended by the Dodd-Frank Act.

The Bureau recognizes that extending the record retention requirement for creditors from two years for specific information related to loan originator compensation, as currently provided in Regulation Z, to three years may result in some increase in costs for creditors. The Bureau believes, however, that creditors should be able to use existing recordkeeping systems to maintain the records for an additional year at minimal cost. Similarly, although loan originator organizations may incur some costs to establish and maintain recordkeeping systems, loan originator organizations may be able to use existing recordkeeping systems that they maintain for other purposes at minimal cost. During the Small Business Review Panel process, the small entity representatives were asked about their current record retention practices and the potential impact of the proposed enhanced record retention requirements. Of the few small entity representatives who gave feedback on the issue, one creditor small entity representative stated that it maintained detailed records of compensation paid to all of its employees and that a regulator already reviews its compensation plans regularly, and another creditor small entity representative reported that it did not believe the proposed record retention requirement would require it to change its current practices.

Applying the current two-year record retention period to information specified in proposed § 1026.25(c) could adversely affect the ability of consumers to bring actions under TILA. The extension also would serve to reduce litigation risk and maintain consistency

between creditors and loan originator organizations. The Bureau therefore believes it is appropriate to expand the time period for record retention to effectuate the three-year statute of limitations period established by Congress for actions against loan originators under section 129B of TILA.

Exclusion of Individual Loan Originators

The proposed recordkeeping requirements do not apply to individual loan originators. Although section 129B(d) of TILA, as amended by the Dodd-Frank Act, permits consumers to bring actions against mortgage originators (which include individual loan originators), the Bureau believes that applying the proposed record retention requirements of § 1026.25 to individual loan originators is unnecessary. Under the proposed record retention requirements, loan originator organizations and creditors must retain certain records regarding all of their individual loan originator employees. Applying the same record retention requirements to the individual loan originator employees themselves would be duplicative. In addition, such a requirement may not be feasible in all cases, because individual loan originators may not have access to the types of records required to be retained under § 1026.25, particularly after they cease to be employed by the creditor or loan originator organization. An individual loan originator who is a sole proprietor, however, is responsible for compliance with provisions that apply to the proprietorship (which is a loan originator organization) and, as a result, is responsible for compliance with the proposed record retention requirements. Similarly, an individual who is a creditor is subject to the requirements that apply to creditors.

Substance of Record Retention Requirements

As discussed above, proposed § 1026.25(c)(2) makes two changes to the current record retention provisions. First, proposed § 1026.25(c)(2)(i) requires a creditor to maintain records sufficient to evidence all compensation it pays to a loan originator organization or the creditor's individual loan originators, and a copy of the governing compensation agreement. Second, proposed § 1026.25(c)(2)(ii) requires a loan originator organization to maintain records of all compensation that it receives from a creditor, a consumer, or another person or that it pays to its individual loan originators; it also requires the loan originator organization to maintain a copy of the compensation

agreement that governs those receipts or payments.

Proposed comment 25(c)(2)-1.i clarifies that, under proposed § 1026.25(c)(2), records are sufficient to evidence that compensation was paid and received if they demonstrate facts enumerated in the comment. The comment gives examples of the types of records that, depending on the facts and circumstances, may be sufficient to evidence compliance. Proposed comment 25(c)(2)-1.ii clarifies that the compensation agreement, evidence of which must be retained under 1026.25(c)(2), is any agreement, written or oral, or course of conduct that establishes a compensation arrangement between the parties. Proposed comment 25(c)(2)-1.iii provides an example where the expiration of the three-year retention period varies depending on when multiple payments of compensation are made. Proposed comment 25(c)(2)-2 provides an example of retention of records sufficient to evidence payment of compensation.

25(c)(3) Records Related to Requirements for Discount Points and Origination Points or Fees

Proposed § 1026.25(c)(3) requires creditors to retain records pertaining to compliance with the provisions of § 1026.36(d)(2)(ii), regarding the payment of discount points and origination points or fees (see the section-by-section analysis to proposed § 1026.36(d)(2)(ii), below, for further discussion of these proposed requirements). Specifically, it provides that, for each transaction subject to proposed § 1026.36(d)(2)(ii), the creditor must maintain records sufficient to evidence that the creditor has made available to the consumer the comparable, alternative loan that does not include discount points and origination points or fees as required by § 1026.36(d)(2)(ii)(A) or if such a loan was not made available to the consumer, a good-faith determination that the consumer was unlikely to qualify for such a loan. The creditor must also maintain records to evidence compliance with the "bona fide" requirements under proposed § 1026.36(d)(2)(ii)(C) (e.g., that the payment of discount points and origination points or fees leads to a bona fide reduction in the interest rate). For the same reasons discussed above under § 1026.25(c)(2), the Bureau also proposes that creditors be required to retain records under § 1026.25(c)(3) for three years and also invites comment on whether the period of required record

retention for purposes of § 1026.25(c)(3) should be five years.

Section 36 Prohibited Acts or Practices and Certain Requirements for Credit Secured by a Dwelling

36(a) Loan Originator, Mortgage Broker, and Compensation Defined

As discussed above, this proposed rule would implement new TILA sections 129B(b)(1), (c)(1) and (c)(2) and 129C(d) and (e), as added by sections 1402, 1403, and 1414(d) and (e) of the Dodd-Frank Act. TILA section 103(cc), which was added by section 1401 of the Dodd-Frank Act, contains definitions for “mortgage originator” and “residential mortgage loan.” These definitions are relevant to the implementation of loan originator compensation restrictions, limitations on discount points and origination points or fees, and loan originator qualification provisions under this proposal. The statutory definitions largely parallel the existing regulation’s coverage, in terms of both persons and transactions subject to its requirements. As discussed below, the Bureau is seeking to retain the existing regulatory terms, to maximize continuity, while adjusting as necessary to reflect statutory differences, to reflect the fact that they now relate to more than just loan originator compensation limitations, and to facilitate the additional interpretation and clarification being proposed under existing rules.

Current § 1026.36 uses the term “loan originator.” Dodd-Frank Act amendments to TILA being addressed in this proposed rulemaking use the term “mortgage originator” as defined in TILA section 103(cc)(2). The Bureau does not propose to change the existing terminology in § 1026.36, although the Bureau is proposing certain clarifying amendments to the definition and its commentary. As discussed in more detail below, the Bureau believes that the definition of “loan originator” set forth in existing § 1026.36(a)(1) is consistent with the definition of “mortgage originator” in TILA section 103(cc) as amended by the Dodd-Frank Act. The Bureau also believes that the term “loan originator” has been in wide use since first adopted by the Board in 2010. Any changes to the “loan originator” terminology could require stakeholders to make equivalent revisions in many aspects of their operations, including in policies and procedures, compliance materials, and software and training. In addition, for the reasons discussed below, the Bureau is proposing two new definitions, in proposed § 1026.36(a)(1)(ii) and (iii), to

establish the terms “loan originator organization” and “individual loan originator.”

The Bureau also proposes to add new § 1026.36(a)(3) to define compensation. The proposal transfers guidance on the meaning of the term “compensation” in current comment 36(d)(1)– to § 1026.36(a)(3). Other guidance regarding the term “compensation” in comment 36(d)(1)–1 is proposed to be transferred to new comment 36(a)–5 and revised.

36(a)(1) Loan Originator

36(a)(1)(i)

The Bureau is proposing to redesignate § 1026.36(a)(1) as § 1026.36(a)(1)(i) and to make certain amendments to it and its commentary, as discussed below, to reflect new TILA section 103(cc)(2). TILA section 103(cc)(2)(A) defines “mortgage originator” to mean: “any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain—(i) takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan.” TILA section 103(cc)(2)(B) further defines a mortgage originator as including “any person who represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such person can or will provide any of the services or perform any of the activities described in subparagraph A.” TILA section 103(cc)(2)(C) through (G) provides certain exclusions from the general definition of mortgage originator, as discussed below.

In current § 1026.36(a)(1), the term “loan originator” means “with respect to a particular transaction, a person who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person.” The Bureau broadly interprets the phrase “arranges, negotiates, or otherwise obtains an extension of consumer credit for another person” in the definition of “loan originator.”⁴¹

⁴¹ This is consistent with the Board’s related rulemakings on this issue. See 75 FR 58509, 58518 (Sept. 24, 2010); 74 FR 43232, 43279 (Aug. 26, 2009); 73 FR 44522, 44565 (July 30, 2008); 73 FR 1672, 1726 (Jan. 9, 2008); 76 FR 27390, 27402 (May 11, 2011).

The Bureau believes the phrase includes the specific activities set forth in TILA section 103(cc)(2)(A), including: (1) Takes a loan application; (2) assists a consumer in obtaining or applying to obtain a loan; or (3) offers or negotiates terms of a loan.

The meaning of the term “arranges” is very broad,⁴² and the Bureau believes that it includes any part of the process of originating a credit transaction, including advertising or communicating to the public that one can perform loan origination services and referrals of a consumer to another person who participates in the process of originating a transaction (subject to administrative, clerical and other applicable exclusions discussed in more detail below). That is, the definition includes persons who participate in arranging a credit transaction with others and persons who arrange the transaction entirely, including initial contact with the consumer, assisting the consumer to apply for a loan, taking the application, offering and negotiating loan terms, and consummation of the credit transaction.

These statutory refinements to the phrase, “assists a consumer in obtaining or applying to obtain a residential mortgage loan,” suggest that minor actions, e.g., accepting a completed application form and delivering it to a loan officer, without assisting the consumer in completing it, processing or analyzing the information, or discussing loan terms, would not be included in the definition. In this situation, the person is not engaged in any action specific to actively aiding or further achieving a complete loan application or collecting information on behalf of the consumer specific to a mortgage loan. This interpretation is also consistent with the exclusion in TILA section 103(cc)(2)(C)(i) for certain administrative and clerical persons, which is discussed in more detail below.

Nevertheless, the Bureau proposes to add “takes an application” and “offers,” as used in the definition of “mortgage originator” in TILA section 103(cc)(2)(A), to the definition of “loan originator” in current § 1026.36(a). The Bureau believes that, even though the definition of “loan originator” in current § 1026.36(a) includes the meaning of these terms, expressly stating them clarifies that the definition

⁴² Arrange is defined by Merriam-Webster Online Dictionary to include: (1) “to put into a proper order or into a correct or suitable sequence, relationship, or adjustment;” (2) “to make preparations for;” (3) “to bring about an agreement or understanding concerning.” *Arrange Definition*, Merriam-Webster.com, available at: <http://www.merriam-webster.com/dictionary/arrange>.

of “loan originator” in § 1026.36(a) includes the core elements of the definition of “mortgage originator” in TILA section 103(cc)(2)(A). Inclusion of the terms also facilitates compliance with TILA by removing any risk of uncertainty on this point.

Arranges, Negotiates, or Otherwise Obtains

TILA section 103(cc)(2) defines “mortgage originator” to include a person who “takes a residential mortgage loan application” and “assists a consumer in obtaining or applying to obtain a residential mortgage loan.” TILA section 103(cc)(4) provides that a person “assists a consumer in obtaining or applying to obtain a residential mortgage loan” by taking actions such as “advising on residential mortgage loan terms (including rates, fees, and other costs), preparing residential mortgage loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan.” The Bureau proposes comment 36(a)–1.i.A to provide further guidance on the existing phrase “arranges, negotiates, or otherwise obtains,” as used in § 1026.36(a)(1), to clarify the phrase’s applicability in light of these statutory provisions. Specifically, the Bureau proposes to clarify in comment 36(a)–1.i.A that “takes an application, arranges, offers, negotiates, or otherwise obtains an extension of consumer credit for another person” includes “assists a consumer in obtaining or applying for consumer credit by advising on credit terms (including rates, fees, and other costs), preparing application packages (such as a loan or pre-approval application or supporting documentation), or collecting information on behalf of the consumer to submit to a loan originator or creditor, and includes a person who advertises or communicates to the public that such person can or will provide any of these services or activities.”

Advising on Residential Mortgage Loan Terms

TILA section 103(cc)(2)(A)(ii) provides that a mortgage originator includes a person who “assists a consumer in obtaining or applying to obtain a residential mortgage loan.” TILA section 103(cc)(4) defines this phrase to include persons “advising on residential mortgage loan terms (including rates, fees, and other costs).” Thus, this section applies to persons advising on credit terms (including rates, fees, and other costs) advertised or offered by that person on its own behalf or for another person. The Bureau

believes that the definition of “mortgage originator” does not include bona fide third-party advisors such as accountants, attorneys, registered financial advisors, certain housing counselors, or others who do not receive or are paid no compensation for originating consumer credit transactions. Should these persons receive payments or compensation from loan originators, creditors, or their affiliates in connection with a consumer credit transaction, however, they could be considered loan originators.

Advertises or Communicates

TILA section 103(cc)(2)(B) provides that a mortgage originator “includes any person who represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such person can or will provide any of the services or perform any of the activities described in subparagraph (A).” The Bureau believes the current definition of “loan originator” in § 1026.36(a) includes persons who in expectation of compensation or other monetary gain communicate or advertise loan origination activities or services to the public.

The Bureau therefore proposes to amend comment 36(a)–1.i.A to clarify that a loan originator “includes a person who in expectation of compensation or other monetary gain advertises or communicates to the public that such person can or will provide any of these [loan origination] services or activities.” The Bureau notes that the phrase “advertises or communicates to the public” is very broad and includes, but is not limited to, the use of business cards, stationery, brochures, signs, rate lists, or other promotional items listed in TILA section 103(cc)(2)(B) if these items advertise or communicate to the public that a person can or will provide loan origination services or activities. The Bureau believes this clarification furthers TILA’s goal in section 129B(a)(2) of ensuring that responsible, affordable credit remains available to consumers. The Bureau also invites comment on this clarification to the definition of loan originator.

Manufactured Home Retailers

The definition of “mortgage originator” in TILA section 103(cc)(2)(C)(ii) also expressly excludes certain employees of manufactured home retailers. The definition of “loan originator” in current § 1026.36(a)(1) does not address such employees. The

Bureau proposes to implement the new statutory exclusion by revising the definition of “loan originator” in § 1026.36(a)(1) to exclude employees of a manufactured home retailer who assist a consumer in obtaining or applying to obtain consumer credit, provided such employees do not take a consumer credit application, offer or negotiate terms of a consumer credit transaction, or advise a consumer on credit terms (including rates, fees, and other costs).

Creditors

Current § 1026.36(a) includes in the definition of loan originator only creditors that do not finance the transaction at consummation out of the creditor’s own resources, including, for example, drawing on a bona fide warehouse line of credit, or out of deposits held by the creditor (table-funded creditors). TILA section 129B(b), as added by section 1402 of the Dodd-Frank Act, imposes new qualification and loan document unique identifier requirements that apply under certain circumstances to all creditors, including non-table-funded creditors, which are not loan originators for other purposes. Section 1401 of the Dodd-Frank Act amended TILA to add section 103(cc)(2)(F), which provides that the definition of “mortgage originator” expressly excludes creditors (other than creditors in table-funded transactions) for purposes of section 129B(c)(1), (2), and (4). Those provisions contain restrictions on steering activities and rules of construction for the statute. Thus, the term “mortgage originator” includes creditors for purposes of other TILA provisions that use the term, such as section 129B(b), as added by section 1402 of the Dodd-Frank Act. Section 129B(b) imposes on mortgage originators new qualification and loan document unique identifier requirements, discussed below under § 1026.36(f) and (g). The Bureau therefore proposes to amend the definition of loan originator in § 1026.36(a)(1)(i) to include creditors (other than creditors in table-funded transactions) for purposes of those provisions only.

The Bureau also proposes to make technical amendments to comment 36(a)–1.ii on table funding to clarify the applicability of TILA section 129B(b)’s new requirements to all creditors. Non-table-funded creditors are included in the definition of loan originator only for the purposes of § 1026.36(f) and (g). The proposed revisions additionally clarify the applicability of § 1026.36 to table-funded creditors.

Servicers

TILA section 103(cc)(2)(G) defines “mortgage originator” not to include “a servicer or servicer employees, agents and contractors, including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing or subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind.” The term “servicer” is defined by TILA section 103(cc)(7) as having the same meaning as “servicer” “in section 6(i)(2) of the Real Estate Settlement Procedures Act of 1974 [RESPA] (12 U.S.C. 2605(i)(2)).”

RESPA defines the term “servicer” as “the person responsible for servicing of a loan (including the person who makes or holds a loan if such person also services the loan).”⁴³ The term “servicing” is defined to mean “receiving any scheduled periodic payments from a borrower pursuant to the terms of any loan, including amounts for escrow accounts described in section 2609 of this title [Title 12], and making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan.” 12 U.S.C. 2605(i)(3).

Current comment 36(a)–1.iii provides that the definition of “loan originator” does not “apply to a loan servicer when the servicer modifies an existing loan on behalf of the current owner of the loan. The rule only applies to extensions of consumer credit and does not apply if a modification of an existing obligation’s terms does not constitute a refinancing under § 1026.20(a).” The Bureau proposes to amend comment 36(a)–1.iii to clarify how the definition of loan originator applies to servicers and to implement the Dodd-Frank Act’s definition of mortgage originator.

The Bureau believes the exception in TILA section 103(cc)(2)(G) narrowly applies to servicers, servicer employees, agents and contractors only when engaging in limited servicing activities with respect to a particular transaction after consummation, including loan

modifications that do not constitute a refinancing. The Bureau does not believe, however, that the statutory exclusion was intended to shield from coverage companies that intend to act as servicers on loans when they engage in loan origination activities prior to consummation or servicers of existing loans that refinance such loans. The Bureau believes that exempting such companies merely because of the general status of “servicer” with respect to some loans would not reflect Congress’s intended statutory scheme.

The Bureau’s interpretation rests on analyzing the two distinct parts of the statute. Under TILA section 103(cc)(2)(G), the definition of “mortgage originator” does not include: (1) “a servicer” or (2) “servicer employees, agents and contractors, including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind.” Under a textual analysis of this provision in combination with the definition of “servicer” under RESPA in 12 U.S.C. 2605(i)(2), which is referenced by TILA section 103(cc)(7), a servicer that is responsible for servicing a loan or that makes a loan *and* services it is excluded from the definition of “mortgage originator” for that particular loan after the loan is consummated and the servicer becomes responsible for servicing it. “Servicing” is defined under RESPA as “receiving and making payments according to the terms of the loan.” Thus, a servicer cannot be responsible for servicing a loan that does not exist. A loan exists only after consummation. Therefore, for purposes of TILA section 103(cc)(2)(G), a person is a servicer with respect to a particular transaction only after it is consummated and that person retains or obtains its servicing rights.

The Bureau believes this interpretation of the statute is the most consistent with the definition of “mortgage originator” in TILA section 103(cc)(2). A person cannot be a servicer until after consummation of a transaction. A person taking an application, assisting a consumer in obtaining or applying to obtain a loan, or offering or negotiating terms of a loan, or funding the transaction prior to and through the time of consummation, is a mortgage originator or creditor (depending upon the person’s role). Thus, a person that funds a loan from the person’s own resources or a table-

funded creditor is subject to the appropriate provisions in TILA section 103(cc)(2)(F) for creditors until the person becomes responsible for servicing the loan after consummation. The Bureau believes this interpretation is also consistent with the definition of “loan originator” in current § 1026.36(a) and comment 36(a)–1.iii. If a loan modification by the servicer constitutes a refinancing under § 1026.20(a), the servicer is considered a creditor until after consummation of the refinancing when responsibility for servicing the refinanced loan arises.

The Bureau believes the second part of the statutory provision applies to individuals (*i.e.*, natural persons) who are employees, agents or contractors of the servicer, “including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind.” The Bureau further believes that, to be considered employees, agents or contractors of the servicer for the purposes of TILA section 103(cc)(2)(G), the person for whom the employees, agent or contractors are working first must be a servicer. Thus, as discussed above, the particular loan must have already been consummated before such employees, agents, or contractors can be excluded from the statutory term, “mortgage originator” under TILA section 103(cc)(2)(G).

The Bureau interprets the phrase “including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind” to be an example of the types of activities the individuals are permitted to engage in that satisfy the purposes of TILA section 103(cc)(2)(G). However, the Bureau believes that “renegotiating, modifying, replacing and subordinating principal of existing mortgages” or any other related activities that occur must not be a refinancing, as defined in § 1026.20(a), for the purposes of TILA section 103(cc)(2)(G). Under the Bureau’s view, a servicer may modify an existing loan in several ways without being considered a loan originator. A formal satisfaction of the existing obligation and replacement by a new obligation is a refinancing. But, short of that, a

⁴³RESPA defines “servicer” to exclude: (A) The FDIC in connection with changes in rights to assets pursuant to section 1823(c) of title 12 or as receiver or conservator of an insured depository institution; and (B) Ginnie Mae, Fannie Mae, Freddie Mac, or the FDIC, in any case in which changes in the servicing of the mortgage loan is preceded by (i) termination of the servicing contract for cause; (ii) commencement of bankruptcy proceedings of the servicer; or (iii) commencement of proceedings by the FDIC for conservatorship or receivership of the servicer (or an entity by which the servicer is owned or controlled). 12 U.S.C. 2605(i)(2).

servicer may modify a loan without being considered a loan originator.

The Bureau interprets the term “replacing” in TILA section 103(cc)(2)(G) not to include refinancings of consumer credit. The term “replacing” is not defined in TILA or Regulation Z, but the Bureau believes the term “replacing” in this context means replacing existing debt without also satisfying the original obligation. For example, a first- and second-lien loan may be “replaced” by a single, new loan with a reduced interest rate and principal amount, the proceeds of which do not satisfy the full obligation of the prior loans. In such a situation, the agreement for the new loan may stipulate that the consumer is responsible for the remaining outstanding balances of the prior loans if the consumer refinances or defaults on the replacement loan within a stated period of time. This is conceptually distinct from a refinancing as described in § 1026.20(a), which refers to situations where an existing “obligation is satisfied and replaced by a new obligation.”⁴⁴ (Emphasis added.)

The ability to repay provisions of TILA section 129C, which were added by section 1411 of the Dodd-Frank Act, make numerous references to certain “refinancings” for exemptions from the income verification requirement of section 129C. TILA section 128A, as added by section 1419 of the Dodd-Frank Act, contains a disclosure requirement that includes a “refinancing” as an alternative for consumers of hybrid adjustable rate mortgages to pursue before the interest rate adjustment or reset after the fixed introductory period ends. Moreover, TILA’s text prior to Dodd-Frank Act amendments contained the term “refinancing” in numerous provisions. For example, TILA section 106(f)(2)(B) provides finance charge tolerance requirements specific to a “refinancing,” TILA section 125(e)(2) exempts certain “refinancings” from right of rescission disclosure requirements, and TILA section 128(a)(11) requires disclosure of whether the borrower is entitled to a rebate upon “refinancing” an obligation in full that involves a precomputed finance charge. For these reasons the Bureau believes that, if Congress intended for “replacing” to include or

⁴⁴ Comment 20(a)–1 clarifies: “The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer’s behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the prior one.” (Emphasis added.)

mean a “refinancing” of consumer credit, Congress would have used the existing term, “refinancing,” as Congress did for sections 1411 and 1419 of the Dodd-Frank Act and in prior TILA legislation. Instead, without any additional guidance from Congress, the Bureau defers to the current definition of “refinancing” in § 1026.20(a), where part of the definition of “refinancing” requires both replacement and satisfaction of the original obligation as separate and distinct elements of the defined term.

Furthermore, the above interpretation of “replacing” better accords with the surrounding statutory text, which provides that servicers include persons offering or negotiating a residential mortgage loan for the purposes of “renegotiating, modifying, replacing or subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind.” Taken as a whole, this text applies to distressed consumers for whom replacing and fully satisfying the existing obligation(s) is not an option. The situation covered by the text is distinct from a refinancing in which a consumer would simply use the proceeds from the refinancing to satisfy an existing loan or existing loans.

The Bureau believes this interpretation gives full effect to the exclusionary language as Congress intended, to avoid undesirable impacts on servicers’ willingness to modify existing loans to benefit distressed consumers, without undermining the new protections generally afforded by TILA section 129B. A broader interpretation that excludes servicers and their employees, agents, and contractors from those protections solely by virtue of their coincidental status as servicers is not the best reading of the statute as a whole and likely would frustrate rather than further congressional intent.

Indeed, if persons are not included in the definition of mortgage originator when making but prior to servicing a loan or based on a person’s status as a servicer under the definition of “servicer,” at least two-thirds of mortgage lenders (and their originator employees) nationwide could be excluded from the definition of “mortgage originator” in TILA section 103(cc)(2)(G). Many, if not all, of the top ten mortgage lenders by volume either hold and service loans they originated in portfolio or retain servicing rights for the loans they originate and sell into the

secondary market.⁴⁵ Under an interpretation that would categorically exclude a person who makes and services a loan or whose general “status” is a “servicer,” these lenders would be excluded as “servicers” from the definition of “mortgage originator.” Thus, their employees and agents would also be excluded from the definition under this interpretation.

The Bureau believes this result would be not only contrary to the statutory text but also contrary to Congress’s stated intent in section 1402 of the Dodd-Frank Act to ensure that responsible, affordable mortgage credit remains available to consumers by regulating practices related to residential mortgage loan origination. For example, based on the top ten mortgage lenders by origination and servicing volume alone, as much as 61 percent of the nation’s loan originators could not only be excluded from prohibitions on dual compensation and compensation based on loan terms but also from the new qualification requirements added by the Dodd-Frank Act.

The Bureau proposes to amend comment 36(a)–1.iii to reflect the Bureau’s interpretation of the statutory text, to facilitate compliance, and to prevent circumvention. The Bureau interprets the statement in existing comment 36(a)–1.iii that the “definition of ‘loan originator’ does not apply to a loan servicer when the servicer modifies an existing loan on behalf of the current owner of the loan” as consistent with the definition of mortgage originator as it relates to servicers in TILA section 103(cc)(2)(G). Proposed comment 36(a)–1.iii thus clarifies that the TILA section 103(cc)(2)(G) definition of “loan originator” includes a servicer or a servicer’s employees, agents, and contractors when offering or negotiating terms of a particular existing loan obligation on behalf of the current owner for purposes of renegotiating, modifying, replacing, or subordinating principal of such a debt where the borrower(s) is not current, in default, or has a reasonable likelihood of becoming in default or not current. The Bureau proposes to amend comment 36(a)–1.iii to clarify that § 1026.36 “only applies to

⁴⁵ For example, the top ten U.S. lenders by mortgage origination volume in 2011 held 72.7 percent of the market share. 1 Inside Mortg. Fin., The 2012 Mortgage Market Statistical Annual 52–53 (2012) (these percentages are based on the dollar amount of the loans). These same ten lenders held 60.8 percent of the market share for servicing mortgage loans. 1 Inside Mortg. Fin., The 2012 Mortgage Market Statistical Annual 185–186 (2012) (these percentages are based on the dollar amount of the loans). Most of the largest lenders do not ordinarily sell loans into the secondary market with servicing released.

extensions of consumer credit that constitute a refinancing under § 1026.20(a). Thus, the rule does not apply if a renegotiation, modification, replacement, or subordination of an existing obligation's terms occurs, unless it is a refinancing under § 1026.20(a)."

Real Estate Brokers

TILA section 103(cc)(2)(D) states that the definition of "mortgage originator" does not "include a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with applicable State law, unless such person or entity is compensated by a lender, a mortgage broker, or other mortgage originator or by any agent of such lender, mortgage broker, or other mortgage originator." Thus, the statute provides that real estate brokers are not included in the definition of "mortgage originator" if they: (1) Only perform real estate brokerage activities, (2) are licensed or registered under applicable State law to perform such activities, and (3) do not receive compensation from loan originators, creditors, or their agents. Therefore, a real estate broker that performs loan originator activities or services as defined by proposed § 1026.36(a) is a loan originator for the purposes of § 1026.36.⁴⁶ The Bureau proposes to add comment 36(a)-1.iv to clarify that the term loan originator does not include certain real estate brokers.

The Bureau believes the text of TILA section 103(cc)(2)(D) related to payments to a real estate broker "by a lender, a mortgage broker, or other mortgage originator or by any agent of such lender, mortgage broker, or other mortgage originator" is directed at payments by such persons in connection with the origination of a particular consumer credit transaction secured by a dwelling. Each of the three core elements in the definition of mortgage originator in TILA section 103(cc)(2)(A) describes activities related to a residential mortgage loan.⁴⁷ Moreover, if real estate brokers are deemed mortgage originators simply by receiving compensation from a creditor, then a real estate broker would be

considered a mortgage originator if the real estate broker received compensation from a creditor for reasons wholly unrelated to loan origination (e.g., if the real estate broker found new office space for the creditor). The Bureau does not believe that either the definition of "mortgage originator" in TILA section 103(cc)(2) or the statutory purpose of TILA section 129B(a)(2) to "assure consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deception or abusive," demonstrate that Congress intended for TILA section 129B to cover this type of real estate brokerage activity. Thus, for a real estate broker to be included in the definition of "mortgage originator," the real estate broker must receive compensation in connection with performing one or more of the three core "mortgage originator" activities for a particular consumer credit transaction secured by a dwelling.

For example, assume XYZ Bank pays a real estate broker for a broker price opinion in connection with a pending modification or default of a mortgage loan for consumer A. In an unrelated transaction, consumer B compensates the same real estate broker for assisting consumer B with finding and negotiating the purchase of a home. Consumer B also obtains credit from XYZ Bank to purchase the home. This real estate broker is not a loan originator under these facts. Proposed comment 36(a)-1.iv clarifies this point. The proposed comment also clarifies that a payment is not from a creditor, a mortgage broker, other mortgage originator, or an agent of such persons if the payment is made on behalf of the consumer to pay the real estate broker for real estate brokerage activities performed for the consumer.

The Bureau notes that the definition of "mortgage originator" in the statute does not "include a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with applicable State law." The Bureau believes that, if applicable State law defines real estate brokerage activities to include activities that fall within the definition of loan originator in § 1026.36(a), the real estate broker is a loan originator when engaged in such activities subject to § 1026.36 and is not a real estate broker under TILA section 103(cc)(2)(D). The Bureau invites comment on this proposed clarification of the meaning of "loan originator" for real estate brokers.

Seller Financing

TILA section 103(cc)(2)(E) provides that the term "mortgage originator" does not include:

with respect to a residential mortgage loan, a person, estate, or trust that provides mortgage financing for the sale of 3 properties in any 12-month period to purchasers of such properties, each of which is owned by such person, estate, or trust and serves as security for the loan, provided that such loan—(i) is not made by a person, estate, or trust that has constructed, or acted as a contractor for the construction of, a residence on the property in the ordinary course of business of such person, estate, or trust; (ii) is fully amortizing; (iii) is with respect to a sale for which the seller determines in good faith and documents that the buyer has a reasonable ability to repay the loan; (iv) has a fixed rate or an adjustable rate that is adjustable after 5 or more years, subject to reasonable annual and lifetime limitations on interest rate increases; and (v) meets any other criteria the Bureau may prescribe.

This provision must be read in conjunction with the existing exceptions in Regulation Z (§ 1026.2(a)(17)(v)), which provide that the definition of creditor: (1) Does not include persons that extend credit secured by a dwelling (other than high-cost mortgages) five or fewer times in the preceding calendar year and (2) does not include a person who extends no more than one high-cost mortgage (subject to § 1026.32) in any 12-month period. Based on the definition of mortgage originator as described above and the exception for creditor together, the Bureau believes that persons, estates, or trusts are not included in the definition of "mortgage originator" when engaged in such described activities. That is, any person, estate, or trust who otherwise would be a mortgage originator under the statutory definition on the basis of engaging in activities other than those described above is a mortgage originator. Thus, only persons whose activity is financing sales of their own properties as described above are excluded under TILA section 103(cc)(2)(E). A person who finances sales of property, if such financing is subject to a finance charge or payable in more than four installments, generally is a creditor under § 1026.2(a)(17)(i) (except where excluded by virtue of the person's annual transaction volume).

Moreover, TILA section 103(cc)(2)(F) provides that the definition of mortgage originator does not include creditors (other than creditors in table-funded transactions), except for purposes of TILA section 129B(c)(1), (2), and (4). Thus, those creditors that are not included in the definition of mortgage

⁴⁶ The Bureau understands that a real estate broker license in some states also permits the licensee to broker mortgage loans and in certain cases make mortgage loans. The Bureau does not consider brokering mortgage loans and making mortgage loans to be real estate brokerage activities.

⁴⁷ The three core elements in the definition of mortgage originator in TILA section 103(cc)(2)(A) are: "(i) Takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan." (Emphasis added).

originator as a result of TILA section 103(cc)(2)(E) are still subject to the remaining provisions of TILA section 129B. Of these provisions of TILA section 129B, only section 129B(b)(1) imposes any substantive requirements on creditors: the qualification requirements and the requirement to include a unique identifier on loan documents, implemented by proposed § 1026.36(f) and (g).

The proposed definition of loan originator, however, would not include seller financiers who finance three or fewer sales in any 12-month period without extending high-cost mortgage financing. The proposed definition of the term loan originator includes “a creditor for the transaction if the creditor does not finance the transaction at consummation *out of the creditor’s own resources*, including drawing on a *bona fide* warehouse line of credit, or out of deposits held by the creditor” (emphasis added). The term “creditor for the transaction” is intended to apply to persons who would otherwise be a “creditor” as defined in § 1026.2(a)(17) but for the exception for not regularly extending consumer credit. Therefore, such a seller financier who finances three or fewer sales with a non-high cost mortgage in any 12-month period is a “creditor for the transaction,” and is included neither in the definition of loan originator in § 1026.36(a) nor the definition of creditor in § 1026.2(a)(17). Thus, these persons are not subject to TILA and Regulation Z, including § 1026.36.

Section 1026.2(a)(17)(v) excludes from the definition of creditor persons that extend credit secured by a dwelling (other than high-cost mortgages) five or fewer times in the preceding calendar year. This has two implications. First, if a person’s activity is limited to financing sales of three or fewer properties in any 12-month period by making extensions of credit that are not high-cost mortgages, the person cannot exceed the five-loan threshold in § 1026.2(a)(17)(v) to be deemed a creditor and therefore be subject to any provision of Regulation Z, including § 1026.36. Second, a person who finances the sale of no more than one property in any 12-month period by making an extension of one high-cost mortgage also is not a creditor under § 1026.2(a)(17)(v). Thus, this person is not a creditor for the purposes of being included in the definition of “mortgage originator” as described by TILA section 103(cc)(2)(F). This person also is not subject to Regulation Z, including § 1026.36.

Given all of the foregoing, the only persons that are not included in the

definition of mortgage originator as provided in TILA section 103(cc)(2)(E), but are creditors for the purposes of Regulation Z, are persons, estates, or trusts that finance the sale of their own properties by extending high-cost mortgages either twice or three times in a calendar year. Thus, such persons are not subject to § 1026.36(f) and (g) because, they are not a loan originator and thus also are not subject to the other provisions of § 1026.36. Nevertheless, to reflect this interpretation that a narrow category of persons are not included in the definition of loan originator in § 1026.36(a), the Bureau is proposing new comment 36(a)–1.v.

Proposed comment 36(a)–1.v tracks the criteria set forth in TILA section 103(cc)(2)(E). The comment provides that the definition of “loan originator” does not include a natural person, estate, or trust that finances the sale of three or fewer properties in any 12-month period owned by such natural person, estate, or trust where each property serves as a security for the credit transaction. It further states that the natural person, estate, or trust also must not have constructed or acted as a contractor for the construction of the dwelling in its ordinary course of business. The natural person, estate, or trust must additionally determine in good faith and document that the buyer has a reasonable ability to repay the credit transaction. Finally, the proposed comment states that the credit transaction must be fully amortizing, have a fixed rate or an adjustable rate that adjusts only after five or more years, and be subject to reasonable annual and lifetime limitations on interest rate increases.

The Bureau also is proposing to include further guidance in the comment as to how a person may satisfy the requirement to determine in good faith that the buyer has a reasonable ability to repay the credit transaction. The comment would provide that the natural person, estate, or trust makes such a good faith determination by complying with the requirements of § 1026.43. This refers to the requirements applicable generally to credit extensions secured by a dwelling, as proposed by the Board in its 2011 ATR Proposal. Those requirements implement TILA section 129C, and the language of section 129C(a)(1) parallels in almost identical language the ability to repay requirement in TILA section 103(cc)(2)(E). Any creditor seeking to rely on proposed comment 36(a)–1.v to avoid inclusion in the definition of loan originator (*i.e.*, creditors as defined by § 1026.2(a)(17)(v) making a second or a third high-cost mortgage in a calendar

year) already must comply with the requirements of proposed § 1026.43 as well as the provisions of Regulation Z other than § 1026.36.

Administrative or Clerical Tasks

TILA section 103(cc)(2)(C) defines “mortgage originator” to exclude persons who are not otherwise described by the three core elements of the mortgage originator definition or communicate to the public or advertise they can perform or provide the services described in those elements and who perform purely administrative or clerical tasks on behalf of mortgage originators. Existing comment 36(a)–4 clarifies that managers, administrative staff, and similar individuals who are employed by a creditor or loan originator but do not arrange, negotiate, or otherwise obtain an extension of credit for a consumer, or whose compensation is not based on whether any particular loan is originated, are not loan originators. The Bureau believes the existing comment is largely consistent with TILA section 103(cc)(2)(C)’s treatment of administrative and clerical tasks.

The Bureau proposes a minor technical revision to comment 36(a)–4, however, to implement the exclusion from “mortgage originator” in TILA section 103(cc)(2)(C), by including “clerical” staff. The proposed revisions would also clarify that producing managers who also meet the definition of a loan originator would be considered a loan originator. Producing managers generally are managers of an organization (including branch managers and senior executives) that in addition to their management duties also originate loans. Thus, compensation received by producing managers would be subject to the restrictions of § 1026.36. Non-producing managers (*i.e.*, managers, senior executives, etc., who have a management role in an organization including, but not limited to, managing loan originators, but who do not otherwise meet the definition of loan originator) would not be considered a loan originator.

36(a)(1)(ii); 36(a)(1)(iii)

Certain provisions of TILA section 129B, such as the qualification and loan document unique identifier requirements, as well as certain new guidance in the Bureau’s proposal, necessitate a distinction between loan originators that are natural persons and those that are organizations. The Bureau therefore proposes to establish the distinction by creating new definitions for “individual loan originator” and

“loan originator organization” in new § 1026.36(a)(1)(ii) and (iii).

The Bureau proposes to revise comment 36(a)–1.i.B to clarify that the term “loan originator organization” is a loan originator other than a natural person, including but not limited to a trust, sole proprietorship, partnership, limited liability partnership, limited partnership, limited liability company, corporation, bank, thrift, finance company, or a credit union. The Bureau understands that States have recognized many new business forms over the past 10 to 15 years. The Bureau believes that the additional examples should help to facilitate compliance with § 1026.36 by clarifying the types of persons that fall within the definition of “loan originator organization.” The Bureau invites comment on whether other examples would be helpful for these purposes.

36(a)(2) Mortgage Broker

Existing § 1026.36(a)(2) defines “mortgage broker” as “any loan originator that is not an employee of the creditor.” As noted elsewhere, under this proposal the meaning of loan originator is expanded for purposes of § 1026.36(f) and (g) to include all creditors. The Bureau is therefore proposing a conforming amendment to exclude such creditors from the definition of “mortgage broker” even though for certain purposes such creditors are loan originators. Proposed § 1026.36(a)(2) provides that a mortgage broker is “any loan originator that is not a creditor or the creditor’s employee.”

36(a)(3) Compensation

The Bureau proposes to define the term “compensation” in new § 1026.36(a)(3) to include “salaries, commissions, and any financial or similar incentive provided to a loan originator for originating loans.” Sections 1401 and 1403 of the Dodd-Frank Act contain multiple references to the term “compensation” but do not define the term. The current rule does not define the term in regulatory text. Existing comment 36(d)(1)–1, however, provides guidance on the meaning of compensation. The Bureau’s proposal reflects the basic principle of that guidance in proposed § 1026.36(a)(3). The further guidance in comment 36(d)(1)–1 would be transferred to new comment 36(a)–5.

The Bureau proposes to add comment 36(a)–5.iii (re-designated from comment 36(d)(1)–1.iii and essentially the same as that comment, except as noted below) to be consistent with provisions set forth in TILA section 129B(c)(2), as added by section 1403 of the Dodd-

Frank Act. Specifically, TILA section 129B(c)(2)(A) provides that, for any residential mortgage loan, a mortgage originator generally may not receive from any person other than the consumer any origination fee or charge except bona fide third-party charges not retained by the creditor, the mortgage originator, or an affiliate of either. Likewise, no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third-party charges as described above. In addition, section TILA 129B(c)(2)(B) provides that a mortgage originator may receive an origination fee or charge from a person other than the consumer if, among other things, the mortgage originator does not receive any compensation directly from the consumer. As discussed in more detail in the section-by-section analysis to proposed § 1026.36(d)(2)(ii), the Bureau interprets “origination fee or charge” to mean compensation that is paid in connection with the transaction, such as commissions that are specific to, and paid solely in connection with, the transaction.

Nonetheless, TILA section 129B(c)(2) does not appear to prevent a mortgage originator from receiving payments from a person other than the consumer for bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of either, even if the mortgage originator also receives loan originator compensation directly from the consumer. For example, assume that a mortgage originator receives compensation directly from a consumer in a transaction. TILA section 129B(c)(2) does not restrict the mortgage originator from receiving payment from a person other than the consumer (*e.g.*, a creditor) for bona fide and reasonable charges, such as title insurance or appraisals, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator.

Consistent with TILA section 129B(c)(2) and pursuant to the Bureau’s authority under TILA section 105(a) to effectuate the purposes of TILA and facilitate compliance with TILA, the Bureau proposes to retain in new comment 36(a)–5.iii essentially the same guidance as set forth in current comment 36(d)(1)–1.iii. Thus, the new comment clarifies that the term “compensation” as used in § 1026.36(d) and (e) does not include amounts a loan originator receives as payment for bona

fide and reasonable charges, such as title insurance or appraisals, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. Accordingly, under proposed § 1026.36(d)(2)(i) and comment 36(a)–5.iii, a loan originator that receives compensation directly from a consumer would not be restricted from receiving a payment from a person other than the consumer for such bona fide and reasonable charges. In addition, a loan originator would not be deemed to be receiving compensation directly from a consumer for purposes of § 1026.36(d)(2) where the originator imposes such a bona fide and reasonable third-party charge on the consumer.

Proposed comment 36(a)–5.iii also recognizes that, in some cases, amounts received for payment for such third-party charges may exceed the actual charge because, for example, the originator cannot determine with accuracy what the actual charge will be before consummation when the charge is imposed on the consumer. In such a case, under proposed comment 36(a)–5.iii, the difference retained by the originator would not be deemed compensation if the third-party charge collected from a person other than the consumer was bona fide and reasonable, and also complies with State and other applicable law. On the other hand, if the originator marks up a third-party charge and retains the difference between the actual charge and the marked-up charge, the amount retained is compensation for purposes of § 1026.36(d) and (e). This guidance parallels that in existing comment 36(d)(1)–1.

Proposed comment 36(a)–5.iii, like current comment 36(d)(1)–1.iii, contains two illustrations. The illustrations in proposed comment 36(a)–5.iii.A and B are similar to the ones contained in current comment 36(d)(1)–1.iii.A and B except that the illustrations are amended to clarify that the charges described in those illustrations are not paid to the creditor, its affiliates, or the affiliate of the loan originator. The proposed illustrations also simplify the current illustrations.

The first illustration, in proposed comment 36(a)–5.iii.A, assumes a loan originator will receive compensation directly from either a consumer or a creditor. The illustration further assumes the loan originator uses average charge pricing in accordance with Regulation X⁴⁸ to charge the consumer

⁴⁸ See 12 CFR 1024.8(b).

a \$25 credit report fee for a credit report provided by a third party that is not the loan originator, creditor, or affiliate of either. At the time the loan originator imposes the credit report fee on the consumer, the loan originator is uncertain of the cost of the credit report because the cost of a credit report from the consumer reporting agency is paid in a monthly bill and varies between \$15 and \$35 depending on how many credit reports the originator obtains that month. Later, the cost for the credit report is determined to be \$15 for this consumer's transaction. In this case, the \$10 difference between the \$25 credit report fee imposed on the consumer and the actual \$15 cost for the credit report is not deemed compensation for purposes of § 1026.36(d) and (e), even though the \$10 is retained by the loan originator. Proposed comment 36(a)–5.iii.B provides a second illustration that explains that, in the same example above, the \$10 difference would be compensation for purposes of § 1026.36(d) and (e) if the credit report fees vary between \$10 and \$15.

The Bureau solicits comment on proposed comment 36(a)–5.iii. Specifically, the Bureau requests comment on whether the term “compensation” should exclude payment from the consumer or from a person other than the consumer to the loan originator, as opposed to a third party, for certain services that unambiguously relate to ancillary services rather than core loan origination services, such as title insurance or appraisal, if the loan originator, creditor or the affiliates of either performs those services, so long as the amount paid for those services is bona fide and reasonable. The Bureau further solicits comment on how such ancillary services might be described clearly enough to distinguish them from the core origination charges that would not be excluded under such a provision.

The Bureau also proposes new comment 36(a)–5.iv to clarify that the definition of compensation for purposes of § 1026.36(d) and (e) includes stocks, stock options, and equity interests that are provided to individual loan originators and that, as a result, the provision of stocks, stock options, or equity interests to individual loan originators is subject to the restrictions in § 1026.36(d) and (e). The proposed comment further clarifies that bona fide returns or dividends paid on stocks or other equity holdings, including those paid to loan originators who own such stock or equity interests, are not considered compensation for purposes of § 1026.36(d) and (e). The comment explains that: (1) Bona fide returns or

dividends are those returns and dividends that are paid pursuant to documented ownership or equity interests allocated according to capital contributions and where the payments are not mere subterfuges for the payment of compensation based on loan terms and (2) bona fide ownership or equity interests are ownership or equity interests not allocated based on the terms of a loan originator's transactions. The comment gives an example of a limited liability company (LLC) loan originator organization that allocates its members' respective equity interests based on the member's transaction terms; in that instance, the distributions are not bona fide and, thus, are considered compensation for purposes of § 1026.36(d) and (e). The Bureau believes the clarification provided by proposed comment 36(a)–5.iv is necessary to distinguish legitimate returns on ownership from returns on ownership in companies that manipulate business ownership structures as a means to circumvent the restrictions on compensation in § 1026.36(d) and (e).

The Bureau invites comment on comment 36(a)–5.iv as proposed and on whether other forms of corporate structure or returns on ownership interest should be specifically addressed in the definition of “compensation.” The Bureau also seeks comment generally on other methods of providing incentives to loan originators that the Bureau should consider specifically addressing in the proposed guidance on the definition of “compensation.”

36(d)) Prohibited Payments to Loan Originators

36(d)(1) Payments Based on Transaction Terms

Section 1026.36(d)(1)(i), which was added to Regulation Z by the Board's 2010 Loan Originator Final Rule, provides that, in connection with a consumer credit transaction secured by a dwelling, “no loan originator shall receive and no person shall pay to a loan originator, directly or indirectly, compensation in an amount that is based on any of the transaction's terms or conditions.” Section 1026.36(d)(1)(ii) states that the amount of credit extended is not deemed to be a transaction term or condition, provided compensation received by or paid to a loan originator, directly or indirectly, is based on a fixed percentage of the amount of credit extended; the provision also states that such compensation may be subject to a minimum or maximum dollar amount. Section 1026.36(d)(1)(iii) provides that

§ 1026.36(d)(1)(i) does not apply to any transaction subject to § 1026.36(d)(2) (*i.e.*, where a consumer pays a loan originator directly).

In adopting its 2010 Loan Originator Final Rule, the Board noted that “compensation payments based on a loan's terms or conditions create incentives for loan originators to provide consumers loans with higher interest rates or other less favorable terms, such as prepayment penalties,” citing “substantial evidence that compensation based on loan rate or other terms is commonplace throughout the mortgage industry, as reflected in Federal agency settlement orders, congressional hearings, studies, and public proceedings.” 75 FR 58520. Among the Board's stated concerns was: “Creditor payments to brokers based on the interest rate give brokers an incentive to provide consumers loans with higher interest rates. Large numbers of consumers are simply not aware this incentive exists.”⁴⁹ *Id.* The official commentary to § 1026.36(d)(1) provides further guidance regarding the general prohibition on loan originator compensation based on terms and conditions of loans.

Since the Board's 2010 Loan Originator Final Rule was promulgated, the Board and the Bureau (following the transfer of authority over TILA to the Bureau under the Dodd-Frank Act) have received numerous interpretive questions about the provisions of § 1026.36(d)(1). First, questions have arisen about the application of the Board's rule to payments that are based on factors that may be “proxies” for loan terms. The Bureau understands there has been considerable uncertainty on this issue. Furthermore, mortgage creditors and others have raised questions about whether § 1026.36(d)(1) prohibits the pooling of compensation and sharing in such pooled compensation by loan originators that are compensated differently and originate loans with different terms.

The Board and the Bureau also have received a number of questions about

⁴⁹The Board adopted this prohibition on certain compensation practices based on its finding that compensating loan originators based on a loan's terms or conditions, other than the amount of credit extended, is an unfair practice that causes substantial injury to consumers. *Id.* The Board stated that it was relying on authority under TILA section 129(l)(2) (since re-designated as section 129(p)(2)) to prohibit acts or practices in connection with mortgage loans that it finds to be unfair or deceptive. *Id.* The Board decided to issue its 2010 Loan Originator Final Rule even though a subsequent rulemaking was necessary to implement TILA section 129B(c). See 75 FR at 58509. As discussed below, Dodd-Frank Act section 1403 provides an additional express statutory base of authority for the Bureau's rulemaking.

whether, and how, the current regulation applies to employer contributions to profit-sharing, 401(k), and employee stock ownership plans (ESOPs) that are qualified under section 401(a) of the Internal Revenue Code and how the regulation applies to compensation paid pursuant to employer-sponsored profit-sharing plans that are not qualified plans. These questions have arisen because often the amount of payments to individual loan originators under profit-sharing plans and of contributions to qualified or non-qualified plans in which individual loan originators participate will depend substantially on the profits of the creditors and the loan originator organizations, which in turn often may depend in part on the terms of the loans generated by the individual loan originators, such as the interest rate. In response to these questions, the Bureau issued a bulletin on April 2, 2012 (CFPB Bulletin 2012-2), clarifying that, until the Bureau adopts final rules implementing the Dodd-Frank Act provisions regarding loan originator compensation, an employer may make contributions to a qualified retirement plan out of a pool of profits derived from loans originated by the company's loan originator employees. CFPB Bulletin 2012-02 (Apr. 2, 2012).⁵⁰ The Bureau did not believe it was practical at the time, however, to provide guidance on the application of the current rules to plans that are not qualified plans because such questions are fact-specific in nature. *Id.* The Bureau noted that it anticipated providing greater clarity on these arrangements in connection with a proposed rule on the loan origination provisions in the Dodd-Frank Act. *Id.* This proposed rule is intended, in part, to provide such clarity.

As discussed earlier, section 1403 of the Dodd-Frank Act added new TILA section 129B(c). This new statutory provision builds on, but in some cases imposes new or different requirements than, the current Regulation Z provisions established by the Board's 2010 Loan Originator Final Rule. Under TILA section 129B(c)(1), for any residential mortgage loan, no mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal). 12 U.S.C. 1639b(c)(1).

⁵⁰ U.S. Consumer Fin. Prot. Bureau, CFPB Bull. No. 2012-2, *Payments to Loan Originators Based on Mortgage Transaction Terms or Conditions under Regulation Z* (Apr. 2, 2012), available at: http://files.consumerfinance.gov/f/201204_cfpb_LoanOriginatorCompensationBulletin.pdf.

Further, TILA section 129B(c)(4)(A) provides that nothing in section 129B(c) of TILA permits yield spread premiums or other similar compensation that would, for any residential mortgage loan, permit the total amount of direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of the loan (other than the amount of the principal). 12 U.S.C. 1639b(c)(4)(A).⁵¹ The statute also provides that nothing in TILA section 129B(c) prohibits incentive payments to a mortgage originator based on the number of residential mortgage loans originated within a specified period of time. 12 U.S.C. 1639b(c)(4)(D).⁵² The statute serves as an additional express base of authority for the Bureau to undertake this rulemaking.

Although the language in section 1403 of the Dodd-Frank Act amending TILA and addressing mortgage originator compensation that varies based on terms of the transaction generally mirrors the current regulatory text and commentary of § 1026.36(d)(1), the statutory and regulatory provisions differ in several respects. First, unlike § 1026.36(d)(1)(iii), the statute does not contain an exception to the general prohibition on compensation varying based on loan terms for transactions where the mortgage originator receives compensation directly from the consumer. Second, while § 1026.36(d)(1) prohibits compensation that is based on a transaction's "terms or conditions," TILA section 129B(c)(1) refers only to compensation that varies based on "terms." Finally, § 1026.36(d)(1)(i) provides that the loan originator may not receive and no person shall pay compensation in an amount "that is based on" any of the transaction's terms or conditions, whereas TILA section 129B(c)(1)

⁵¹ TILA section 129B(c)(4) also states that nothing in TILA section 129B(c) shall be deemed to limit or affect the amount of compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser. 12 U.S.C. 1639b(c)(4)(B). Moreover, a consumer is not restricted from financing at his or her option, including through principal or rate, any origination fees or costs permitted under TILA section 129B(c)(4), and a mortgage originator may receive such fees or costs, including compensation (subject to other provisions of TILA section 129B(c)), so long as such fees or costs do not vary based on the terms of the loan (other than the amount of the principal) or the consumer's decision as to whether to finance the fees or costs. 12 U.S.C. 1639b(c)(4)(C).

⁵² Comment 36(d)(1)-3 already clarifies that the loan originator's overall loan volume delivered to the creditor is an example of permissible compensation for purposes of the regulation.

prohibits compensation that "varies based on" the terms of the loan.⁵³

In view of the differences in the statutory and regulatory provisions prohibiting loan originator compensation based on transaction terms and the interpretive questions that have arisen with regard to the current regulations noted above, the Bureau is proposing revisions to § 1026.36(d)(1) and its commentary to harmonize the regulatory provisions with the language added to TILA by the Dodd-Frank Act. Moreover, the Bureau is proposing certain revisions to § 1026.36(d)(1) and its commentary to address the interpretive issues that have arisen under the current regulations.

36(d)(1)(i)

Terms or Conditions

As noted previously, § 1026.36(d)(1)(i) provides that, in connection with a consumer credit transaction secured by a dwelling, "no loan originator shall receive and no person shall pay to a loan originator, directly or indirectly, compensation in an amount that is based on any of the transaction's terms or conditions." The Dodd-Frank Act section 1403 amendments, which added TILA section 129B(c), limits restrictions on mortgage originator compensation to "terms of the loan" only. Current § 1026.36(d)(1)(i) and commentary provide that a loan originator may not receive and no person may pay to a loan originator compensation that is based on any of the "transaction's terms or conditions."

The Bureau proposes to retain the word "transaction," rather than use the statutory term "loan," to preserve consistency within Regulation Z. The Bureau makes this proposal pursuant to its authority under TILA section 105(a) to prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions, that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. The Bureau believes that "transaction" and "loan," as that term is used in TILA section 129B(c), have consistent meanings and, therefore, that preserving the use of "transaction" in § 1026.36(d)(1)(i) will facilitate compliance for creditors by avoiding the need to contend with a distinct, but duplicative, defined term.

On the other hand, the Bureau proposes to revise the phrase "terms or conditions" to delete the word

⁵³ The latter two differences are discussed in the section-by-section analysis of proposed § 1026.36(a), above.

“conditions” for § 1026.36(d)(1)(i) where applicable in both the regulatory text and commentary. The Bureau is also proposing conforming amendments to § 1026.36(d)(1)(ii). The Bureau believes that removal of the term “conditions” from “transaction terms or conditions” clarifies § 1026.36(d)(1) but does not materially amend the provision’s scope. The Bureau also proposes to revise the discussion about proxies, discussed in more detail below, to aid in determining whether a factor is a proxy for a transaction’s terms.

Varies Based On

TILA section 129B(c)(1) prohibits a mortgage originator from receiving, and any person from paying a mortgage originator, “compensation that *varies* based on” the terms of the loan (emphasis added). The prohibition in current § 1026.36(d)(1) is on “compensation in an amount that *is based on*” the transaction’s terms and conditions (emphasis added). The Bureau believes the meaning of the statute’s reference to compensation that “varies” based on loan terms is already embodied in § 1026.36(d)(1). Thus, the Bureau does not propose to revise § 1026.36(d)(1) to include the word “varies.”

The Bureau believes that compensation to loan originators violates the prohibition if the amount of the compensation is based on the terms of the transaction (that is, a violation does not require a showing of any person’s subjective intent to relate the amount of the payment to a particular loan term). Proposed new comment 36(d)(1)–1.i clarifies these points. The Bureau is proposing new comment 36(d)(1)–1 in place of existing comment 36(d)(1)–1, which is being moved to comment 36(a)–5, as discussed above.

The proposed comment also clarifies that a difference between the amount of compensation paid and the amount that would have been paid for different terms might be shown by a comparison of different transactions with different terms made by the same loan originator, but a violation does not require a comparison of multiple transactions.

Proxy for Loan Terms

The Bureau also proposes revisions to § 1026.36(d)(1) and comment 36(d)(1)–2 to provide guidance for determining whether a factor is a proxy for a transaction’s term and also provide examples. As stated above, § 1026.36(d)(1)(i) provides that, in connection with a consumer credit transaction secured by a dwelling, no loan originator shall receive and no person shall pay to a loan originator,

directly or indirectly, compensation in an amount that is based on any of the transaction’s terms or conditions. Existing comment 36(d)(1)–2 further elaborates on the prohibition by stating:

The rule also prohibits compensation based on a factor that is a proxy for a transaction’s terms or conditions. For example, a consumer’s credit score or similar representation of credit risk, such as the consumer’s debt-to-income ratio, is not one of the transaction’s terms or conditions. However, if a loan originator’s compensation varies in whole or in part with a factor that serves as a proxy for loan terms or conditions, then the originator’s compensation is based on a transaction’s terms or conditions.

The existing comment also illustrates the guidance by providing an example of payments based on credit score that would violate § 1026.36(d)(1).

Since the Board’s 2010 Loan Originator Final Rule was promulgated, the Board and the Bureau have received numerous inquiries on whether particular loan originator payment structures are based on factors that are proxies for loan terms. Small Entity Representatives (SERs) on the Small Business Review Panel also urged the Bureau to use this rulemaking to clarify when a factor used to determine compensation for a loan originator is a proxy for a loan term. The Bureau does not believe that any departure from the approach to proxies in current comment 36(d)(1)–2 is necessitated by the Dodd-Frank Act. The Bureau also believes that current § 1026.36(d)(1)(i) prohibits compensation based on a factor that is a proxy for a transaction’s terms. However, the Bureau understands there has been considerable uncertainty on this issue and proposes clarifications in § 1026.36(d)(1)(i) and comment 36(d)(1)–2.i to help creditors and loan originators determine whether a factor on which compensation would be based is a proxy for a transaction’s terms.

The proposal clarifies in § 1026.36(d)(1)(i), rather than commentary only, that compensation based on a proxy for a transaction’s terms is prohibited. The proposed clarification in § 1026.36(d)(1)(i) and comment 36(d)(1)–2.i also provides that a factor (that is not itself a term of a transaction originated by the loan originator) is a proxy for the transaction’s terms if: (i) The factor substantially correlates with a term or terms of the transaction and (ii) the loan originator can, directly or indirectly, add, drop, or change the factor when originating the transaction.⁵⁴

⁵⁴ The Bureau specifically sought input during the Small Business Review Panel process on

Both conditions must be satisfied for a factor to be considered a proxy for a transaction’s terms. If a factor does not “substantially” correlate with a term of a transaction originated by the loan originator, the factor is not a proxy for a transaction’s terms. The Bureau proposes to use the term “substantially” but invites comment on whether this term is sufficiently clear and, if not, what other terms should be considered. The Bureau also seeks comment on how correlation to a term should be determined.

If the factor does substantially correlate with a term of a transaction originated by the loan originator, then the factor must be analyzed under the second condition, whether the loan originator can, directly or indirectly, add, drop, or change the factor when originating the transaction. The Bureau believes that, where a loan originator has no or minimal ability directly or indirectly to add, drop, or change a factor, that factor cannot be a proxy for the transaction’s terms because such a factor cannot be the basis for incentives to steer consumers inappropriately. For example, loan originators cannot change a property’s location, thus property location cannot be a proxy for a transaction’s terms. Arguably, a loan originator could indirectly change the property location by steering a consumer to choose a property in a particular location. However, the ability for loan originators to steer consumers to a particular property location with such frequency to serve as an incentive for steering consumers is minimal. In proposed comment 36(d)(1)–2.i, the Bureau provides three new examples to illustrate use of the proposed proxy standard and to facilitate compliance with the rule.

The Bureau also proposes to delete the current proxy example in the comment that identifies credit scores as a proxy for a transaction’s terms. The Bureau believes the current credit score proxy example is confusing and created uncertainty for creditors and loan originators depending on their

clarifying the rule’s application to proxies. The proxy proposal under consideration presented to the SERs during the Small Business Review Panel process stated that “a factor is a proxy if: (1) It substantially correlates with a loan term; and (2) the MLO has discretion to use the factor to present a loan to the consumer with more costly or less advantageous term(s) than term(s) of another loan available through the MLO for which the consumer likely qualifies.” After further consideration, the Bureau believes the proxy proposal contained in this proposed rule would be easier to apply uniformly and would better address cases where the loan originator does not “use” the factor than the specific proposal presented to the Small Business Review Panel. The Bureau, however, welcomes comment on how best to address proxies.

particular facts and circumstances. Moreover, under the guidance discussed above, a credit score may or may not be a proxy for a transaction's terms, depending on the facts and circumstances; it is not automatically a proxy, as many creditors and loan originators have inferred from the existing comment's example.

The Bureau proposes to add comment 36(d)(1)–2.i.A which provides an example of compensation based on a loan originator's employment tenure. This factor likely has little (if any) correlation to loan terms. This example illustrates how, if a factor that compensation is based on has little to no correlation to a transaction's term or terms, it is not a proxy for a transaction's terms.

Proposed comment 36(d)(1)–2.i.B provides an example illustrating how a loan originator's compensation varies based on whether a loan is held in portfolio or sold into the secondary market. In this case, the example assumes a loan is held in portfolio or sold into the secondary market depending in large part on whether the loan is a five-year balloon loan or a thirty-year loan. Thus, whether a loan is held in portfolio or sold into the secondary market substantially correlates with the transaction's terms. The loan originator in the example may be able to change the factor indirectly by steering the consumer to choose the five-year loan or the thirty-year loan. Thus, whether a loan is held in portfolio or sold into the secondary market is a proxy for a transaction's terms under these particular facts and circumstances.

Proposed comment 36(d)(1)–2.i.C illustrates an example where compensation is based on the geographic location of the property securing a refinancing. The loan originator is paid a higher commission for refinancings secured by property in State A than in State B. Even if refinancings secured by property in State A have lower interest rates than loans secured by property in State B, the property's location substantially correlates with loan terms. However, the loan originator cannot change the presence or absence of the factor (*i.e.*, whether the refinancing is secured by property in State A or State B). Thus, geographic location, under these particular facts and circumstances, would not be considered a proxy for a transaction's terms.

Other proposed revisions to comment 36(d)(1)–2 include clarifying that the rule does not prohibit compensating loan originators differently on different transactions, provided such differences in compensation are not based on a

transaction's terms or a proxy for a transaction's terms. The Bureau also proposes to delete "conditions" from the comment where applicable and the existing guidance that the loan-to-value ratio is not a term of the transaction to conform to the proposed amendment discussed above concerning the prohibition on compensation based on the transaction's "terms."

The Bureau believes that the proposed changes and the addition of new commentary should reduce uncertainty and help simplify application of the prohibition on compensation based on the transaction's terms. The Bureau has learned through outreach, however, that a number of creditors pay loan originators the same commission regardless of loan product or type. Many of these institutions have expressed concerns about revising the proxy guidance. They argue that unscrupulous loan originators will attempt to use any specific proxy guidance to justify compensation schemes that violate the principles of the rule. The Bureau therefore solicits comment on the proposal, alternatives the Bureau should consider, or whether any action to revise the proxy concept and analysis is helpful and appropriate.

Pooled Compensation

Comment 36(d)(1)–2 provides examples of compensation that is based on transaction terms or conditions. Mortgage creditors and others have raised questions about whether loan originators that are compensated differently and originate loans with different terms are prohibited under § 1026.36(d)(1) from pooling their compensation and sharing in that compensation pool. For example, assume that Loan Originator A receives a commission of two percent of the loan amount for each loan that he or she originates and originates loans that generally have higher interest rates than the loans that Loan Originator B originates. In addition, assume Loan Originator B receives a commission of one percent of the loan amount for each loan that he or she originates and originates loans that generally have lower interest rates than the loans originated by Loan Originator A. The Bureau proposes to revise comment 36(d)(1)–2 to make clear that, where loan originators are compensated differently and they each originate loans with different terms, § 1026.36(d)(1) does not permit the pooling of compensation so that the loan originators share in that pooled compensation. In this example, proposed comment 36(d)(1)–2.ii clarifies that the compensation of the

two loan originators may not be pooled so that the loan originators share in that pooled compensation. The Bureau believes that this type of pooling is prohibited by § 1026.36(d)(1) because each loan originator is being paid based on loan terms, with each loan originator receiving compensation based on the terms of the loans made by the loan originators collectively. This type of pooling arrangement could provide an incentive for the loan originators participating in the pooling arrangement to steer some consumers to loan originators that originate loan with less favorable terms (for example, that have a higher interest rate), to maximize their compensation.

Creditor's Ability to Offer Certain Loan Terms

Comment 36(d)(1)–4 clarifies that § 1026.36(d)(1) does not limit the creditor's ability to offer certain loan terms. Specifically, comment 36(d)(1)–4 makes clear that § 1026.36(d)(1) does not limit a creditor's ability to offer a higher interest rate as a means for the consumer to finance the payment of the loan originator's compensation or other costs that the consumer would otherwise pay (for example, in cash or by increasing the loan amount to finance such costs). Thus, a creditor is not prohibited by § 1026.36(d)(1) from charging a higher interest rate to a consumer who will pay some or none of the costs of the transaction directly, or offering the consumer a lower rate if the consumer pays more of the costs directly. For example, a creditor may charge an interest rate of 6.0 percent where the consumer pays some or all of the transaction costs but may charge an interest rate of 6.5 percent where the consumer pays none of those costs (subject to the requirements of proposed § 1026.36(d)(2)(ii), discussed below). Section 1026.36(d)(1) also does not limit a creditor from offering or providing different loan terms to the consumer based on the creditor's assessment of credit and other risks (such as where the creditor uses risk-based pricing to set the interest rate for consumers). Finally, a creditor is not prohibited under § 1026.36(d)(1) from charging consumers interest rates that include an interest rate premium to recoup the loan originator's compensation through increased interest paid by the consumer (such as by adding a 0.25 percentage point to the interest rate on each loan). This guidance recognizes that creditors that pay a loan originator's compensation generally recoup that cost through a higher interest rate charged to the consumer.

As discussed in the section-by-section analysis to proposed § 1026.36(d)(2)(ii), for transactions subject to proposed § 1026.36(d)(2)(ii), a creditor, a loan originator organization, or affiliates of either may not impose on the consumer any discount points and origination points or fees unless the creditor complies with § 1026.36(d)(2)(ii)(A). As discussed below, proposed § 1026.36(d)(2)(ii)(A) requires, as a prerequisite to a creditor, loan originator organization, or affiliates of either imposing any discount points and origination points or fees on a consumer in a transaction, that the creditor also make available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan. Because of these restrictions in proposed § 1026.36(d)(2)(ii), the Bureau proposes to revise comment 36(d)(1)–4 to clarify that charging different interest rates, such as in accordance with risk-based pricing policies, relates only to § 1026.36(d)(1) and is not intended to override the restrictions in proposed § 1026.36(d)(2)(ii).

Point Banks

Based on numerous inquiries received, the Bureau considered proposing commentary language addressing whether there are any circumstances under which point banks are permissible under § 1026.36(d). The Bureau received and considered the views of SERs participating in the Small Business Review Panel process as well as the views expressed by other stakeholders during outreach. Based on those views and the Bureau's own considerations, the Bureau believes that there are no circumstances under which point banks are permissible, and they therefore continue to be prohibited.

Point banks operate as follows: Each time a loan originator closes a transaction, the creditor contributes some agreed upon, small percentage of that transaction's principal amount (for example, 0.15 percent, or 15 "basis points") into the loan originator's point bank account. This account is not actually a deposit account with the creditor or any depository institution but is only a continuously maintained accounting balance of basis points credited for originations and amounts debited when "spent" by the loan originator. The loan originator may spend any amount up to the current balance in the point bank to obtain pricing concessions from the creditor on the consumer's behalf for any transaction. For example, the loan originator may pay discount points to

the creditor from the loan originator's point bank to obtain a lower rate for the consumer.

Payments to point banks serve as a form of loan originator compensation because they enable additional transactions to be consummated and loan originators to receive compensation on these transactions. Accordingly, they are a financial incentive to the loan originator and, therefore, compensation as proposed § 1026.36(a)(3) defines that term. To the extent such payments are based on the transaction's terms or a factor that operates as a proxy for the transaction's terms, they violate § 1026.36(d)(1) directly. Even if the contribution to a loan originator's point bank for a given transaction is not based on the transaction's terms (or a proxy therefor), the loan originator's subsequent spending of amounts from the point bank on other transactions violates § 1026.36(d)(1) as an impermissible pricing concession pursuant to comment 36(d)(1)–5, discussed below. The Bureau believes that even a point bank whose funds are reserved for use in the unique circumstances described in proposed new comment 36(d)(1)–7 where pricing concessions would be permitted, discussed below, cannot be legitimate because the criteria set forth in comment 36(d)(1)–7 limit such concessions to unusual and infrequent cases of unforeseen increases in closing costs; by definition, a point bank contemplates routine use, which is contrary to the premises of comment 36(d)(1)–7.

The Bureau's decision not to propose to allow point banks was also informed by the uniformly negative view of SERs participating in the Small Business Review Panel process and negative views expressed by many other stakeholders in further outreach. The SERs listed a number of concerns, including the risk that points bank would create incentives for loan originators to upcharge some consumers to create flexibility for themselves to provide concessions to other consumers; the possibility that point banks would permit loan officers to treat consumers differently, which could lead to fair lending concerns; and the prospect of mortgage brokers steering consumers to the lender that provided them with the greatest point bank contributions. For the reasons stated above, the Bureau is not proposing to provide guidance describing circumstances under which point banks are permissible under § 1026.36(d).

Pricing Concessions

The Bureau proposes two revisions to the § 1026.36(d)(1) commentary addressing loan originator pricing concessions. Comment 36(d)(1)–5 discusses the effect of modifying loan terms on loan originator compensation. The existing comment provides that a creditor and loan originator may not agree to set the originator's compensation at a certain level and then subsequently lower it in selective cases (such as where the consumer is offered a reduced rate to meet a quote from another creditor), *i.e.*, the compensation is not subject to change (increase or decrease) based on whether different loan terms are negotiated. The Bureau is proposing a revision to this comment. The revised comment provides that, while the creditor may change loan terms or pricing, for example to match a competitor, avoid triggering high-cost loan provisions, or for other reasons, the loan originator's compensation on that transaction may not be changed. Thus, the revised comment clarifies that a loan originator may not agree to reduce its compensation or provide a credit to the consumer to pay a portion of the consumer's closing costs, for example, to avoid high-cost loan provisions. The revised comment also includes a cross-reference to comment 36(d)(1)–7 for further guidance.

The Bureau proposes to delete existing comment 36(d)(1)–7, which clarifies that the prohibition in § 1026.36(d)(1) does not apply to transactions in which any loan originator receives compensation directly from the consumer (*i.e.*, "consumer-paid transactions"). Like the language in current § 1026.36(d)(1)(iii) (discussed later in this section-by-section analysis), this comment has been superseded by the Dodd-Frank Act, which applies the prohibition on compensation based on transaction terms to consumer-paid transactions.

In its place, the Bureau proposes to include a new comment 36(d)(1)–7 addressing a discrete issue related to pricing concessions. The proposed comment provides that, notwithstanding comment 36(d)(1)–5, § 1026.36(d)(1) does not prohibit loan originators from decreasing their compensation to cover unanticipated increases in non-affiliated third-party closing costs that result in the actual amounts of such closing costs exceeding limits imposed by applicable law (*e.g.*, tolerance violations under Regulation X). This interpretation of § 1026.36(d)(1) does not apply if the creditor or the loan originator knows or should reasonably be expected to know the amount of any

third-party closing costs in advance. Proposed comment 36(d)(1)–7 explains, by way of example, that a loan originator is reasonably expected to know the amount of the third-party closing costs in advance if the loan originator allows the consumer to choose from among only three pre-approved third-party service providers.

The Bureau believes that such concessions, when made in response to unforeseen events outside the loan originator's control to comply with otherwise applicable legal requirements, do not raise concerns about the potential for steering consumers to different loan terms. That is, if the excess closing cost is truly unanticipated and results in the loan originator having to take less compensation to cure the violation of applicable law, no steering issues are present because the loan originator's compensation is being decreased after-the-fact. Thus, a loan originator's reduced compensation in such cases is not in fact based on the transaction's terms and does not violate § 1026.36(d)(1). This further clarification effectuates the purposes of, and facilitates compliance with, TILA section 129B(c)(1) and § 1026.36(d)(1)(i) because, without it, creditors and loan originators might incorrectly conclude that such concessions being borne by a loan originator would violate those provisions, or they could face unnecessary uncertainty with regard to compliance with these provisions and other laws, such as Regulation X's tolerance requirements.

Under the proposed comment, a loan originator cannot make a pricing concession where the loan originator knows or reasonably is expected to know the amount of the third-party closing costs in advance. If a loan originator makes repeated pricing concessions for the same categories of closing costs across multiple transactions, based on a series of purportedly unanticipated expenses, the Bureau believes proposed comment 36(d)(1)–7 does not apply because the loan originator is reasonably expected to know the closing costs across multiple transactions. In that instance, the pricing concessions would raise the same concerns that resulted in the guidance under current comment 36(d)(1)–5 that pricing concessions are not permissible under § 1026.36(d)(1)(i) (*i.e.*, because loan originators could knowingly overestimate the closing costs and then selectively reduce the closing costs as a concession).

The Bureau solicits comment on whether this interpretation is appropriate, too narrow, or creates a risk

of undermining the principal prohibition of compensation based on a transaction's terms.

Compensation Based on Terms of Multiple Transactions by an Individual Loan Originator

Section 1026.36(d)(1)(i) prohibits payment of an individual loan originator's compensation that is directly or indirectly based on the terms of "the transaction." The Bureau believes that "transaction" necessarily includes multiple transactions by a single individual loan originator because the payment of compensation is not always tied to a single transaction. Current comment 36(d)(1)–3 lists several examples of compensation methods not based on transaction terms that take into account multiple transactions, including compensation based on overall loan volume and the long-term performance of the individual loan originator's loans. Moreover, multiple transactions by definition comprise the individual transactions. Thus, the Bureau believes that the singular word "transaction" in § 1026.36(d)(1)(i) includes multiple transactions by a single individual loan originator. To avoid any possible uncertainty, however, the Bureau proposes to clarify, as part of proposed comment 36(d)(1)–1.ii, that § 1026.36(d)(1)(i) prohibits compensation based on the terms of multiple transactions by an individual loan originator.

Compensation Based on Terms of Multiple Individual Loan Originators' Transactions

As noted above, current § 1026.36(d)(1)(i) prohibits payment of an individual loan originator's compensation that is "directly or indirectly" based on the terms of "the transaction," and TILA (as amended by the Dodd-Frank Act) similarly prohibits compensation that "directly or indirectly" varies based on the terms of "the loan." However, the current regulation and its commentary do not expressly address whether a person may pay compensation by considering the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators employed by the person during the time period for which the compensation is being paid. Compensation in the form of a bonus, for example, may be based indirectly on the terms of multiple individual loan originators' transactions. For example, assume that a creditor employs six individual loan originators and offers loans at a minimum rate of 6.0 percent and a maximum rate of 8.0 percent

(unrelated to risk-based pricing). Assuming relatively constant loan volume and amounts of credit extended and relatively static market rates, if the six individual loan originators' aggregate transactions in a given calendar year average a rate of 7.5 percent rather than 7.0 percent, creating a higher interest rate spread over the creditor's minimum acceptable rate of 6.0 percent, the creditor will generate higher amounts of interest revenue if the loans are held in portfolio and increased proceeds from secondary market purchasers if the loans are sold. Assume that the increased revenues lead to higher profits for the creditor (*i.e.*, expenses do not increase so as to negate the effect of higher revenues). If the creditor pays a bonus to an individual loan originator out of a bonus pool established with reference to the creditor's profitability that, all other factors being equal, is higher than it would have been if the average rate of the six individual loan originators' transactions was 7.0 percent, then the bonus is indirectly related to the terms of multiple transactions of multiple loan originators.

Because neither TILA (as amended by the Dodd-Frank Act) nor the current regulations expressly addresses the payment of compensation that is based on the terms of multiple loan originators' transactions, numerous questions have been posed regarding the applicability of the current regulation to qualified plans and profit-sharing and retirement plans that are not qualified plans. In CFPB Bulletin 2012–2, the Bureau stated that it was permissible to pay contributions to qualified plans if the contributions to the qualified plans are derived from profits generated by mortgage loan originations but did not address how the rules applied to non-qualified plans. CFPB Bulletin 2012–2 stated further that guidance on the payment of compensation out of profits generated by mortgage loan originations would be forthcoming. The proposed rule reflects the Bureau's views on this issue.

The Bureau believes that compensation that directly or indirectly is based on the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators poses the same fundamental problems that the Dodd-Frank Act and the current regulation address with regard to the individual loan originator's transactions. A profit-sharing plan, bonus pool, or profit pool set aside out of a portion of a creditor or loan originator organization's profits, from which bonuses are paid or contributions to qualified or non-qualified plans are

made, may readily and directly reflect transaction terms of multiple individual loan originators taken in the aggregate. As a result, this type of compensation creates potential incentives for individual loan originators to steer consumers to different loan terms.

In view of such matters, the framing of compensation restrictions in current § 1026.36(d)(1)(i) in terms of “the transaction” permits an interpretation that could undermine the purpose of the rule. The prohibition in current § 1026.36(d)(1)(i) means that a creditor or loan originator organization cannot differentially distribute compensation among individual loan originators based on each individual loan originator’s transaction terms. Because the current regulation does not expressly address compensation based on the terms of multiple individual loan originators’ transactions, however, creditors and loan originator organizations could establish compensation policies that evade the intent of § 1026.36(d)(1)(i). For example, creditors and loan originator organizations could restructure their compensation policies to pay a higher percentage of the individual loan originator’s compensation through bonuses under profit-sharing plans rather than through salary, commissions, or other forms of compensation that are not based on aggregate transaction terms of multiple individual loan originators.

Through outreach with creditors and loan originator organizations, the Bureau is aware that their bonus structures take a multitude of forms, including payment of so-called “top-down” and “bottom-up” bonuses. In a top-down process, management determines the size of a bonus pool for the firm as a whole at or near the end of the performance year, splits the bonus pool into sub-pools for each line of business, and then allocates the sub-pools to individual employees in a manner related to their individual performance. In contrast, a bottom-up bonus is paid following the firm’s assessment of each employee’s performance and assignment of an incentive compensation award, with the firm’s total amount of incentive compensation for the year being the sum of the individual incentive compensation awards. For many large banks, the processes are a mixture of top-down and bottom-up, but the emphasis can differ markedly.⁵⁵

⁵⁵ See Bd. of Governors of the Fed. Reserve Sys., *Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations* 15 (2011), available at: <http://www.federalreserve.gov/publications/other-reports/incentive-compensation-report-201110.htm>

Although the potential incentive for steering consumers to different loan terms is clearly present with top-down bonuses, where an actual profit pool is set up, steering incentives exist with regard to bottom-up bonuses as well. This is because the profitability of the company could be one of several factors taken into account in awarding a bonus package for an individual loan originator, making it clear to the individual loan originators that the employers are basing the amount of any bonuses paid on a factor (profits) which is substantially correlated to the terms of multiple transactions. Moreover, the Bureau understands that many companies utilize a mix of bottom-up and top-down bonuses, so drawing a distinction between top-down and bottom-up bonuses for regulatory purposes may be artificial and under-inclusive.

In light of the foregoing, the Bureau is proposing a new comment 36(d)(1)–1.ii to clarify that the prohibition on payment and receipt of compensation based on the transaction’s terms under § 1026.36(d)(1)(i) covers compensation that directly or indirectly is based on the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators employed by the person. Proposed comment 36(d)(1)–1.ii also gives examples illustrating the application of this guidance. Proposed comment 36(d)(1)–2.iii.C provides further clarification on these issues. The Bureau believes this approach is necessary to implement the statutory provisions and is appropriate to address the potential incentives to steer consumers to different loan terms that are present with profit-sharing plans and to prevent circumvention or evasion of the statute.

The Bureau believes this proposed clarification sets a bright-line standard with regard to compensating individual loan originators through bonuses and contributions to qualified or non-qualified plans based on the terms of multiple loan transactions by multiple individual loan originators. As discussed below, the Bureau believes it is appropriate to create additional rules to take into account circumstances where any potential incentives are sufficiently attenuated to permit such compensation. Specifically, the Bureau’s proposal would permit employer contributions made to qualified plans in which individual loan originators participate, pursuant to § 1026.36(d)(1)(iii), discussed below.

The proposal also would permit

(discussing bottom-up and top-down bonus structures).

payment of bonuses under profit-sharing plans and contributions to non-qualified defined benefit and contribution plans even if the compensation is directly or indirectly based on the terms of multiple individual loan originators’ transactions where: (1) The revenues of the mortgage business do not predominate with respect to the total revenues of the person or business unit to which the profit-sharing plan applies, as applicable (pursuant to proposed § 1026.36(d)(1)(iii)(B)(1)) or (2) the individual loan originator being compensated was the loan originator for a de minimis number of transactions (pursuant to proposed § 1026.36(d)(1)(iii)(B)(2)). The section-by-section analysis of proposed § 1026.36(d)(1)(iii), below, discusses these additional provisions in more detail. In all instances, the compensation cannot take into account an individual loan originator’s transaction terms, pursuant to § 1026.36(d)(1)(iii)(A). Because the Bureau is proposing to permit compensation based on multiple individual loan originators’ terms in certain circumstances under proposed § 1026.36(d)(1)(iii), the Bureau is proposing to revise § 1026.36(d)(1)(i) to include the language “Except as provided in [§ 1026.36(d)(1)(iii)]” to emphasize that the compensation restrictions in § 1026.36(d)(1)(i) are subject to the provisions in proposed § 1026.36(d)(1)(iii).

The Bureau recognizes that the potential incentives to steer consumers to different loan terms that are inherent in profit-sharing plans may vary based on many factors, including the organizational structure, size, diversity of business lines, and compensation arrangements. In certain circumstances, a particular combination of factors may substantially mitigate the potential steering incentives arising from profit-sharing plans. For example, the incentive of individual loan originators to upcharge likely diminishes as the total number of individual loan originators contributing to the profit pool increases. That is, the incentives may be mitigated because: (1) Each individual loan originator’s efforts will have increasingly less impact on compensation paid under profit-sharing plans; and (2) the ability of an individual loan originator to coordinate efforts with the other individual loan originators will decrease.⁵⁶ This may be

⁵⁶ This “free-riding” behavior has long been observed by economists. See, e.g., Martin L. Weitzman, *Incentive Effects of Profit Sharing* (1980); Robert M. Axelrod, *The Evolution of*

particularly true for large depository institution creditors or large non-depository loan originator organizations that employ many individual loan originators.⁵⁷ In such a large organization, moreover, the nexus between the terms of the transactions of the multiple individual loan originators, the revenues of the organization, the profits of the organization, and the compensation decisions may be more diffuse. The Bureau thus solicits comment on the scope of the steering incentive problem presented by profit-sharing plans, whether the proposal effectively addresses these issues, and whether a different approach would better address these issues.

The Bureau is further cognizant of the burdens that restrictions on compensation may impose on creditors, loan originator organizations, and individual loan originators. The Bureau believes that, when paid for legitimate reasons, bonuses and contributions to defined contribution and benefit plans can be useful and important inducements for individual loan originators to perform well. Profit-sharing plans, moreover, are a means for individual loan originators to become invested in the success of the organization as a whole. The Bureau solicits comment on whether the proposed restrictions on bonuses and

other compensation paid under profit-sharing plans and contributions to defined contribution and benefit plans accomplish the Bureau's objectives without unduly restricting compensation approaches that address legitimate business needs.

Current comment 36(d)(1)–1⁵⁸ provides guidance on what constitutes compensation and refers to salaries, commissions and similar payments. The Bureau is not proposing any clarifications to this existing guidance. In general, salary and commission amounts are more likely than bonuses to be set in advance. Salaries, unlike bonuses, are typically paid out of budgeted operating expenses rather than a “profit pool.” Commissions typically are paid for individual transactions and without reference to the person's profitability. Thus, payment of fixed percentage or fixed dollar amount commissions typically does not raise the potential issue of individual loan originators steering consumers to different loan terms. Also, the amounts of the individual loan originator's salary and commission often are stipulated by an employment contract, commission agreement, or similar agreement, the terms of which the employer agrees to satisfy so long as the employee meets the conditions set forth in the agreement or other employment performance requirements. The Bureau seeks comment on whether the prohibition on compensation relating to aggregate transaction terms of multiple individual loan originators should encompass a broader array of compensation methods, including, *e.g.*, salaries and commissions.

36(d)(1)(ii)

Amount of Credit Extended

As discussed above, § 1026.36(d)(1)(i) provides that a loan originator may not receive and a person may not pay to a loan originator, directly or indirectly, compensation in an amount that is based on any of the transaction's terms or conditions. Section 1026.36(d)(1)(ii) provides that the amount of credit extended is not deemed to be a transaction term or condition, provided compensation is based on a fixed percentage of the amount of credit extended. Such compensation may be subject to a minimum or maximum dollar amount.

Use of the term “amount of credit extended.” TILA section 129B(c)(1), which was added by section 1403 of the

Dodd-Frank Act, provides that a mortgage originator may not receive (and no person may pay to a mortgage originator), directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of principal). 12 U.S.C. 1639b(c)(1). Thus, TILA section 129B(c)(1) permits mortgage originators to receive (and a person to pay mortgage originators) compensation that varies based on the “amount of the principal” of the loan. Section 1026.36(d)(1)(ii) currently uses the phrase “amount of credit extended” instead of the phrase “amount of the principal” as set forth in TILA section 129B(c)(1). Those phrases, however, typically are used to describe the same amount and generally have the same meaning. The term “principal,” in certain contexts, sometimes may mean only the portion of the total credit extended that is applied to the consumer's primary purpose, such as purchasing the home or paying off the existing balance in the case of a refinancing. When used in this sense, the “amount of the principal” might represent only a portion of the amount of credit extended, for example where the consumer also borrows additional amounts to cover transaction costs. The Bureau does not believe that Congress intended “amount of the principal” in this narrower, less common way, however, because the exception appears intended to accommodate existing industry practices, under which loan originators generally are compensated based on the total amount of credit extended without regard to the purposes to which any portions of that amount may be applied.

For the foregoing reasons, pursuant to its authority under TILA section 105(a) to facilitate compliance with TILA, the Bureau proposes to retain the phrase “amount of credit extended” in § 1026.36(d)(1)(ii) instead of replacing it with the statutory phrase “amount of the principal.” The Bureau believes that using the same phrase that is in the current regulatory language will ease compliance burden without diminishing the consumer protection afforded by § 1026.36(d) in any foreseeable way. Creditors already have developed familiarity with the term “amount of credit extended” in complying with the current regulation. The Bureau solicits comment on these beliefs and this proposal to keep the existing regulatory language in place.

Fixed percentage with minimum and maximum dollar amounts. Section 1026.36(d)(1)(ii) provides that loan originator compensation paid as a fixed percentage of the amount of credit extended may be subject to a minimum

Cooperation (1984); Oliver Hart & Bengt Holmstrom, *The Theory of Contracts*, in *Advanced Economic Theory* (T. Bewley ed., 1987); Douglas L. Kruse, *Profit Sharing and Employment Variability: Microeconomic Evidence on Weizman Theory*, 44 *Indus. and Lab. Rel. Rev.*, 437 (1991); Haig R. Nalbantian, *Incentive Compensation in Perspective*, in *Incentive Compensation and Risk Sharing* (Haig R. Nalbantian ed., 1987); and Roy Radner, *The Internal Organization of Large Firms*, 96 *Econ. J.* 1 (1986). Quantifying these trade-offs has been difficult for practical applications, however. See Sumit Agarwal & Itzhak Ben-David, *Do Loan Officers' Incentives Lead to Lax Lending Standards?* (Fisher Coll. of Bus. Working Paper No. 2012–03–007, 2012); Stefan Grosse, Louis Putterman & Bettina Rockenbach, *Monitoring in Teams*, 9 *J. Eur. Econ. Ass'n.* 785 (2011); and Claude Meidenger, Jean-Louis Rulliere & Marie-Claire Villeval, *Does Team-Based Compensation Give Rise to Problems when Agents Vary in Their Ability?* (GATE Groupe, Working Paper No. W.P. 01–13, 2001).

⁵⁷ The Bureau notes that incentive compensation practices at large depository institutions were the subject of final guidance issued in 2010 by the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision. 75 FR 36395 (Jun. 17, 2010) (the Interagency Guidance). The Interagency Guidance was issued to help ensure that incentive compensation policies at large depository institutions do not encourage imprudent risk-taking and are consistent with the safety and soundness of the institutions. *Id.* The Bureau's proposed rule does not affect the Interagency Guidance on loan origination compensation. In addition, to the extent a person is subject to both the Bureau's rulemaking and the Interagency Guidance, compliance with Bureau's rulemaking is not deemed to be compliance with the Interagency Guidance.

⁵⁸ As discussed in the section-by-section analysis of § 1026.36(a), the Bureau is proposing to move the text of this comment to proposed comment 36(a)–5.

or maximum dollar amount. On the other hand, TILA section 129B(c)(1), as added by section 1403 of the Dodd-Frank Act, permits mortgage originators to receive (and a person to pay the mortgage originator) compensation that varies based on the “amount of the principal” of the loan, without addressing the question of whether such compensation may be subject to minimum or maximum limits. 12 U.S.C. 1639b(c)(1). Pursuant to its authority under TILA section 105(a) to facilitate compliance with TILA, the Bureau proposes to retain the current restrictions in § 1026.36(d)(1)(ii) on when loan originators are permitted to receive (and when persons are permitted to pay loan originators) compensation that is based on the amount of credit extended. Specifically, proposed § 1026.36(d)(1)(ii) continues to provide that the amount of credit extended is not deemed to be a transaction term, provided compensation received by or paid to a loan originator is based on a fixed percentage of the amount of credit extended; however, such compensation may be subject to a minimum or maximum dollar amount.

The Bureau believes that permitting creditors to set a minimum and maximum dollar amount is consistent with, and therefore furthers the purposes of, the statutory provision allowing compensation based on a percentage of the principal amount, consistent with TILA section 105(a). As noted above, the Bureau believes the purpose of excluding the principal amount from the “terms” on which compensation may not be based is to accommodate common industry practice. The Bureau also believes that, for some creditors, setting a maximum and minimum dollar amount also is common and appropriate because, without such limits, loan originators may be unwilling to originate very small loans and could receive unreasonably large commissions on very large loans. The Bureau therefore believes that, consistent with TILA section 105(a), permitting creditors to set minimum and maximum commission amounts may facilitate compliance and also may benefit consumers by ensuring that loan originators have sufficient incentives to originate particularly small loans.

In addition, comment 36(d)(1)–9 provides that § 1026.36(d)(1) does not prohibit an arrangement under which a loan originator is compensated based on a percentage of the amount of credit extended, provided the percentage is fixed and does not vary with the amount of credit extended. However, compensation that is based on a fixed

percentage of the amount of credit extended may be subject to a minimum and/or maximum dollar amount, as long as the minimum and maximum dollar amounts do not vary with each credit transaction. For example, a creditor may offer a loan originator one percent of the amount of credit extended for all loans the originator arranges for the creditor, but not less than \$1,000 or greater than \$5,000 for each loan. On the other hand, as comment 36(d)(1)–9 clarifies, a creditor may not compensate a loan originator one percent of the amount of credit extended for loans of \$300,000 or more, two percent of the amount of credit extended for loans between \$200,000 and \$300,000, and three percent of the amount of credit extended for loans of \$200,000 or less. For the same reasons discussed above, consistent with TILA section 105(a), the Bureau believes this guidance is consistent with and furthers the statutory purposes and therefore proposes to retain it. To the extent a creditor seeks to avoid disincentives to originate small loans and unreasonably high compensation amounts on larger loans, the Bureau believes the ability to set minimum and maximum dollar amounts meets such goals.

Reverse mortgages. Industry representatives have asked what the phrase “amount of credit extended” means in the context of closed-end reverse mortgages. For closed-end reverse mortgages, a creditor typically calculates a “maximum claim amount.” Under the Federal Housing Administration’s (FHA’s) Home Equity Conversion Mortgage program, the “maximum claim amount” is the home value at origination (or applicable FHA loan limit, whichever is less). The creditor then calculates the maximum dollar amount the consumer is authorized to borrow (typically called the “initial principal limit”) by multiplying the “maximum claim amount” by an applicable “principal limit factor,” which is calculated based on the age of the youngest borrower and the interest rate. The initial principal limit sets the maximum proceeds available to the consumer for the reverse mortgage. For closed-end reverse mortgages, a consumer often borrows the “initial principal limit” in a lump sum at closing. There can also be payments from the loan proceeds on behalf of the consumer such as to pay off existing tax liens.

Reverse mortgage creditors have requested guidance on whether the “maximum claim amount” or the “initial principal limit” is the “amount of credit extended” in the context of closed-end reverse mortgages. The

Bureau believes that the “initial principal limit” most closely resembles the amount of credit extended on a traditional, “forward” mortgage. Thus, consistent with Dodd-Frank Act section 1403 and pursuant to its authority under TILA section 105(a) to facilitate compliance with TILA, the Bureau proposes to add comment 36(d)(1)–10 to provide that, for closed-end reverse mortgage loans, the “amount of credit extended” for purposes of § 1036.36(d)(1) means the maximum proceeds available to the consumer under the loan, which is the “initial principal limit.”

36(d)(1)(iii)

Consumer Payments Based On Loan Terms

As discussed above, § 1026.36(d)(1)(i) currently provides that no loan originator may receive and no person may pay to a loan originator compensation based on any of the transaction’s terms or conditions. Section 1026.36(d)(1)(iii), however, currently provides that the prohibition in § 1026.36(d)(1)(i) does not apply to transactions in which a loan originator received compensation directly from the consumer and no other person provides compensation to a loan originator in connection with that transaction. Thus, even though, in accordance with § 1026.36(d)(2), a loan originator organization that receives compensation from a consumer may not split that compensation with its individual loan originator, current § 1026.36(d)(1) does not prohibit a consumer’s payment of compensation to the loan originator organization from being based on the transaction’s terms or conditions.

TILA section 129B(c)(1), which was added by section 1403 of the Dodd-Frank Act, provides that mortgage originators may not receive (and no person may pay to mortgage originators), directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of principal). 12 U.S.C. 1639b(c)(1). Thus, TILA section 129B(c)(1) imposes a ban on compensation that varies based on loan terms even in transactions where the mortgage originator receives compensation directly from the consumer. For example, under the amendment, even if the only compensation that a loan originator receives comes directly from the consumer, that compensation may not vary based on the loan terms.

Consistent with TILA section 129B(c)(1), the Bureau proposes to delete existing § 1026.36(d)(1)(iii) and a related sentence in existing comment

36(d)(1)–7. Thus, transactions where a loan originator receives compensation directly from the consumer would no longer be exempt from the prohibition set forth in § 1026.36(d)(1)(i). As a result, whether the consumer or another person, such as a creditor, pays a loan originator compensation, that compensation may not be based on any of the transaction's terms. Comment 36(d)(1)–7 provides guidance on when payments to a loan originator are considered compensation received directly from the consumer. As discussed in more detail in the section-by-section analysis to proposed § 1026.36(d)(2)(i), the Bureau proposes to delete the first sentence of this comment and move the other content of this comment to new comment 36(d)(2)(i)–2.i.

Profit-Sharing and Related Plans

The Bureau proposes a new § 1026.36(d)(1)(iii), which permits in limited circumstances the payment of compensation that directly or indirectly is based on the terms of transactions subject to § 1026.36(d) of multiple individual loan originators.

Qualified plans. As noted above, following a number of inquiries about how the restrictions in the current regulation apply to qualified retirement and profit-sharing plans, the Bureau issued a Bulletin stating that bonuses and contributions to qualified plans out of loan origination profits were permissible under the current rules. The Bureau's position was based in part on certain structural and operational requirements that the Internal Revenue Code (IRC) imposes on qualified plans, including contribution and benefit limits, deferral requirements (regarding both access to and taxation of the funds contributed), the considerable tax penalties for non-compliance, non-discrimination provisions, and requirements to allocate among plan participants based on a definite formula.⁵⁹ Employers also may receive tax deductions for contributions to defined contribution plans up to defined limits, which typically places upward limits on the compensation awarded to individual loan originators through qualified plans. Consistent with its position in CFPB Bulletin 2012–2, the Bureau believes that these structural and operational requirements greatly reduce the likelihood of steering incentives.

Based on these considerations, proposed § 1026.36(d)(1)(iii) permits a

person to compensate an individual loan originator through a contribution to a qualified defined contribution or benefit plan in which an individual loan originator employee participates, provided that the contribution is not directly or indirectly based on the terms of that individual loan originator's transactions subject to § 1026.36(d). Proposed comment 36(d)(1)–2.iii.E clarifies the types of plans that are considered qualified plans for purposes of § 1026.36(d)(1)(iii) (*i.e.*, plans, such as 401k plans, that satisfy the qualification requirements of section 401(a) of the IRC and applicable terms of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001, *et seq.*, the requirements for tax-sheltered annuity plans under IRC section 403(b), or governmental deferred compensation plans under IRC section 457(b)).

Proposed comment 36(d)(1)–2.iii.B clarifies the meaning of defined benefit plan and defined contribution plan as such terms are used in § 1026.36(d)(1)(iii). The proposed comment cross-references proposed comments 36(d)(1)–2.iii.E and –2.iii.G for guidance on the distinction between qualified and non-qualified plans and the relevance of such distinction to the provisions of proposed § 1026.36(d)(1)(iii).

The Bureau solicits comment on whether any other types of retirement plan, profit-sharing plan, or other defined benefit or contribution plans should be treated similarly to qualified plans for purposes of permitting contributions to such plans, even if the compensation relates directly or indirectly to the transaction terms of multiple individual loan originators. For example, the Bureau understands that some non-qualified pension plans limit distribution of funds to participating employees until their separation of service from their employer, which would seem to present more limited incentives to steer consumers to different loan terms.

Non-qualified plans. Proposed § 1026.36(d)(1)(iii) provides that, notwithstanding § 1026.36(d)(1)(i), an individual loan originator may receive, and a person may pay to an individual loan originator, compensation in the form of a bonus or other payment under a profit-sharing plan or a contribution to a defined benefit or contribution plan other than a qualified plan in certain circumstances. Specifically, the proposed rule permits such compensation even if the compensation directly or indirectly is based on the terms of the transactions subject to § 1026.36(d) of multiple individual loan originators, provided that the conditions

set forth in proposed § 1026.36(d)(1)(iii)(A) and (B) are satisfied.

Proposed comment 36(d)(1)–2.iii.A provides guidance on the definition of profit-sharing plan as that term is used in proposed § 1026.36(d)(1)(iii). The proposed comment clarifies that for purposes of the rule, profit-sharing plans include so-called “bonus plans,” “bonus pools,” or “profit pools” from which a person or the business unit, as applicable, pays individual loan originators employed by the person (as well as other employees, if it so elects) bonuses or other compensation with reference to the profitability of the person or business unit, as applicable (*i.e.*, depending on the level within the company at which the profit-sharing plan is established). The proposed comment gives an example of a compensation structure that is a profit-sharing plan under § 1026.36(d)(1)(iii). The proposed comment also notes that a bonus that is made without reference to profitability, such a retention payment budgeted for in advance, does not violate the prohibition on payment of compensation based on transaction terms under § 1026.36(d)(1)(i), as clarified by proposed comment 36(d)(1)–1.ii, meaning that the provisions of proposed § 1026.36(d)(1)(iii) do not apply.

Proposed comment 36(d)(1)–2.iii.C clarifies that the compensation addressed in proposed § 1026.36(d)(1)(iii) directly or indirectly is based on the terms of transactions of multiple individual loan originators when the compensation, or its amount, results from or is otherwise related to the terms of multiple transactions subject to § 1026.36(d). The proposed comment provides that if a creditor does not permit its individual loan originator employees to deviate from the creditor's pre-established loan terms, such as the interest rate offered, then the creditor's payment of a bonus at the end of a calendar year to an individual loan originator under a profit-sharing plan is not related to the transaction terms of multiple individual loan originators. The proposed comment also clarifies that if a loan originator organization whose revenues are derived exclusively from fees paid by the creditors that fund its originations (*i.e.*, “creditor-paid transactions”) pays a bonus under a profit-sharing plan, the bonus is permitted. Proposed comment 36(d)(1)–2.iii.C cross-references proposed comment 36(d)(1)–1.i and –1.ii for further guidance on when a payment is “based on” transaction terms.

Proposed comment 36(d)(1)–2.iii.D clarifies that, under proposed

⁵⁹ See Internal Revenue Serv., U.S. Dep't of the Treasury, Publication 560, *Retirement Plans for Small Businesses* (2012).

§ 1026.36(d)(1)(iii), the time period for which the compensation is paid is the time period for which the individual loan originator's performance was evaluated for purposes of the compensation decision (e.g., calendar year, quarter, month), whether the compensation is actually paid during or after that time period. The proposed comment provides an example where a "pre-holiday" bonus paid in November is "based on" multiple individual loan originators' terms during the entire calendar year because it is paid following an accounting of multiple individual loan originators' transaction terms during the first three quarters of a calendar year and projected similar transaction terms for the remainder of the calendar year.

36(d)(1)(iii)(A)

Proposed § 1026.36(d)(1)(iii)(A) prohibits payment of compensation to an individual loan originator that directly or indirectly is based on the terms of that individual loan originator's transaction or transactions. This language is intended to underscore the fact that a person cannot pay compensation to an individual loan originator based on the terms of that individual loan originator's transactions regardless of whether the compensation is of the type that is permitted in limited circumstances under § 1026.36(d)(1)(iii)(B). Proposed comment 36(d)(1)–2.iii.F clarifies the provision by giving an example and cross-referencing proposed comment 36(d)(1)–1 for further guidance on determining whether compensation is "based on" transaction terms.

36(d)(1)(iii)(B)

36(d)(1)(iii)(B)(1)

Proposed § 1026.36(d)(1)(iii)(B)(1) permits a creditor or a loan originator organization to pay compensation in the form of a bonus or other payment under a profit-sharing plan (including bonus or profit pools) or a contribution to a non-qualified defined benefit or contribution plan where the steering incentives are sufficiently attenuated, even if the compensation is directly or indirectly based on the terms of transactions of multiple individual loan originators employed by the person. As described above, the Bureau is concerned that the current regulation does not provide the requisite clarity to address the potential steering incentives present where creditors or loan originator organizations reward their individual loan originator employees through compensation that is directly or indirectly based on the terms of

multiple transactions of multiple individual loan originator employees. That said, the Bureau recognizes the challenges of developing a clear and practical standard to determine whether the particular compensation method creates incentives for individual loan originators to steer consumers into different loan terms. The Bureau is cognizant that a formulaic approach may pose challenges given the plethora of different entities that will be affected by this proposed rule, which vary greatly in size, organizational structure, diversity of business lines, and compensation structures. Depending on the circumstances, any or all of these factors could accentuate or mitigate the prevalence of steering incentives.

The Bureau also acknowledges the difficulty of establishing a direct nexus between the multiple individual loan originators' actions that may adversely affect consumers and the payment and receipt of bonuses or other compensation that directly or indirectly is based on the terms of those individual loan originators' transactions. Creditors and loan originator organizations use a variety of revenue and profitability measures, and each organization presumably employs methods of compensation that are tailored to fit their business needs. Therefore, a regulatory approach that addresses the potential steering incentives created by compensation methods that reward individual loan originators based on the collective terms of multiple transactions of multiple individual loan originators must be flexible enough to take such factors into account.

With these considerations in mind, the Bureau believes that proposed § 1026.36(d)(1)(iii)(B)(1) balances the need for a bright-line rule with the recognition that a rigid, one-size-fits-all approach may not be workable in light of the wide spectrum of size, type, and business line diversity of the companies that would be subject to the requirement. Assuming that the conditions set forth in proposed § 1026.36(d)(1)(iii)(A) have been met, proposed § 1026.36(d)(1)(iii)(B)(1) permits compensation in the form of a bonus or other payment under a profit-sharing plan or a contribution to a non-qualified defined benefit or contribution plan, even if the compensation relates directly or indirectly to the terms of the transactions subject to § 1026.36(d) of multiple individual loan originators, so long as not more than a certain percentage of the total revenues of the person or business unit to which the profit-sharing plan applies, as applicable, are derived from the person's mortgage business during the

tax year immediately preceding the tax year in which the compensation is paid. As described below, the Bureau is proposing two alternatives for the threshold percentage—50 percent, under Alternative 1 proposed by the Bureau, or 25 percent, under Alternative 2 proposed by the Bureau. To ascertain whether the conditions under § 1026.36(d)(1)(iii)(B)(1) are met, a person measures the revenue of the mortgage business divided by the total revenue of the person or business unit, as applicable. Section 1026.36(d)(1)(iii)(B)(1) explains how total revenues are determined, when the revenues of a person's affiliates are or are not taken into account, and how total revenues derived from the mortgage business are determined. Proposed comment 36(d)(1)–2.iii provides additional guidance on the meaning of the terms total revenue, mortgage business, and tax year under proposed § 1026.36(d)(1)(iii)(B)(1), all discussed below.

The proposed revenue test is intended as a bright-line rule to distinguish methods of compensation where there is a substantial risk of consumers being steered to different loan terms from compensation methods where steering potential is sufficiently attenuated. The proposed bright-line rule recognizes the intertwined relationship among the person's revenues, profitability, and payment of compensation to its individual loan originators. The aggregate loan terms of multiple transactions at a creditor or loan originator organization within a given time period generally affect the revenues of that creditor or loan originator organization during that period. The creditor or loan originator organization's revenues during that period, in turn, generally affect the profitability of the person during that period. And the profitability of the creditor or loan originator organization presumably relates to—if not determines—the amount of compensation available for the profit-sharing plan, bonus pool, or profit pool and distributed to individual loan originators in the form of bonuses or contributions to defined benefit or contribution plans. In other words, the Bureau is treating revenue as a proxy for profitability, and profitability as a proxy for transaction terms in the aggregate.

Furthermore, the Bureau is proposing a threshold of 50 percent because if more than 50 percent of the person's total revenues are derived from the person's mortgage business, the mortgage business revenues are predominant, at which point the attendant steering incentives seem most

likely to exist.⁶⁰ For example, loans with higher interest rate spreads over the creditor's minimum acceptable rate, all else being equal, will yield greater amounts of interest payments if the loans are kept in portfolio by the creditor and a greater gain on sale if sold on the secondary market. As discussed above, in general revenues drive profitability and profitability relates to, if not drives, decisions about compensation for individual loan originators. Thus, if the mortgage-related revenues predominate, there is more risk that the individual loan originators, whose transactions generate mortgage business revenue, will be incentivized to upcharge or otherwise steer consumers to different loan terms. On the other hand, where the person's revenues do not predominantly consist of revenue from its mortgage business, the connection between revenue received from multiple individual loan originators' transactions and the payment from the profit-sharing plan or contribution to the defined benefit or contribution plan in which the individual loan originator participates may be sufficiently attenuated to mitigate steering concerns given the number of other employees, products or services, and other actions that contribute to the overall profitability of the company.

The Bureau recognizes, however, that a bright-line rule with a threshold set at 50 percent of total revenue may not be commensurate in all cases with steering incentives in light of the differing sizes, organizational structures, and compensation structures of the persons affected by the proposed rule. Even if the mortgage business does not predominate the overall generation of revenues, the revenues may be sufficiently high that, in view of other facts and circumstances, the connection between the mortgage-business revenue generated and the compensation paid to individual loan originators may not be sufficiently attenuated, and thus still present a steering risk. Therefore, the Bureau is proposing an alternative approach that includes the same regulatory text and commentary language but contains a stricter threshold amount of 25 percent for purposes of the revenue test under § 1026.36(d)(1)(iii)(B)(1). The Bureau solicits comment on whether 50

percent, 25 percent, or a different threshold amount would better effectuate the purposes of the rule.

The Bureau is also aware of the potential differential effects the provisions of § 1026.36(d)(1)(iii)(B)(1) may have on small creditors and loan originator organizations that employ individual loan originators when compared to the effects on larger institutions. In particular, the Bureau recognizes that loan originator organizations that originate loans as their exclusive, or primary, line of business will, barring diversification of their business lines, not be able to pay the types of compensation that are permitted in limited circumstances under § 1026.36(d)(1)(iii)(B)(1). During the Small Business Review Panel process, a SER stated that there should be no threshold limit because any limit would disadvantage small businesses that originate only mortgages. In response to this and other SERs' feedback, the Small Business Review Panel recommended that the Bureau seek public comment on the ramifications for small businesses and other businesses of setting the revenue limit at 50 percent of company revenue or at other levels. The Small Business Review Panel also recommended that the Bureau solicit public comment on the treatment of qualified and non-qualified plans and whether treating qualified plans differently than non-qualified plans would adversely affect small creditors and loan originator organizations relative to large creditors and loan originator organizations. The Bureau accordingly seeks comment on these issues. The Bureau is also proposing, as discussed in the section-by-section analysis to proposed § 1026.36(d)(1)(iii)(B)(2), below, to permit compensation in the form of bonuses and other payments under profit-sharing plans and contributions to non-qualified defined benefit or contribution plans where an individual loan originator is the loan originator for five or fewer transactions within the 12-month period preceding the payment of the compensation. The Bureau expects that for some small entities, this de minimis exception should address some of the concerns expressed by the small entity representatives.

Revenue Test Formula

Proposed comment 36(d)(1)–2.iii.G clarifies various aspects of the revenue test. Proposed comment 36(d)(1)–2.iii.G.1 addresses the measurement of total revenue under the revenue test formula, which pursuant to § 1026.36(d)(1)(iii)(B)(1) is the person's total revenues or the total revenues of

the business unit to which the profit-sharing plan applies, as applicable, during the tax year immediately preceding the tax year in which the compensation is paid. The comment clarifies that under this provision, whether the revenues of the person or business unit are used depends on the level within the person's organizational structure at which the profit-sharing plan is established and whose profitability is referenced for purposes of payment of the compensation. The comment provides that if the profitability of the person is referenced for purposes of establishing the profit-sharing plan, then the total revenues of the person are used, and gives an example of how total revenues are calculated for a creditor that has two separate business units. The Bureau believes that the total revenues for purposes of the revenue test under § 1026.36(d)(1)(iii)(B)(1) must reflect the revenues of the business unit within the company whose profitability is referenced for purposes of paying compensation to the individual loan originators, because including the revenues of business units to which the profit-sharing plan does not apply would lead to an artificially over-inclusive measurement of total revenues, thus undermining the purpose of the revenue test in § 1026.36(d)(1)(iii)(B)(1). For example, if the overall revenues of a creditor with diverse revenue sources across business units were included in the total revenues regardless of the level in the ownership structure at which the profit-sharing plan was established, the creditor could establish a profit-sharing plan at the level of the mortgage business unit to pay bonuses to individual loan originators only, and yet still pass the revenue test. This type of arrangement is one where incentives to steer consumers to different loan terms are present, and therefore the Bureau believes that it should be captured by the revenue test.

Proposed comment 36(d)(1)–2.iii.G.1 also clarifies that a tax year is the person's annual accounting period for keeping records and reporting income and expenses (*i.e.*, it may be a calendar year or a fiscal year depending on the person's annual accounting period) and gives an example showing how the revenue test is applied in the context of a creditor that uses a calendar year accounting period. The Bureau acknowledges that taking only one tax year's revenues into account necessitates an annual reevaluation of whether the revenue test is met. This also could result in a person with

⁶⁰ In its materials prepared for the Small Business Review Panel process in May 2012, the Bureau indicated that it was considering a revenue test threshold of between 20 and 50 percent. As noted above, the Bureau is proposing two alternative threshold amounts—50 percent and 25 percent—and is soliciting comment on whether the threshold should be different.

relatively consistent revenue flow over a number of years falling above or below the threshold based on an anomalous tax year where revenues fluctuate greatly for reasons that are not related to incentive structures. Moreover, the proposed rule requires evaluation of the previous tax year's revenues. This means that, for example, whether a company can pay a bonus under a profit-sharing plan in December of a particular year might, under the proposed revenue test, depend in part on the level of mortgage business and total revenues generated beginning in January of the previous calendar year (*i.e.*, 23 months prior), which in the context may be a stale data point. The Bureau, therefore, solicits comment on whether the total revenues should instead be based on a rolling average of revenues over two tax years, a rolling average of revenues during the 12 months preceding the decision to make the compensation payment, or another time period.

Section 1026.36(d)(1)(iii)(B)(1) also provides that total revenues are determined through a methodology that is consistent with generally accepted accounting principles and, as applicable, the reporting of the person's income for purposes of Federal tax filings or, if none, any industry call reports filed regularly by the person. As applicable, the methodology also shall reflect an accurate allocation of revenues among the person's business units. The proposed commentary notes that industry call reports filed regularly by the person could, depending on the person, include the NMLSR Mortgage Call Report or the National Credit Union Administration (NCUA) Call Report. The proposed commentary also notes that a Federal credit union that is exempt from paying Federal income tax would, under the proposed rule, use a methodology to determine total annual revenues that reflects the income reported in any NCUA Call Reports filed by the credit union; if none, the methodology otherwise must be consistent with GAAP and, as applicable, reflects an accurate allocation of revenues among the credit union's business units. The Bureau is proposing that a person determine total revenues in this manner to ensure that the measurement of total revenues is methodologically sound and consistent with the company's own reporting of income for Federal tax purposes or, if none, any industry call reports filed regularly by the person, and to ensure that it is not subject to manipulation to produce an outcome favorable to the company (presumably, a total revenue

measurement of over 50 percent or 25 percent, depending on the alternative threshold chosen for the revenue test). The Bureau solicits comment on whether this standard for measuring total revenues is appropriate in light of the diversity in size of the financial institutions that would be subject to the requirement and, more generally, on what types of income should be included in the definition of total revenues. The Bureau also solicits comment on whether the definition of total revenues should be tied to a more objective standard such as the Bureau's definition of "receipts" in the Bureau's final "larger participants" rule regarding the supervision of consumer reporting agencies.⁶¹

The Bureau recognizes that some of the creditors and loan originator organizations subject to this proposed rule may have numerous business organizations set up under common ownership, and the determination of profitability (which, in turn, relates to compensation decisions) may be made at a different level than by the management of the individual loan originators' business unit. Moreover, the nature of the ownership hierarchy, both horizontal and vertical, and the level of proximity within the organization among the individual loan originators, the employees of the other business units, and the compensation decision-makers all may serve to reduce or enhance the prevalence of steering incentives depending on the circumstances. In general, the Bureau believes that the revenues of the business organization or unit whose profits are used as reference for compensation decisions—whether the person, a business unit within the person, or an affiliate of the person—should be the business organization or unit whose revenues are evaluated for purposes of proposed § 1026.36(d)(1)(iii)(B)(1). Therefore, proposed § 1026.36(d)(1)(iii)(B)(1) states that the revenues of the person's affiliates generally are not taken into account for purposes of the revenue test unless the profit-sharing plan applies to the affiliate, in which case the person's total revenues also include the total revenues of the affiliate. Proposed comment 36(d)(1)–2.iii.G.1 notes that the profit-sharing plan applies to the affiliate when, for example, the funds

used to pay a bonus to an individual loan originator are the same funds used to pay a bonus to employees of the affiliate. The Bureau solicits comment on whether the revenues of affiliates should be treated in a different manner for purposes of the revenue test under § 1026.36(d)(1)(iii)(B)(1).

Section 1026.36(d)(1)(iii)(B)(1) provides that the revenues derived from mortgage business are the portion of those total revenues that are generated through a person's transactions subject to § 1026.36(d). Proposed comment 36(d)(1)–2.iii.G.2 clarifies that, pursuant to § 1026.36(j) and comment 36–1, § 1026.36(d) applies to closed-end consumer credit transactions secured by dwellings and reverse mortgages that are not home-equity lines of credit under § 1026.40. The proposed comment also gives guidance that a person's revenues from its mortgage business include, for example: origination fees and interest associated with loans for purchase money or refinance purposes originated by individual loan originators employed by the person, income from servicing of loans for purchase money or refinance purposes originated by individual loan originators employed by the person, and proceeds of secondary market sales of loans for purchase money or refinance purposes originated by individual loan originators employed by the person. The proposed comment further notes that revenues derived from mortgage business do not include, for example, servicing income where the loans being serviced were purchased by the person after their origination by another person. This distinction is drawn because the individual loan originators employed by a particular creditor or loan originator organization do not have steering incentives when the loans being serviced were originated by another person. In addition, origination fees, interest, and secondary market sale proceeds associated with home-equity lines of credit, loans secured by consumers' interests in timeshare plans, or loans made primarily for business, commercial, or agricultural purposes are not counted as mortgage business revenues because such transactions are outside the coverage of § 1026.36(d). In light of the distinctions drawn to include and exclude categories of mortgage-related revenues for purposes of the revenue test, the Bureau requests comment on the scope of revenues included in the definition of mortgage revenues. The Bureau also recognizes that the definition of mortgage business revenues, as clarified by proposed comment 36(d)(1)–2.iii.G.2, includes revenues, such as origination fees,

⁶¹ Defining Larger Participants of the Consumer Reporting Market, 77 FR 42873 (July 20, 2012) (to be codified at 12 CFR part 1090). In the final rule, the Bureau noted that the proposed definition of "annual receipts" is adapted in part from the existing measure used by the U.S. Small Business Administration (SBA) for its small business loan programs.

interest, and servicing income, of transactions subject to § 1026.36(d) that were originated before the current regulation on mortgage loan origination went into effect. During the Small Business Review Panel process, the SERs asserted that using mortgage revenue as a standard would be over-inclusive because the standard would capture income from all mortgage loans, including existing portfolio loans, rather than only newly originated loans. The Bureau thus solicits comment on whether revenues associated with transactions originated prior to the effect of the Board's 2010 Loan Originator Final Rule or this proposed rule (if adopted) should be excluded.

Alternative Approaches to Revenue Test

The Bureau recognizes that, for purposes of proposed § 1026.36(d)(1)(iii)(B)(1), a formula that utilizes profitability as a measuring point may be more appropriate than revenues. Compensation decisions are more likely to relate to profits than revenues because the funds available for bonuses will be driven by the amount remaining following payment of expenses, rather than the gross revenues generated by the company. Focusing on revenues may be an imperfect test to measure the relationship between the mortgage business and the profitability of the person or business unit, as applicable (which, in turn, relates to the compensation decisions). For example, a company could derive 40 percent of its total revenues from its mortgage business, but that same line of business may generate 80 percent of the company's profits. In such an instance, the steering incentives could be significant given the impact the mortgage business has on the company's overall profitability. Yet, under the revenue test this organization would be permitted to pay certain compensation based on terms of multiple individual loan originators' transactions taken in the aggregate. The Bureau believes a test based on profitability would create significant challenges, such as the need to define profitability and the question of how affiliate relationships are addressed. Such an approach could require detailed, complex rules to clarify how the test works. Moreover, the Bureau is concerned that using profitability as the metric could lead to evasion of the rule if a person were to allocate costs in a manner across business lines that would lead to understatement of the mortgage business profits (making it more likely that the revenue test would be passed even though steering incentives are still present). In light of these

considerations, the Bureau solicits comment on whether the formula under § 1026.36(d)(1)(iii)(B)(1) should be changed to the total profits of the mortgage business divided by the total profits of the person or business unit, as applicable, and, if so, how profits should be calculated.

The Bureau recognizes that concerns about individual loan originators steering consumers to different loan terms may vary depending on the proportion of an individual loan originator's total compensation that is attributable to payments permitted under § 1026.36(d)(1)(iii)(B)(1). Thus, the Bureau additionally solicits comment on whether to establish a cap on the percentage of an individual loan originator's total compensation that can be attributable to payments permitted under § 1026.36(d)(1)(iii)(B)(1), either in addition to or in lieu of the proposed revenue test. The Bureau also solicits comment on the appropriate threshold amount if the Bureau were to adopt a total compensation test.

The Bureau recognizes that the bright-line standard in proposed § 1026.36(d)(1)(iii)(B)(1) creates an "exempt or non-exempt" approach that prohibits the payment of bonuses and other compensation and the making of contributions to non-qualified defined benefit and contribution plans if the creditor or loan origination organization has mortgage business revenues of greater than 50 percent of its total revenues (under Alternative 1 proposed by the Bureau), 25 percent of its total revenues (under Alternative 2 proposed by the Bureau), or some lesser percentage that the Bureau may determine to be more appropriate. The Bureau acknowledges that terms of multiple individual loan originators' transactions taken in the aggregate will not, in every instance, have a substantial effect on profitability, and likewise there are occasions where the profitability will relate only insubstantially to the compensation. However, the Bureau believes that it is critical to create a workable test that does not have significant complexity. Otherwise, it may be difficult for creditors and loan originator organizations to employ the test. The Bureau also recognizes that any test is likely to be both under- and over-inclusive.

Consequently, the Bureau solicits comment on whether it should include an additional provision under § 1026.36(d)(1)(iii)(B) that would permit bonuses under a profit-sharing plan or contributions to non-qualified defined benefit or contribution plans where the compensation bears an insubstantial

relationship to the terms of transactions subject to § 1026.36(d) of multiple individual loan originators. This test would look to whether the aggregate loan terms of multiple individual loan originators is only one factor or variable among multiple significant factors or variables taken into account in the compensation decision and does not affect the outcome of the compensation decision to a substantial degree. For example, if a creditor pays a year-end bonus based on formula that includes ten different factors, all of which are permissible under § 1026.36(d)(1) (e.g., performance of loans, amount of credit extended, amount of transactions closed relative to application), and the profitability of the creditor will make only a marginal difference of two percent as to the amount of bonus paid (e.g., an individual loan originator who receives a \$2,000 bonus would receive a \$1,960 bonus but for the fact that the person's profitability was taken into account in determining the bonus), the creditor might, depending on the facts and circumstances, demonstrate that the compensation is substantially independent of the terms of transactions subject to § 1026.36(d) of multiple individual loan originators. It is unclear, however, how such a test would work in practice and what standards would apply to determine if compensation is substantially independent. Nonetheless, the Bureau solicits comment on whether such an additional provision should be included under § 1026.36(d)(1)(iii).

36(d)(1)(iii)(B)(2)

Proposed § 1026.36(d)(1)(iii)(B)(2) permits a person to pay, and an individual loan originator to receive, compensation in the form of a bonus or other payment under a profit-sharing plan sponsored by the person or a contribution to a non-qualified defined contribution or benefit plan if the individual is a loan originator (as defined in proposed § 1026.36(a)(1)(i)) for five or fewer transactions subject to § 1026.36(d) during the 12-month period preceding the compensation decision. This compensation is permitted even when the payment or contribution relates directly or indirectly to the terms of the transactions subject to § 1026.36(d) of multiple individual loan originators.

The intent of proposed § 1026.36(d)(1)(iii)(B)(2) is to exempt individual loan originators who engage in a de minimis number of transactions subject to § 1026.36(d) from the restrictions on payment of bonuses and making of contributions to defined benefit and defined contribution plans that are not qualified plans. The Bureau

is proposing to exempt individual loan originators who are loan originators for five or fewer transactions within a 12-month period preceding the date of the decision to pay the compensation. Under TILA, a person is not considered a creditor unless the person regularly extends credit, which with respect to consumer credit transactions secured by a dwelling is at least five transactions per calendar year. See § 1026.2(a)(17)(v). The Bureau believes, by analogy, that an individual loan originator who is a loan originator for five or fewer transactions is not truly active as an individual loan originator and thus is insufficiently incentivized to steer consumers to different loan terms. Proposed comment 36(d)(1)–2.iii.H also provides an example of the de minimis transaction exception as applied to a loan originator organization employing six individual loan originators.

The Bureau solicits comment on the number of individual loan originators who will be affected by the exception and whether, in light of such number, the de minimis test is necessary. The Bureau also solicits comment on the appropriate number of originations that should constitute the de minimis standard, over what time period the transactions should be measured, and whether this standard should be intertwined with the potential total compensation test on which the Bureau is soliciting comment, discussed in the section-by-section analysis to proposed § 1026.36(d)(1)(iii)(B)(1). The Bureau, finally, solicits comment on whether the 12-month period used to measure whether the individual loan originator has a de minimis number of transactions should end on the date on which the compensation is paid, rather than the date on which the compensation decision is made. The Bureau believes that having the 12-month period end on the date on which the decision is made will be simpler for compliance purposes because it would require the person to verify whether the individual loan originator is eligible for the compensation payment when making the decision, but not thereafter. If the 12-month period were to end on the date of the payment, the employer presumably would have to verify the number of transactions twice—at the time the person decides to award the compensation to the individual loan originator, and again before the compensation is paid (assuming there is a time lag between the decision and the payment). The Bureau recognizes, however, that the date on which the compensation is paid may be more easily documentable (e.g., through a

payroll stub) for purposes of the recordkeeping requirements proposed under § 1026.25(c)(2).

Proposed comment 36(d)(1)–2.iii.I.1 and –2.iii.I.2 illustrates the effect of proposed § 1026.36(d)(1)(iii)(A) and (B) on a company that has mortgage and credit card businesses and harmonizes through examples the concepts discussed in other proposed comments to § 1026.36(d)(1)(iii).

36(d)(2) Payments by Persons Other Than Consumer

36(d)(2)(i) Dual Compensation Background

Section 1026.36(d)(2) currently provides that if any loan originator receives compensation directly from a consumer in a consumer credit transaction secured by a dwelling: (1) No loan originator may receive compensation from another person in connection with the transaction; and (2) no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to a loan originator in connection with the transaction.

Comment 36(d)(2)–1 currently provides that the restrictions imposed under § 1026.36(d)(2) relate only to payments, such as commissions, that are specific to and paid solely in connection with the transaction in which the consumer has paid compensation directly to a loan originator. Thus, the phrase “in connection with the transaction” as used in § 1026.36(d)(2) does not include salary or hourly wages that are not tied to a specific transaction.

Thus, under current § 1026.36(d)(2), a loan originator that receives compensation directly from the consumer may not receive compensation in connection with the transaction (e.g., a commission) from any other person (e.g., a creditor). In addition, if any loan originator is paid compensation directly by the consumer in a transaction, no other loan originator may receive compensation in connection with the transaction from a person other than the consumer. Moreover, if any loan originator receives compensation directly from a consumer, no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to a loan originator in connection with the transaction. For example, assume that a loan originator that is not a natural person (loan originator organization) receives compensation directly from the

consumer in a mortgage transaction subject to § 1026.36(d)(2). The loan originator organization may not receive compensation in connection with that particular transaction (e.g., a commission) from a person other than the consumer (e.g., the creditor). In addition, because the loan originator organization is a person other than the consumer, the loan originator organization may not pay individual loan originators any compensation, such as a transaction-specific commission, in connection with that particular transaction. Consequently, under current rules, in the example above, the loan originator organization must pay individual loan originators only in the form of a salary or hourly wage or other compensation that is not tied to the particular transaction.

The Dodd-Frank Act

Section 1403 of the Dodd-Frank Act added TILA section 129B. 12 U.S.C. 1639b. TILA section 129B(c)(2)(A) states that, for any mortgage loan, a mortgage originator generally may not receive from any person other than the consumer any origination fee or charge except bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of either. Likewise, no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third-party charges as described above. Notwithstanding this general prohibition on payments of any origination fee or charge to a mortgage originator by a person other than the consumer, TILA section 129B(c)(2)(B) provides that a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if: (1) The mortgage originator does not receive any compensation directly from the consumer; and (2) “the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator).” TILA section 129B(c)(2)(B) also provides the Bureau authority to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points or fees where doing so is in the interest of consumers and the public.

The Bureau's Proposal

As explained in more detail below, while the statute is structured differently and uses different terminology than existing § 1026.36(d)(2), the restrictions on dual compensation set forth in existing § 1026.36(d)(2) generally are consistent with the restrictions on dual compensation set forth in TILA section 129B(c)(2). Nonetheless, the Bureau proposes several changes to existing § 1026.36(d)(2) (re-designated as § 1026.36(d)(2)(i)) to provide additional guidance and flexibility to loan originators. For example, as explained in more detail below, in response to questions, the Bureau proposes to provide additional guidance on whether compensation to a loan originator paid on the borrower's behalf by a person other than a creditor or its affiliates, such as a non-creditor seller, home builder, home improvement contractor or real estate broker or agent, is considered compensation received directly from a consumer for purposes of § 1026.36(d)(2)(i). Specifically, the Bureau proposes to add § 1026.36(d)(2)(i)(B) and comment 36(d)(2)-2.iii to clarify that such payments to a loan originator are considered compensation received directly from the consumer for purposes of § 1026.36(d)(2) if they are made pursuant to an agreement between the borrower and the person other than the creditor or its affiliates.

In addition, currently, § 1026.36(d)(2) prohibits a loan originator organization that receives compensation directly from a consumer in connection with a transaction from paying compensation in connection with that transaction to individual loan originators (such as its employee brokers), although the organization could pay compensation that is not tied to the transaction (such as salary or hourly wages) to individual loan originators. As explained in more detail below, the Bureau proposes to revise § 1026.36(d)(2) (re-designated as § 1026.36(d)(2)(i)) to provide that, if a loan originator organization receives compensation directly from a consumer in connection with a transaction, the loan originator organization may pay compensation in connection with the transaction to individual loan originators and the individual loan originators may receive compensation from the loan originator organization. As explained in more detail below, the Bureau believes that allowing loan originator organizations to pay compensation in connection with a transaction to individual loan originators, even if the loan originator

organization has received compensation directly from the consumer in that transaction, is consistent with the statutory purpose of ensuring that a loan originator organization is not compensated by both the consumer and the creditor for the same transaction because whether and how the loan originator organization splits its compensation with its individual loan originators does not affect the total amount of compensation paid by the consumer (directly or indirectly).

As discussed in more detail below, the Bureau also believes that the original purpose of the restriction in current § 1026.36(d)(2) is addressed separately by other revisions pursuant to the Dodd-Frank Act. Under current § 1026.36(d)(1)(iii), compensation paid directly by a consumer to a loan originator could be based on loan terms and conditions. Consequently, individual loan originators could have incentives to steer a consumer into a transaction where the consumer compensates the loan originator organization directly, resulting in greater compensation to the loan originator organization than it could receive if compensated by the creditor subject to the restrictions of § 1026.36(d)(1). The Dodd-Frank Act prohibits compensation based on loan terms, even when a consumer is paying compensation directly to a mortgage originator. Thus, if an individual loan originator receives compensation in connection with the transaction from the loan originator organization (where the loan originator organization receives compensation directly from the consumer), the amount of the compensation paid by the consumer to the loan originator organization, and the amount of the compensation paid by the loan originator organization to the individual loan originator, cannot be based on loan terms.

In addition, with this proposed revision, more loan originator organizations may be willing to structure transactions where consumers pay loan originator compensation directly. The Bureau believes that this result may enhance the interests of consumers and the public by giving consumers greater flexibility in structuring the payment of loan originator compensation.

The Bureau's proposal on restrictions related to dual compensation as set forth in proposed § 1026.36(d)(2)(i) are discussed in more detail below.

Compensation received directly from the consumer. As discussed above, under § 1026.36(d)(2), a loan originator that receives compensation directly from the consumer may not receive

compensation in connection with the transaction (e.g., a commission) from any other person (e.g., a creditor). In addition, if any loan originator is paid compensation directly by the consumer in a transaction, no other loan originator (such as an employee of a loan originator organization) may receive compensation in connection with the transaction from another person. Moreover, if any loan originator receives compensation directly from a consumer, no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to a loan originator, directly or indirectly, in connection with the transaction. Existing comment 36(d)(1)-7 provides guidance on when payments to a loan originator are considered compensation received directly from the consumer. The Bureau proposes to delete the first sentence of this comment because it is no longer relevant given that the Bureau proposes to remove § 1026.36(d)(1)(iii), as discussed above under the section-by-section analysis to proposed § 1026.36(d)(1). The Bureau also proposes to move the other content of this comment to proposed comment 36(d)(2)-2.i; no substantive change is intended.

Existing comment 36(d)(2)-2 references Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA), and provides that a yield spread premium paid by a creditor to the loan originator may be characterized on the RESPA disclosures as a "credit" that will be applied to reduce the consumer's settlement charges, including origination fees. Existing comment 36(d)(2)-2 clarifies that a yield spread premium disclosed in this manner is not considered to be received by the loan originator directly from the consumer for purposes of § 1026.36(d)(2). The Bureau proposes to move this guidance to proposed comment 36(d)(2)(i)-2.ii and revise it. The Bureau proposes to revise the guidance in proposed comment 36(d)(2)(i)-2.ii recognizing that § 1026.36 prohibits yield spread premiums and overages. Yield spread premiums and overages were additional sums (premiums or bonuses) paid to mortgage brokers and loan officers, respectively, for selling consumers an interest rate that is higher than the minimum rate the creditor would be willing to offer a particular consumer based on the creditor's specific underwriting criteria (i.e., the difference in interest rate yield, the yield spread, or overage) without the borrower paying

points to reduce this minimum rate further. Yield spread premiums or overages also differed significantly from lender credits or rebates because the loan originator had the discretion to retain all of the proceeds obtained from the yield spread premium or overage and not use any proceeds to reduce the borrower's settlement costs.

"Rebates," "credits," or "lender credits" on the other hand are paid by the creditor for the interest rate chosen by the consumer or on behalf of the consumer to reduce the consumer's settlement costs. Comment 36(d)(2)-2 (re-designated as proposed comment 36(d)(2)(i)-2.ii) would be revised to use the term "rebates" and "credits," instead of yield spread premiums. Rebates are disclosed as "credits" under the current Regulation X disclosure regime.

The Bureau also proposes to add § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii to provide additional guidance on the phrase "compensation directly from the consumer" as used in new TILA section 129B(c)(2)(B), as added by section 1403 of the Dodd-Frank Act, and § 1026.36(d)(2) (as re-designated proposed § 1026.36(d)(2)(i)). Mortgage creditors and other industry representatives have raised questions about whether payments to a loan originator on behalf of the borrower by a person other than the creditor are considered compensation received directly from a consumer for purposes of § 1026.36(d)(2). For example, non-creditor sellers, home builders, home improvement contractors, or real estate brokers or agents may agree to pay some or all of the consumer's closing costs. Some of this payment may be used to compensate a loan originator. In proposed § 1026.36(d)(2)(i)(B), the Bureau proposes to interpret the phrase "compensation directly from the consumer" as used in new TILA section 129B(c)(2)(B) and proposed § 1026.36(d)(2)(i) to include payments to a loan originator made pursuant to an agreement between the consumer and a person other than the creditor or its affiliates. Proposed comment 36(d)(2)(i)-2.iii clarifies that whether there is an agreement between the parties will depend on State law. *See* § 1026.2(b)(3). Also, proposed comment 36(d)(2)(i)-2.iii makes clear that the parties do not have to agree specifically that the payments will be used to pay for the loan originator's compensation, but just that the person will make a payment toward the borrower's closing costs. For example, assume that a non-creditor seller has an agreement with the borrower to pay \$1,000 of the borrower's closing costs on a

transaction. Any of the \$1,000 that is used to pay compensation to a loan originator is deemed to be compensation received directly from the consumer, even if the agreement does not specify that some or all of \$1,000 must be used to compensate the loan originator. In such cases, the loan originator would be permitted to receive compensation from both the consumer and the other person who has the agreement with the consumer (but not from any other person).

The Bureau believes that arrangements where a person other than a creditor or its affiliate pays compensation to a loan originator on behalf of the borrower do not raise the same concerns as when that compensation is being paid by the creditor or its affiliates. The Bureau believes that one of the primary goals of section 1403 of the Dodd-Frank Act is to restrict a loan originator from receiving compensation both directly from a consumer and from the creditor or its affiliates, which more easily may occur without the consumer's knowledge. Allowing loan originators to receive compensation from both the consumer and the creditor can create inherent conflicts of interest of which consumers may not be aware. When a loan originator organization charges the consumer a direct fee for arranging the consumer's mortgage loan, this charge may lead the consumer to infer that the broker accepts the consumer-paid fee to represent the consumer's financial interests. Consumers also may reasonably believe that the fee they pay is the originator's sole compensation. This may lead reasonable consumers erroneously to believe that loan originators are working on their behalf, and are under a legal or ethical obligation to help them obtain the most favorable loan terms and conditions. Consumers may regard loan originators as "trusted advisors" or "hired experts," and consequently rely on originators' advice. Consumers who regard loan originators in this manner may be less likely to shop or negotiate to assure themselves that they are being offered competitive mortgage terms.

The Bureau believes, however, that the statutory goals discussed above are facilitated by proposed § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii. Under the proposal, a payment by a person other than a creditor or its affiliates is considered received directly from the consumer for purposes of § 1026.36(d)(2) only if the payment is made pursuant to an agreement between the consumer and that person. Thus, if there is an agreement, presumably the consumer

will be aware of the payment. In addition, because this payment would be considered compensation directly received from the consumer, the consumer is the only other person in the transaction that could pay compensation in connection with the transaction to the loan originator. For example, the creditor or its affiliates could not pay compensation in connection with the transaction to the loan originator.

In addition, the Bureau believes that proposed § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii help prevent circumvention of the dual compensation provisions. If payments by persons other than the creditor or its affiliates were not deemed to be compensation directly from the consumer, a loan originator could arrange for the consumer to pay compensation to such a person and for that person to pay the compensation to the loan originator. Because this payment would not be deemed to be coming directly from the consumer, the loan originator could receive compensation from a creditor and this other person, circumventing the dual compensation rules.

Under proposed § 1026.36(d)(2)(i)(B) and comment 36(d)(2)(i)-2.iii, payment of loan originator compensation by an affiliate of the creditor, including a seller, home builder, home improvement contractor, etc., to a loan originator is not deemed to be made directly by the consumer for purposes of § 1026.36(d)(2) (re-designated as proposed § 1026.36(d)(2)(i)), even if the payment is made pursuant to an agreement between the borrower and the affiliate. That is, for example, if a home builder is an affiliate of a creditor, proposed § 1026.36(d)(2)(i) prohibits this person from paying compensation in connection with a transaction if a consumer pays compensation to the loan originator in connection with the transaction. This proposal is consistent with current § 1026.36(d)(3), which states that for purposes of § 1026.36(d) affiliates must be treated as a single "person." In addition, considering payments of compensation to a loan originator by an affiliate of the creditor to be payments directly made by the consumer may allow creditors to circumvent the restrictions in proposed § 1026.36(d)(2)(i). A creditor could provide compensation to the loan originator indirectly by structuring the arrangement such that the creditor pays the affiliate and the affiliate pays the loan originator.

Prohibition on a loan originator receiving compensation in connection with a transaction from both the consumer and a person other than the

consumer. As discussed above, under § 1026.36(d)(2), a loan originator that receives compensation directly from the consumer in a closed-end consumer credit transaction secured by a dwelling may not receive compensation from any other person in connection with the transaction. In addition, in such cases, no person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) may pay any compensation to the loan originator in connection with the transaction. Current comment 36(d)(2)–1 provides that, for purposes of § 1026.36(d)(2), compensation that is “in connection with the transaction” means payments, such as commissions, that are specific to, and paid solely in connection with, the transaction in which the consumer has paid compensation directly to a loan originator. To illustrate: Assume that a loan originator organization receives compensation directly from the consumer in a mortgage transaction subject to § 1026.36(d)(2). Because the loan originator organization is receiving compensation directly from the consumer in this transaction, the loan originator organization is restricted under § 1026.36(d)(2) from receiving compensation in connection with that particular transaction (e.g., a commission) from a person other than the consumer (e.g., the creditor). Similarly, a person other than the consumer may not pay the loan originator any compensation in connection with the transaction.

Except as provided below, the Bureau proposes to retain the prohibition described above in current § 1026.36(d)(2) (re-designated as § 1026.36(d)(2)(i)), as consistent with the restriction on dual compensation set forth in TILA section 129B(c)(2). Specifically, TILA section 129B(c)(2)(A) provides that for any mortgage loan, a mortgage originator generally may not receive from any person other than the consumer any origination fee or charge except bona fide third-party charges not retained by the creditor, the mortgage originator, or an affiliate of either. Likewise, no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third party charges as described above. In addition, section 129B(c)(2)(B) provides that a mortgage originator may receive an origination fee or charge from a person other than the consumer if, among other things, the mortgage

originator does not receive any compensation directly from the consumer.

Pursuant to its authority under TILA section 105(a) to effectuate the purposes of TILA and facilitate compliance with TILA, the Bureau interprets “origination fee or charge” to mean compensation that is paid “in connection with the transaction,” such as commissions, that are specific to, and paid solely in connection with, the transaction. The Bureau believes that, if Congress intended the prohibitions on dual compensation to apply to salary or hourly wages that are not tied to a specific transaction, Congress would have used the term “compensation” in TILA section 129B(c)(2), as it did in TILA section 129B(c)(1) that prohibits compensation based on loan terms. Thus, like current § 1026.36(d)(2), TILA section 129B(c)(2) prohibits a mortgage originator that receives compensation directly from the consumer in a closed-end consumer credit transaction secured by a dwelling from receiving compensation, directly or indirectly, from any person other than the consumer in connection with the transaction.

Nonetheless, TILA section 129B(c)(2) does not restrict a mortgage originator from receiving payments from a person other than the consumer for bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator, even if the mortgage originator receives compensation directly from the consumer. For example, assume that a loan originator receives compensation directly from a consumer in a transaction. TILA section 129B(c)(2) does not restrict the loan originator from receiving payment from a person other than the consumer (e.g., a creditor) for bona fide and reasonable charges, such as credit reports, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. Because the loan originator does not retain such charges, they are not considered part of the loan originator’s compensation for purposes of § 1026.36(d).

Consistent with TILA section 129B(c)(2) and pursuant to the Bureau’s authority under TILA section 105(a) to effectuate the purposes of TILA and facilitate compliance with TILA, as discussed in more detail in the section-by-section analysis to proposed § 1026.36(a), the Bureau proposes to amend comment 36(d)(1)–1.iii (re-designated as proposed comment 36(a)–5.iii) to clarify that the term

“compensation” does not include amounts a loan originator receives as payment for bona fide and reasonable charges, such as credit reports, where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. Thus, under proposed § 1026.36(d)(2)(i) and comment 36(a)–5.iii, a loan originator that receives compensation directly from a consumer could receive a payment from a person other than the consumer for bona fide and reasonable charges where those amounts are not retained by the loan originator but are paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. For example, assume a loan originator receives compensation directly from a consumer in a transaction. Further assume the loan originator charges the consumer \$25 for a credit report provided by a third party that is not the creditor, its affiliates or the affiliate of the loan originator, and this fee is bona fide and reasonable. Assume also that the \$25 for the credit report is paid by the creditor with proceeds from a rebate. The loan originator in that transaction is not prohibited by proposed § 1026.36(d)(2)(i) from receiving the \$25 from the creditor, even though the consumer paid compensation to the loan originator in the transaction.

In addition, a loan originator that receives compensation in connection with a transaction from a person other than the consumer could receive a payment from the consumer for a bona fide and reasonable charge where the amount of that charge is not retained by the loan originator but is paid to a third party that is not the creditor, its affiliate, or the affiliate of the loan originator. For example, assume a loan originator receives compensation in connection with a transaction from a creditor. Further assume the loan originator charges the consumer \$25 for a credit report provided by a third party that is not the creditor, its affiliates or the affiliate of the loan originator, and this fee is bona fide and reasonable. Assume the \$25 for the credit report is paid by the consumer. The loan originator in that transaction is not prohibited by proposed § 1026.36(d)(2)(i) from receiving the \$25 from the consumer, even though the creditor paid compensation to the loan originator in connection with the transaction.

As discussed in more detail in the section-by-section analysis to proposed § 1026.36(a), proposed comment 36(a)–5.iii also recognizes that, in some cases, amounts received for payment for such third-party charges may exceed the

actual charge because, for example, the originator cannot determine precisely what the actual charge will be before consummation. In such a case, under proposed comment 36(a)–5.iii, the difference retained by the originator would not be deemed compensation if the third-party charge collected from the consumer or a person other than the consumer was bona fide and reasonable, and also complies with State and other applicable law. On the other hand, if the originator marks up a third-party charge (a practice known as “upcharching”), and the originator retains the difference between the actual charge and the marked-up charge, the amount retained is compensation for purposes of § 1026.36(d) and (e). Proposed comment 36(a)–5.iii contains two illustrations, which are discussed in more detail in the section-by-section analysis to proposed § 1026.36(a).

If any loan originator receives compensation directly from the consumer, no other loan originator may receive compensation in connection with the transaction. Under current § 1026.36(d)(2), if any loan originator is paid compensation directly by the consumer in a transaction, no other loan originator may receive compensation in connection with the transaction from a person other than the consumer. For example, assume that a loan originator organization receives compensation directly from the consumer in a mortgage transaction subject to § 1026.36(d)(2). The loan originator organization may not receive compensation in connection with the transaction (e.g., a commission) from a person other than the consumer (e.g., the creditor). In addition, the loan originator organization may not pay individual loan originators any transaction-specific compensation, such as commissions, in connection with that particular transaction. Nonetheless, the loan originator organization could pay individual loan originators a salary or hourly wage or other compensation that is not tied to the particular transaction. See current comment 36(d)(2)–1. In addition, a person other than the consumer (e.g., the creditor) may not pay compensation in connection with the transaction to any loan originator, such as a loan originator that is employed by the creditor or by the loan originator organization.

TILA section 129B(c)(2), which was added by section 1403 of the Dodd-Frank Act, generally is consistent with the above prohibition in current § 1026.36(d)(2) (re-designated as proposed § 1026.36(d)(2)(i)). 12 U.S.C. 1639b(c)(2). TILA section 129B(c)(2)(B) prohibits a loan originator organization

that receives compensation directly from a consumer in a transaction from paying compensation tied to the transaction (such as a commission) to individual loan originators. Specifically, TILA section 129B(c)(2)(B) provides that a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if: (1) The mortgage originator does not receive any compensation directly from the consumer; and (2) “the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator).” The individual loan originator is the one that is receiving compensation from a person other than the consumer, namely the loan originator organization. Thus, TILA section 129B(c)(2)(B) permits the individual loan originator to receive compensation tied to the transaction from the loan originator organization if (1) the individual loan originator does not receive any compensation directly from the consumer and (2) the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the individual loan originator, creditor, or an affiliate of the creditor or originator). The individual loan originator is not deemed to be receiving compensation in connection with the transaction from a consumer simply because the loan originator organization is receiving compensation from the consumer in connection with the transaction. The loan originator organization and the individual loan originator are separate persons. Nonetheless, the consumer is making “an upfront payment of discount points, origination points, or fees” in the transaction when it pays the loan originator organization compensation. The payment of the origination point or fee by the consumer to the loan originator organization is not a bona fide third-party charge under TILA section 129B(c)(2)(B)(ii). Thus, because the loan originator organization has received an upfront payment of origination points or fees from the consumer in the transaction, unless the Bureau exercises its exemption authority as discussed in more detail below, no loan originator (including an individual loan originator) may receive compensation tied to the transaction from a person other than the consumer.

Nonetheless, TILA section 129B(c)(2)(B) also provides the Bureau authority to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points or fees, where doing so is in the interest of consumers and the public. Pursuant to this waiver/exemption authority, the Bureau proposes to add § 1026.36(d)(2)(i)(C) to provide that, if a loan originator organization receives compensation directly from a consumer in connection with a transaction, the loan originator entity may pay compensation to individual loan originators, and the individual loan originators may receive compensation from the loan originator organization. The Bureau also proposes to amend comment 36(d)(2)–1 (re-designated as proposed comment 36(d)(2)(i)–1) to be consistent with proposed § 1026.36(d)(2)(i)(C). For the reasons discussed below, the Bureau believes that it is in the interest of consumers and the public to allow a loan originator organization to pay individual loan originators compensation in connection with the transaction, even when the loan originator organization has received compensation in connection with the transaction directly from the consumer.

The Bureau believes that the risk of harm to consumers that the current restriction was intended to address is likely no longer present, in light of new TILA provision 129B(c)(1). Under current § 1026.36(d)(1)(iii), compensation paid directly by a consumer to a loan originator could be based on loan terms and conditions. Thus, if a loan originator organization were allowed to pay an individual loan originator that works for the organization a commission in connection with a transaction, the individual loan originator could possibly steer the consumer into a loan with terms and conditions that would produce greater compensation to the loan originator organization, and the individual loan originator, because of this steering, could receive greater compensation if he or she were allowed to receive compensation in connection with the transaction. However, the risk is now expressly addressed by the Dodd-Frank Act. Specifically, TILA section 129B(c)(1), as added by section 1403 of the Dodd-Frank Act, prohibits compensation based on loan terms, even when a consumer is paying compensation directly to a mortgage originator. 12 U.S.C. 1639b(c)(1). Thus, pursuant to TILA section 129B(c)(1), and under proposed § 1026.36(d)(1), even if an individual loan originator is

permitted to receive compensation in connection with the transaction from the loan originator organization where the loan originator organization receives compensation directly from the consumer, the amount of the compensation paid by the consumer to the loan originator organization, and the amount of the compensation paid by the loan originator organization to the individual loan originator, cannot be based on loan terms. In outreach with consumer groups, these groups agreed that loan origination organizations that receive compensation directly from a consumer in a transaction should be permitted to pay individual loan originators that work for the organization compensation in connection with the transaction.

The Bureau believes that it is in the interest of consumers and the public to allow loan originator organizations to pay compensation in connection with the transaction to individual loan originators, even when the loan originator organization is receiving compensation directly from the consumer. As discussed above, the Bureau believes the risk of the harm to the consumer that the restriction was intended to address has been remedied by the statutory amendment prohibiting even compensation that is paid by the consumer from being based on the transaction's terms. With that protection in place, allowing this type of compensation to the individual loan originator no longer presents the same risk to the consumer of being steered into a transaction involving direct compensation from the consumer because both the loan originator organization and the individual loan originator can realize greater compensation. In addition, with this proposed revision, more loan originator organizations may be willing to structure transactions where consumers pay loan originator compensation directly. The Bureau believes that this result will enhance the interests of consumers and the public by giving consumers greater flexibility in structuring the payment of loan originator compensation. In a transaction where the consumer pays compensation directly to the loan originator, the amount of the compensation may be more transparent to the consumer. In addition, in these transactions, the consumer may have more flexibility to choose the pricing of the loan. Subject to proposed § 1026.36(d)(2)(ii), as discussed in more detail below, in transactions where the consumer pays compensation directly to the loan originator, the consumer would

know the amount of the loan originator compensation and could pay all of that compensation upfront, rather than the creditor determining the compensation and recovering the cost of that compensation from the consumer through the rate, or a combination of the rate and upfront origination points or fees.

36(d)(2)(ii) Restrictions on Discount Points and Origination Points or Fees Background

As discussed above, under current § 1026.36(d)(2), a person other than the consumer (e.g., a creditor) is not prohibited from paying compensation to any loan originator in connection with a transaction, so long as no loan originator has received compensation directly from the consumer in that transaction. Loan originator organizations typically are the only loan originators that receive compensation directly from the consumer in a transaction. Individual loan originators that work for a loan originator organization typically are prohibited by applicable law and by the loan originator organization from receiving compensation directly from the consumer. Thus, in the typical transaction that involves a loan originator organization, under § 1026.36(d)(2), a creditor is not prohibited from paying compensation in connection with a transaction (e.g., commission) to a loan originator organization and the loan originator organization is not prohibited from paying compensation in connection with the transaction to individual loan originators, so long as the loan originator organization has not received compensation directly from the consumer in that transaction. In addition, in a transaction that does not involve a loan originator organization, a creditor is not prohibited under § 1026.36(d)(2) from paying compensation in connection with a transaction to individual loan originators that work for the creditor, so long as the individual loan originators have not received compensation directly from the consumer in that transaction, which they are generally prohibited from doing by the creditor pursuant to safety and soundness regulation.

Also, if a creditor is paying compensation in connection with a transaction to a loan originator organization or to individual loan originators that work for the creditor, as described above, current § 1026.36(d)(2) does not prohibit the creditor from collecting discount points or origination points or fees from the consumer in the transaction. For example, current

§ 1026.36(d)(2) does not limit a creditor's ability to charge the consumer origination points or fees which the consumer would pay in cash or out of the loan proceeds at or before closing as a means for the creditor to collect the loan originator's compensation or other costs. In addition, current § 1026.36(d)(2) does not limit a creditor's ability to offer a lower interest rate in a transaction in exchange for the consumer paying discount points.

The Dodd-Frank Act

New TILA section 129B(c)(2), which was added by section 1403 of the Dodd-Frank Act, restricts the ability of a creditor, the mortgage originator, or the affiliates of either to collect from the consumer upfront discount points, origination points, or fees in a transaction. 12 U.S.C. 1639b(c)(2). Specifically, TILA section 129B(c)(2)(B) provides that a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if: (1) the mortgage originator does not receive any compensation directly from the consumer; and (2) "the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator)." TILA section 129B(c)(2)(B)(ii) also provides the Bureau authority to waive or create exemptions from this prohibition on consumers paying upfront discount points, origination points, or fees, where doing so is in the interest of consumers and the public interest.

As discussed in more detail in the section-by-section analysis to proposed § 1026.36(d)(2)(i), the Bureau interprets the phrase "origination fee or charge" as used in new TILA section 129B(c)(2) more narrowly than compensation as used in TILA section 129B(c)(1) and to mean compensation that is paid "in connection with the transaction," such as commissions, that are specific to, and paid solely in connection with, the transaction. Thus, under TILA section 129B(c)(2), for a transaction involving a loan originator organization, a creditor may pay compensation in connection with a transaction (e.g., a commission) to the loan originator organization, and the loan originator organization may pay compensation in connection with a transaction to individual loan originators only if: (1) The loan originator organization does not receive compensation directly from the

consumer; and (2) the consumer does not make an upfront payment of discount points, origination points, or fees as discussed above.

In addition, the Bureau proposes to use its exemption authority in TILA section 129B(c)(2)(B)(ii) to permit a loan originator organization to pay compensation in connection with a transaction to individual loan originators, even if the loan originator organization received compensation directly from the consumer. Assume a transaction where a loan originator organization receives compensation directly from the consumer. As discussed in more detail in the section-by-section analysis to proposed § 1026.36(d)(2)(i), TILA section 129B(c)(2) prohibits the loan originator organization from paying compensation tied to a transaction (such as commission) to an individual loan originator unless: (1) The individual loan originator does not receive compensation directly from the consumer; and (2) the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the individual loan originator, creditor, or an affiliate of the creditor or originator). An individual loan originator is not deemed to be receiving compensation in connection with a transaction from a consumer simply because the loan originator organization is receiving compensation from the consumer in connection with the transaction. The loan originator organization and the individual loan originator are separate persons. Nonetheless, the consumer makes “an upfront payment of discount points, origination points, or fees” in the transaction when the loan originator organization is paid compensation by the consumer. The payment of the origination points or fees by the consumer to the loan originator organization is not considered a bona fide third-party charge under TILA section 129B(c)(2)(B)(ii). Thus, because the loan originator organization has received an upfront payment of origination points or fees from the consumer in the transaction, unless the Bureau exercises its exemption authority, no loan originator (including an individual loan originator) could receive compensation tied to the transaction from a person other than the consumer.⁶²

⁶² The Bureau notes that the restrictions in TILA section 129B(c)(2) do not apply in transactions where a loan originator organization receives compensation directly from the consumer and the

Likewise, under TILA section 129B(c)(2), for a transaction not involving a loan originator organization, unless the Bureau exercises its exemption authority, a creditor may pay compensation in connection with a transaction to individual loan originators, such as the creditor’s employees, only if: (1) These individual loan originators do not receive compensation directly from the consumer, which they are generally prohibited from doing by the creditor pursuant to safety and soundness regulation; and (2) the consumer does not make an upfront payment of discount points, origination points, or fees as discussed above. As a result, under TILA section 129B(c)(2), if a consumer pays discount points, origination points, or fees to a creditor, the creditor cannot pay compensation in connection with the transaction (e.g., a commission) to individual loan originators that work for the creditor. However, the restrictions in TILA section 129B(c)(2) do not apply if a creditor does not pay compensation to individual loan originators that is not tied to a particular transaction. For example, if a creditor pays to individual loan originators only a salary or hourly wage, the restriction on the consumer paying discount points, origination points, or fees in the transaction as set forth in TILA section 129B(c)(2)(B)(ii) would not apply. In this case, the creditor and its affiliates could collect discount points, origination points, or fees, as described in TILA section 129B(c)(2)(B)(ii), from the consumer.

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

loan originator organization does not pay individual loan originators compensation (such as a commission) in connection with the transaction. In these cases, TILA section 129B(c)(2) is not violated because no loan originator is receiving compensation in connection with a transaction from a person other than the consumer.

TILA section 129B(c)(2)(B)(ii) on the consumer paying upfront discount points, origination points, or fees in a transaction generally does not apply in the following two scenarios: (1) The creditor pays individual loan originators, such as the creditor’s employees, only in the form of a salary, hourly wage or other compensation that is not tied to the particular transaction; and (2) the loan originator organization receives compensation directly from the consumer in a transaction and pays individual loan originators that work for the organization only in the form of a salary, hourly wage, or other compensation that is not tied to the particular transaction. The Bureau understands, however, that in most transactions, creditors and loan originator organizations pay individual loan originators compensation tied to a particular transaction (such as a commission). Thus, the Bureau expects that the restrictions in new TILA section 129B(c)(2)(B)(ii) will apply to most mortgage transactions except to the extent that the Bureau exercises its exemption authority as discussed below.

The Bureau’s Proposal

The Bureau is proposing to implement the statutory provisions addressing the prohibition on the upfront payment by the consumer of discount points, origination points, or fees as set forth in TILA section 129B(c)(2)(B)(ii) by using its exemption authority provided in that same section. Specifically, the Bureau proposes to use its exemption authority set forth in TILA section 129B(c)(2)(B)(ii), which provides the Bureau authority to waive or create exemptions from the prohibition on consumers’ paying upfront discount points, origination points, or fees, where doing so is in the interest of consumers and the public.

As discussed in more detail below, the Bureau proposes in new § 1026.36(d)(2)(ii)(A) restrictions on discount points and origination points or fees in a closed-end consumer credit transaction secured by a dwelling, if any loan originator will receive from any person other than the consumer compensation in connection with the transaction. Specifically, in these transactions, a creditor or loan originator organization may not impose on the consumer any discount points and origination points or fees in connection with the transaction unless the creditor makes available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees; the creditor need not make available the

alternative, comparable loan, however, if the consumer is unlikely to qualify for such a loan. The term “comparable” means equal or equivalent. Thus, the term “comparable, alternative loan” would mean that the two loans must have the same terms and conditions, other than the interest rate, any terms that change solely as a result of the change in the interest rate (such as the amount of the regular periodic payments), and the amount of any discount points and origination points or fees.

Under the proposal, a creditor would not be required to provide all consumers the option of a comparable, alternative loan that does not include discount points and origination points or fees. If the creditor determines that a consumer is unlikely to qualify for a comparable, alternative loan that does not include discount points and origination points or fees, the creditor is not required to make such a loan available to the consumer.

The Bureau notes that under § 1026.36(d)(3), affiliates are treated as a single “person.” Thus, affiliates of the creditor and the loan originator organization also could not impose on the consumer any discount points and origination points or fees in connection with the transaction unless the creditor makes available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees, except that the creditor need not make available the alternative, comparable loan if the consumer is unlikely to qualify for such a loan. See proposed comment 36(d)(2)(ii)-3. The proposal also makes clear that proposed § 1026.36(d)(2)(ii) does not override any of the prohibitions on dual compensation set forth in proposed § 1026.36(d)(2)(i), as discussed above. For example, § 1026.36(d)(2)(ii) does not permit a loan originator organization to receive compensation in connection with a transaction both from a consumer and from a person other than the consumer. See proposed comment 36(d)(2)(ii)-1.iii.

The proposal also provides that no discount points and origination points or fees may be imposed on the consumer in connection with a transaction subject to proposed § 1026.36(d)(2)(ii)(A) unless there is a bona fide reduction in the interest rate compared to the interest rate for the comparable, alternative loan that does not include discount points and origination points or fees required to be made available to the consumer under § 1026.36(d)(2)(ii)(A). In addition, for any rebate paid by the creditor that will be applied to reduce the consumer’s

settlement charges, the creditor must provide a bona fide rebate in return for an increase in the interest rate compared to the interest rate for the loan that does not include discount points and origination points or fees required to be made available to the consumer under § 1026.36(d)(2)(ii)(A). As discussed in more detail below, the Bureau has evaluated three primary types of approaches to implement a requirement that the trade-off be “bona fide.”

As described in more detail below, the Bureau proposes in new § 1026.36(d)(2)(ii)(B) to define the term “discount points and origination points or fees” for purposes of § 1026.36(d) and (e) to include all items that would be included in the finance charge under § 1026.4(a) and (b), and any fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2), that are payable at or before consummation by the consumer to a creditor or a loan originator organization, except for: (1) Interest, including per-diem interest; (2) any bona fide and reasonable third-party charges not retained by the creditor or loan originator organization; and (3) seller’s points and premiums for property insurance that are excluded from the finance charge under § 1026.4(c)(5), and (d)(2), respectively. Under the proposal, the phrase “payable at or before consummation by the consumer to a creditor or a loan originator organization” would include amounts paid by the consumer in cash at or before closing or financed and paid out of the loan proceeds.

The Bureau notes that the proposal does not contain two potential restrictions that were discussed as part of the Small Business Review Panel process. First, the proposal does not contain a provision that would ban origination points and prevent origination fees from varying based on loan size. By and large, SERs were strongly opposed to the requirement that origination fees do not vary with the size of loan. SERs’ opposition to the flat fee requirement was based on the view that the costs of origination varied for loans with different characteristics, such as geography and loan type, and GSE-imposed loan level pricing adjustments vary by loan size. In addition, SERs stated that the imposition of the flat fee requirement would disproportionately harm small lenders and would be regressive because borrowers with smaller loan amounts would be charged more than they are typically charged currently. The Bureau believes that the provisions set forth in this proposal accomplish a similar

purpose as the flat fee requirement, namely to ensure that consumers are in the position to shop and receive value for origination points or fees, but does so in a way to minimize adverse consequences for industry and consumers that the flat fee requirement might entail.

Second, the proposal does not contain a provision that would “sunset” the proposed exemptions from the statutory restrictions on consumers’ upfront payment of discount points, origination points, or fees. As detailed in the Small Business Review Panel Report, the Bureau had considered a sunset provision whereby, after a specified period (e.g., three or five years), the proposed rule permitting creditors and loan originator organizations in certain circumstances to impose upfront discount points and origination points or fees on consumers would automatically expire (and the default prohibition would take full effect) unless the Bureau takes affirmative action to extend it. At that time, the Bureau would have had time to conduct a more detailed assessment of the payment of discount points and origination points or fees in a more stable regulatory environment to determine the long-term regulatory regime that would maximize consumer protections and credit availability. As part of the Small Business Review Panel process, the Bureau also noted that with or without a sunset provision, the Bureau would review the regulation within five years of its effective date pursuant to section 1022(d) of the Dodd-Frank Act, which requires the Bureau to “conduct an assessment of each significant rule or order adopted by the Bureau under Federal consumer financial law” and publish a report of its assessment. 12 U.S.C. 5512(d). The assessment must address, among other relevant factors, the effectiveness of the rule or order in meeting the Dodd-Frank Act’s purposes and objectives and the specific goals stated by the Bureau, and it must reflect any available evidence and data collected by the Bureau. Before publishing a report of its assessment, the Bureau is required to invite public comment on recommendations for modifying, expanding, or eliminating the newly adopted significant rule or order.

SERs generally preferred the Bureau to follow its Dodd-Frank-Act requirement to review the impact of whatever regulation is adopted after five years instead of adopting an automatic sunset. The SERs believed an automatic sunset could be disruptive to the market.

To minimize potential disruption to the market, the Bureau is not proposing the “sunset” provision. The Bureau believes that the review it must conduct within five years of the rule’s effective date pursuant to section 1022(d) of the Dodd-Frank Act is the appropriate method to continue to assess the impact of the rule. If the Bureau finds through this review that changes in the rule may be needed, the Bureau could make changes to the rule with notice and comment as appropriate. Nonetheless, the Bureau solicits comment on whether such as “sunset” provision would be beneficial.

Use of the Bureau’s exemption authority. Unlike TILA section 129B(c)(2)(B)(ii), the Bureau’s proposal would permit consumers in certain circumstances to pay upfront discount points and origination points or fees in transactions where any loan originator receives compensation in connection with the transaction from a person other than the consumer. Pursuant to the exemption authority set forth in TILA section 129B(c)(2)(B)(ii), the Bureau believes that it is “in the interest of consumers and the public interest” to permit discount points and origination points or fees to be charged on loans in certain instances.

The Bureau believes that the proposal may benefit consumers and the public by providing consumers the flexibility to decide whether to pay discount points and origination points or fees. The Bureau believes that permitting creditors to offer consumers the option to choose to pay discount points and origination points or fees may benefit consumers by giving them additional options in choosing a loan product that fits their needs.

Some mortgage consumers may want the lowest rate possible on their loans. In addition, some mortgage customers may prefer to lower the future monthly payment on the loan below some threshold amount, and paying discount points and origination points or fees would allow consumers to achieve this lower monthly payment by reducing the interest rate. In addition, some consumers may need to pay discount points and origination points or fees to reduce the monthly payment on the loan so that they can qualify for the loan. Without the ability to pay discount points and origination points or fees to reduce the monthly payment, the interest rate and the monthly payments on the loan that does not include discount points and origination points or fees may be too high for the consumer to qualify for the loan.

A consumer could achieve a lower monthly payment by making a bigger

down payment and thus reducing the loan amount. Nonetheless, it may be difficult for consumers to use this option to reduce significantly the monthly payment because it might take a significant increase in the down payment to achieve the desired reduction in the monthly payment. In other words, if the consumer took the same money that he or she would pay in discount points and origination points or fees and made a bigger down payment to reduce the loan amount, the consumer may not gain as large of a reduction in the monthly payment as if the consumer used that money to pay discount points and origination points or fees to reduce the interest rate. Some consumers may also obtain a tax benefit by paying discount points that applying such funds to a down payment would not achieve.

Having the option to pay discount points and origination points or fees also allows consumers to determine whether they can best lower the overall costs of the mortgage loan by paying discount points and origination points or fees upfront in exchange for a lower interest rate. There will be a specific point in the timeline of the loan where the money spent to buy down the interest rate will be equal to the money saved by making reduced loan payments resulting from the lower interest rate on the loan. Selling the property or refinancing prior to this break-even point will result in a net financial loss for the consumer, while keeping the loan for longer than this break-even point will result in a net financial savings for the consumer. The longer a consumer keeps the same credit extension in place, the more the money spent on the discount points and origination points or fees will pay off. The Bureau believes consumers will be benefited by retaining the option to make these evaluations based upon their assessment of the costs and benefits, as well as their future plans.

On the other hand, some consumers may prefer not to pay discount points and origination points or fees. For example, some consumers may not have the cash to pay discount points and origination points or fees before or at closing, and may wish not to finance such fees or have insufficient equity available to do so. In addition, some consumers may contemplate selling the home or refinancing the mortgage within a short period of time and may believe that it is not in their best interests to pay discount points and origination points or fees upfront in exchange for a lower interest rate.

The Bureau is proposing to structure the use of its exemption authority to

leverage the benefits that would arise if creditors were limited to making loans that do not include discount points and origination points or fees while preserving consumers’ ability to choose another loan when appropriate. Through the proposal, the Bureau hopes to advance two objectives to address the problems in the current mortgage market that the Bureau believes the prohibition on discount points and origination points or fees was designed to address: (1) To facilitate consumer shopping by enhancing the ability of consumers to make comparisons using loans that do not include discount points and origination points or fees available from different creditors as a basis for comparison; and (2) to enhance consumer decisionmaking by facilitating a consumer’s ability to understand and make meaningful trade-offs on loans available from a particular creditor of paying discount points and origination points or fees in exchange for a higher interest rate. In addition, the Bureau is considering whether to adopt additional safeguards to ensure consumers who make upfront payments of discount points and origination points or fees receive value in return.

Making available a loan that does not include discount points and origination points or fees. Under the proposal, a creditor would be required to make available to a consumer a comparable, alternative loan that does not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan. To ensure that consumers are informed of the option to choose such a loan from the creditor that does not include discount points and origination points or fees, the proposal would provide guidance on what it means for the creditor to make such a loan available. Specifically, the proposal would provide that, in a retail transaction, a creditor would be deemed to have made that loan available if any time the creditor gives an oral or written quote specific to the consumer of the interest rate, regular periodic payments, the total discount points and origination points or fees, or the total closing costs for a loan that includes discount points and origination points or fees, the creditor also provides a quote for those same types of information for the comparable, alternative loan that does not include discount points and origination points or fees. The term “comparable, alternative loan” would mean that the two loans for which quotes are provided must have the same terms and conditions, other than the interest rate, any terms that change solely as a result of the change in the

interest rate (such as the amount of regular periodic payments), and the amount of any discount points and origination points or fees.

The quote for the loan that does not include discount points and origination points or fees would need to be given only if the quote for the loan that includes discount points and origination points or fees is given prior to when the consumer receives the Good Faith Estimate (required under RESPA). The requirement to provide a quote for a loan that does not include discount points or origination points or fees would also not apply to any disclosures required by TILA or RESPA on loans that include discount points or origination points or fees. The Bureau believes that consumers generally ask for, and are provided, quotes from creditors prior to application. However, as discussed below, the Bureau is inviting comments as to whether the requirement to provide an alternative quote should apply in conjunction with the Loan Estimate, as proposed in the TILA-RESPA Integration Proposal.

Under the proposal, a creditor using this safe harbor is required to provide information about the loan that does not include discount points and origination points or fees only when the information about the loan that includes discount points or origination points or fees is specific to the consumer. Advertisements would not be subject to this requirement. See comment 2(a)(2)-1.ii.A. If the information about the loan that includes discount points or origination points or fees is an advertisement under § 1026.24, the creditor is not required to provide the quote for the loan that does not include discount points and origination points or fees. For example, if prior to the consumer submitting an application, the creditor provides a consumer an estimated interest rate and monthly payment for a loan that includes discount points and origination points or fees, and the estimates were based on the estimated loan amount and the consumer's estimated credit score, then the creditor must also disclose the estimated interest rate and estimated monthly payment for the loan that does not include discount points and origination points or fees. In contrast, if the creditor provides the consumer with a preprinted list of available rates for different loan products that include discount points and origination points or fees, the creditor is not required to provide the information about the loans that do not include discount points and origination points or fees under this safe harbor. Nonetheless, as discussed in more detail below, the Bureau solicits

comment on whether the advertising rules in § 1026.24(d) should be revised as well.

In addition, in a transaction that involves a loan originator organization, the creditor generally would be deemed to have made available the loan that does not include discount points and origination points or fees if the creditor communicates to the loan originator organization the pricing for all loans that do not include discount points and origination points or fees. Separately, mortgage brokers are prohibited under § 1026.36(e) from steering consumers into a loan solely to maximize the broker's commission. The rule sets forth a safe harbor for complying with provisions prohibiting steering if the broker presents to the consumer three loan options that are specified in the rule. One of these loan options is the loan with the lowest total dollar amount for discount points and origination points or fees. Thus, mortgage brokers that are using the safe harbor must present to the consumer the loan with the lowest interest rate that does not include discount points and origination points or fees. The Bureau believes that most mortgage brokers are using the safe harbor to comply with the provision prohibiting steering, so most consumers in transactions that involve mortgage brokers would be informed of the loan with the lowest interest rate that does not include discount points and origination points or fees.

As discussed above, under the proposal, a creditor is not required to make available a comparable, alternative loan if the consumer is unlikely to qualify for that loan. The Bureau solicits comment on whether consumers should be informed that they were not given information about a comparable, alternative loan because they were unlikely to qualify for that loan. For example, in transactions that do not involve a loan originator organization, should creditors be required either to make the comparable, alternative loan available to the consumer if the consumer likely qualifies for that loan or to inform consumers that the creditor is not making the comparable, alternative loan available because the consumer is unlikely to qualify for that loan? In transactions that involve a loan originator organization, should a loan originator organization using the safe harbor under § 1026.36(e) be required to disclose to a consumer that the loan originator organization did not present a loan that does not include discount points and origination points or fees because the consumer was unlikely to qualify for that loan from the creditors with whom the loan originator

organization regularly does business? The Bureau specifically requests comment on whether it is useful to consumers to be informed that they were unlikely to qualify for the comparable, alternative loan.

The Bureau recognizes that creditors who do not wish to make loans that do not include discount points and origination points or fees available to particular consumers could possibly manipulate their underwriting standards so that those consumers do not qualify for such a loan. To prevent this practice, the Bureau is considering safeguards designed to prohibit creditors from changing their qualification standards, such as loan-to-value ratios and credit score requirements, solely for the purpose of disqualifying consumers from receiving loans that does not include discount points and origination points or fees. This alternative would make clear that creditors must make available the loan that does not include discount points and origination points or fees unless, as a result of the increased monthly payment resulting from the higher interest rate on the loan that does not include discount points and origination points or fees, the consumer cannot satisfy the creditor's underwriting rules. The Bureau invites comments on whether there is a risk that, absent such a requirement, some creditors might manipulate their underwriting standards and whether the Bureau should adopt a rule against doing so.

The Bureau recognizes, however, that even if underwriting standards could not be manipulated, creditors who do not want to make loans that do not include discount points and origination points or fees could set the interest rates high for certain consumers, which could increase the monthly payment on those loans to be high so that those consumers cannot satisfy the creditor's underwriting rules. Thus, the Bureau is considering another alternative, whereby a creditor would be able to make available a loan that includes discount points and origination points or fees only when the consumer also qualifies for a comparable, alternative loan that does not include discount points and origination points or fees. A potential advantage of this alternative is that it would effectively limit creditors' opportunity to manipulate their underwriting standards or charge above-market interest rates to prevent particular consumers from qualifying for a loan that does not include discount points and origination points or fees.

On the other hand, the Bureau is concerned that adoption of such an alternative may impact access to credit.

The Bureau recognizes that there are some creditors who will not make a loan where the debt-to-income ratio exceeds a certain level and that there may be some consumers for whom the difference between the interest rate on a loan that includes and does not include discount points and origination points or fees will determine whether the consumer can satisfy the creditor's debt-to-income standard. In that case, consumers who do not qualify for specific loans that do not include discount points and origination points or fees would not be able to receive from the creditor the same type of loans that include discount points and origination points or fees. This could harm those consumers who might prefer to obtain from a creditor a specific type of loan that includes discount points and origination points or fees, rather than not be able to obtain that type of loan at all from the creditor.

The Bureau specifically requests comment on credit availability issues of adopting such an alternative. For example, in some cases, a consumer may not qualify for the loan that does not include discount points and origination points or fees because the loan has a higher interest rate and the monthly payments on that loan will be too high for the consumer to qualify based on the debt-to-income ratio and other underwriting standards used by the creditor. The Bureau recognizes that this may be true even if the interest rate the creditor charges on the loan that does not include discount points and origination points or fees is a competitive market rate, and the creditor does not change its underwriting standards purposefully to prevent consumers from qualifying for the loan. The Bureau requests comment on how common it would be for this to occur, in which scenarios it would be more likely to occur, and what types of consumers would likely be affected.

In addition, in industry outreach meetings, some creditors expressed concern that the interest rate (and corresponding APR) that a creditor may need to charge a less-creditworthy consumer for a loan that does not include discount points and origination points or fees to make the loan profitable to the creditor could exceed the APR threshold set forth in the rules under § 1026.32 for high-cost mortgages ("high-cost mortgage rules") and could make that loan a high-cost mortgage. These creditors also pointed out that there are State laws that have restrictions similar to the high-cost mortgage rules. Many creditors generally do not want to make loans that would be subject to the high-cost

mortgage rules or similar State laws. If the alternative were adopted where a consumer must qualify for the comparable, alternative loan that does not include discount points and origination points or fees, the consumer could not obtain this specific type of loan from the creditor even though the creditor would be willing to make the consumer a comparable, alternative loan that includes discount points and origination points or fees because this loan would not trigger the high-cost mortgage rules or similar State laws. The Bureau does not currently have sufficient data to model the impact of the requirement for a creditor to make available a comparable, alternative loan that does not include discount points and origination points or fees on triggering the high-cost mortgage rules or similar State laws or to model the impact on credit availability to the extent that such rules or laws are triggered. The Bureau seeks data and comment on the potential triggering of the high-cost mortgage rule or similar State laws, the potential impact on credit availability, and potential modifications to the requirement to mitigate these effects.

Moreover, the Bureau is aware that certain State loan programs that permit creditors to charge origination points on the loans do not permit the option of charging a higher interest rate in lieu of charging the origination points. The Bureau requests additional comment on these types of State loan programs, how they work, how prevalent they are, the types of consumers these programs typically serve; and how common it is for creditors under these programs not to have the option of charging a higher interest rate.

Also, in outreach meetings, some creditors mentioned that, while creditors that sell loans in the secondary market typically can recover their origination costs through the premium paid through the sale of the loan for the higher interest rate, creditors that hold loans in portfolio do not have that option and would be required to recover the origination costs through a higher interest rate if the creditor cannot charge an upfront origination fee. Consumers with loan products with higher rates are more likely to refinance those loan products and thus a creditor that holds those loans in portfolio would have to use another approach to recover the costs to originate those loans. Thus, creditors that plan to hold a loan in portfolio may be more reluctant to make available to a consumer a loan that does not include discount points and origination points or fees. This may particularly affect small or specialty

creditors that may be more likely to hold a sizable number of loans in portfolio. The Bureau requests comment on whether creditors currently make portfolio loans that do not include discount points and origination points or fees, and if so, how creditors typically manage the risk that such consumers will refinance the loans or sell the homes and repay the loans prior to the origination costs being recovered.

In addition, in outreach with industry, some creditors raised concerns that, even for creditors that sell loans into the secondary market, it may not be possible for creditors in all cases to make available to all consumers a loan that does not include discount points and origination points or fees. These creditors indicated that in some cases it is possible that the premium paid in the secondary market for a loan will not be sufficient for the creditor to cover origination and other costs and to realize a profit. These creditors indicated that this may occur more often for smaller loans, or riskier loans (such as where the consumer's credit score is low and the loan-to-value ratio on the loan is high). These creditors indicated that the interest rates on these types of loans would likely be high, and the secondary market may not pay sufficient premiums for those loans even though they have a higher interest rate because secondary market investors would be concerned about prepayment risk. These creditors indicated that in these situations, creditors may not make loans that include discount points and origination points or fees available to consumers because they would be unwilling to make available, as required, a comparable, alternative loan that does not include discount points and origination points or fees.

The Bureau requests comment, however, on: (1) The circumstances, either currently or in the past, where creditors are unable to make available to consumers loans that do not include discount points and origination points or fees because the premiums received by the creditor on those loans are not sufficient to sell the loan into the secondary market, and (2) the characteristics of the types of loans and consumers affected in these circumstances. In addition, the Bureau requests comment on whether the secondary market is likely to adjust to create new securities to disperse risk, including prepayment risk, if the volume of loans with higher interest rates increases because more consumers are offered the option, and actually choose, not to pay discount points and origination points or fees.

The Bureau also solicits comment on whether, if the alternative were adopted where a consumer must qualify for the comparable, alternative loan that does not include discount points and origination points or fees, creditors should be required to inform a consumer that he or she is not being offered a loan that includes discount points and origination points or fees because the consumer does not qualify for the comparable, alternative loan that does not include discount points and origination points or fees.⁶³ The Bureau solicits comment on whether it would be useful or beneficial to consumers to be informed that they did not qualify in these circumstances. The Bureau also solicits comment on, if such notification would be useful or beneficial, what form such a notice should take.

Facilitating consumer shopping. Through the proposal, the Bureau intends to facilitate consumer shopping by enhancing the ability of consumers to make comparisons using loans that do not include discount points and origination points or fees made available by different creditors as a basis for comparison. As discussed above, for retail transactions, a creditor will be deemed to be making the loan available if, any time the creditor provides a quote specific to the consumer for a loan that includes discount points and origination points or fees, the creditor also provides a quote for a comparable, alternative loan that does not include discount points and origination points or fees (unless the consumer is unlikely to qualify for the loan). Nonetheless, the Bureau is concerned that by the time a consumer receives a quote from a particular creditor for a loan that does not include discount points and origination points or fees, the consumer may have already completed his or her shopping in comparing loans from different creditors.

Thus, the Bureau solicits comment on whether the advertising rules in § 1026.24(d) should be revised to enable consumers to make comparisons using loans that does not include discount points and origination points or fees made available by different creditors as a basis for comparison. Currently, under § 1026.24(d), if an advertisement includes a “trigger term,” the advertisement must contain certain

other information described in § 1026.24(d). The “trigger terms” set forth in § 1026.24(d)(1) are: (1) The amount or percentage of any downpayment; (2) the number of payments or period of repayment; (3) the amount of any payment; and (4) the amount of any finance charge (which includes the interest rate). Currently, under § 1024(d)(2), if one or more of these trigger terms are set forth in such an advertisement, the following information (“triggered terms”) must also be contained in the advertisement: (1) The amount or percentage of the downpayment; (2) the terms of repayment, which reflect the repayment obligations over the full terms of the loan, including any balloon payment; and (3) the “annual percentage rate,” using that term and, if the rate may be increased after consummation, that fact.⁶⁴ Thus, currently under § 1026.24(d)(2), if a creditor includes in an advertisement the interest rate that applies to a loan that includes discount points and origination points or fees, the creditor must include in that advertisement the following terms related to that loan: (1) The amount or percentage of the downpayment; (2) the terms of repayment, which reflect the repayment obligations over the full terms of the loan, including any balloon payment; and (3) the “annual percentage rate,” using that term and, if the rate may be increased after consummation, that fact. Currently, under § 1024(d)(2), a creditor may use an example of one or more typical extensions of credit with a statement of all the terms described above applicable to each example.

The Bureau solicits comment on whether the creditor in such an advertisement that contains the interest rate for a loan that includes discount points and origination points or fees also must contain the following information for the comparable, alternative loan that does not include discount points and origination points or fees: (1) The interest rate; and (2) the amount or percentage of the downpayment; (3) the terms of repayment, which reflect the repayment obligations over the full terms of the loan, including any balloon payment; and (4) the “annual percentage rate,” using that term and, if the rate may be increased after consummation, that fact. The Bureau solicits comment on whether this information about the loan that does not include discount points and origination points or fees must be

equally prominent in the advertisement as the information about the loan that includes discount points and origination points or fees. The Bureau expects that the other rules set forth in § 1026.24 (such as the special rules applicable to catalog advertisements, and radio and television advertisements) would apply to this additional information about the loan that does not include discount points and origination points or fees, as applicable, in the same way that it applies to the information that is provided for the loan that includes discount points and origination points or fees. For example, in radio and television advertisements where the creditor discloses an interest rate for a loan that includes discount points and origination points or fees, a creditor is given the option (1) to comply with the rules in § 1026.24(d), as described above; or (2) to state the “annual percentage rate,” using that term and, if the rate may be increased after consummation, that fact and to list a toll-free telephone number that may be used by consumers to obtain additional cost information. See § 1026.24(g). The Bureau expects that a similar alternative method of disclosure would apply to the information that must be provided for the comparable, alternative loan that does not include discount points and origination points or fees.

The Bureau solicits comment on whether § 1026.24 should be revised, as discussed above, to require that a creditor that provides in an advertisement the interest rate for a loan that includes discount points and origination points or fees to include in such advertisement certain information for a comparable, alternative loan that does not include discount points and origination points or fees. The Bureau specifically solicits comment on whether this information would be useful to consumers that are interested in loans that do not include discount points and origination points or fees to compare such loans available from different creditors.

Consumers may find it easier to compare the loan pricing on loans that do not include discount points and origination points or fees available from different creditors because most of the cost of the loans would be incorporated into the interest rate. A consumer could compare the interest rates on such loans available from different creditors, without having to consider a variety of different discount points and origination points or fees that might be charged on each loan.

The Bureau recognizes that new TILA section 129B(c)(2)(B)(ii), and this

⁶³ The Bureau notes that in these circumstances, a creditor would not be required to provide an adverse action notice to the consumer under the Bureau's Regulation B, 12 CFR part 1002, which implements the Equal Credit Opportunity Act, because the creditor's denial of the loan that includes discount points and origination points or fees would be required by law. See 12 CFR 1002.2(c).

⁶⁴ Section 1026.24(g) provides an alternative disclosure method for television and radio advertisements.

proposal in its definition of discount points and origination points or fees, treats charges differently based on whether they are paid to the creditor, loan originator organization, or the affiliates of either, or paid to an unaffiliated third party. Concerns have been raised that these advertising rules (and the quotes discussed above) may not effectively enable consumers to shop among multiple different creditors. If a consumer is comparing two loan products with no discount points and origination points or fees from different creditors, it may be difficult for the consumer to compare the two interest rates because the interest rate that is available from each creditor may depend at least in part on whether certain services, such as appraisal or lender's title insurance, are performed by the creditor, the loan originator organization, or affiliates of either, or whether they are performed by an unaffiliated third party. For example, if for one creditor the creditor's title insurance services will be performed by the creditor's affiliate while for another creditor these services will be performed by a third party, the interest rate available on the loan that does not include discount points and origination points or fees is likely to be higher for the first creditor than the interest rate available from the second creditor because the first creditor may not collect the cost of the title insurance from the consumer in cash at or before closing or through the loan proceeds but instead may collect those costs from the consumer through a higher rate.

The Bureau potentially could address this inconsistent treatment of third-party charges by providing that certain third-party charges are always excluded from discount points and origination points or fees, even when they are payable to an affiliate of the creditor or a loan originator organization. Nonetheless, even if payments for certain services were consistently excluded from the definition of discount points and origination points or fees, the consumer still may need to consider the amount of such closing costs in comparing alternative transactions. Consistently excluding certain services from the definition of discount points and origination points or fees may make it easier for a consumer to compare the interest rates on loan products available from different creditors if (1) the total amount of the closing costs that are not incorporated into the interest rate generally remains similar among different creditors; or (2) consumers have the ability to hold these costs constant by shopping for these services.

The Bureau requests comment on the scope of the definition of discount points and origination points or fees.

The Bureau also requests comment on ways to revise the definition of discount points and origination points or fees to facilitate consumers' ability to compare alternative loans that do not include discount points and origination points or fees from different creditors. In particular, the Bureau solicits comment on whether it should exempt from the definition of discount points and origination points or fees any fees imposed for lender's title insurance, regardless of whether this service is provided by the creditor, the loan originator organization, or the affiliates of either or is provided by an unaffiliated third party, so long as the fees are bona fide and reasonable. The Bureau understands that the cost of lender's title insurance can be a significant portion of a mortgage loan's total closing costs. Thus, excluding this cost from being incorporated into the rate for the loan that does not include discount points and origination points or fees, regardless of what party provides the service, may help produce interest rates that are more comparable across different creditors. In addition, the Bureau believes that, because the cost of lender's title insurance often is regulated by the States, the cost may remain constant from creditor to creditor. Accordingly, excluding lender's title coverage from the definition of discount points and origination points or fees in all cases may increase the ease with which consumers can shop among multiple creditors using the interest rate that does not include discount points and origination points or fees as a means of comparison. The Bureau also solicits comment on whether this same reasoning may be applicable for other types of insurance, assuming those costs also generally are regulated by the States.

The Bureau also recognizes that there may be other services that might be performed either by the creditor, the loan originator organization, or affiliates of either, or by an unaffiliated third party. For example, such services may include appraisal, credit reporting, property inspections, and others. The Bureau requests comment on whether continuing to treat these services differently for purposes of the definition of discount points and origination points or fees depending on what party provides those services would hinder consumers' ability to shop among multiple creditors using the interest rate on loans that do not include discount points and origination points or fees.

Alternatively, the Bureau solicits comment on whether fees for all services provided by an affiliate of a creditor or loan originator organization should be excluded from the definition of discount points and origination points or fees. The Bureau solicits comment on whether excluding affiliate fees consistent with the exclusion for third-party fees would facilitate consumers' ability to shop using the interest rates on loans that do not include discount points and origination points or fees. The Bureau remains concerned, however, that such an exclusion for affiliates fees could be used by creditors to circumvent the prohibition in proposed § 1026.36(d)(2)(ii). For example, creditors could have affiliates perform certain services that are typically performed by the creditor (subject to RESPA restrictions), and exclude fees for those services under this exception. This would permit such a creditor to make available to consumers an interest rate for a loan that does not include discount points or origination points or fees, as defined, but still impose up front through its affiliate some or all of the costs that, in light of the purpose of proposed § 1026.36(d)(2)(ii), more properly should be included in the interest rate.

As a third alternative, the Bureau solicits comment on whether it should exclude certain services that unambiguously relate to ancillary services, such as credit reports, appraisals, and property inspections, rather than core loan origination services, even if the creditor, loan originator organization, or an affiliate of either performs those services, so long as the amount paid for those services is bona fide and reasonable. The core loan origination services that could not be excluded would be ones that specifically relate to the origination of a mortgage loan and typically are provided by the creditor or the loan originator organization, possibly clarified further by reference to the meaning of "loan originator" in proposed § 1026.36(a)(3). The Bureau requests comment on whether such an approach is likely to improve the ease with which consumers can compare loans that does not include discount points and origination points or fees from different creditors, by ensuring that the types of fees incorporated into the interest rate for the loans that does not include discount points and origination points or fees generally remain constant across different creditors. The Bureau further solicits comment on how such ancillary

services that would be excluded from the definition, and core origination services that would not be excluded from the definition, might be described clearly enough to distinguish the two. For example, would elaborating on core origination services by reference to the kinds of activities described in the definition of "loan originator" in proposed § 1026.36(a)(3) be a workable and sufficient approach?

Understanding trade-offs. As previously discussed, the Bureau is proposing to mandate that creditors make available a comparable, alternative loan that does not include discount points and origination points or fees to help assure that consumers understand that points and fees can vary with the interest rate and that there are trade-offs for the consumer to consider.

Consumer groups have raised concerns that consumers' ability to choose to pay discount points and origination points or fees may not actually be beneficial to consumers because they do not understand trade-offs between upfront discount points and origination points or fees and paying a higher interest rate. Furthermore, even if consumers understand such trade-offs, they may not be able to determine whether discount points and origination points or fees paid up front result in a reasonably proportionate interest rate reduction. There is also concern that creditors may present multiple permutations and, because of their complexity and opaqueness, consumers may not be easily able to make such evaluations.

Consumer testing conducted by the Bureau on closed-end mortgage disclosures suggests that some consumers do understand that there is a trade-off between paying upfront discount points and origination points or fees and paying a higher interest rate. Specifically, as discussed in part II.E above, the Bureau is proposing to combine certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan under TILA and RESPA. As discussed in the supplementary information to that proposed rule, the Bureau conducted extensive consumer testing on these proposed disclosure forms. Through this consumer testing, the Bureau specifically examined how the required disclosures should work together on the integrated disclosure to maximize consumer understanding. As part of the consumer testing, the Bureau looked at how consumers would make trade-offs between the interest rate and closing costs. For example, in one round of testing, participants compared two

adjustable rate loans with different closing costs. One loan had a 2.75 percent initial interest rate that adjusted every year after Year 5 with \$11,448 in closing costs; the other loan had a 3.5 percent initial interest rate that adjusted every year after Year 5 with \$3,254 in closing costs. In subsequent rounds of testing, the Bureau tested forms that presented interest only loans; various adjustable rate loans; balloon payments; bi-weekly payment loans; loans with escrow accounts, partial escrow accounts, and no escrow accounts; different closing costs; and different amounts of cash to close.

Significantly, in this testing, participants were able to make multi-factored trade-offs between the interest rate and monthly payments and the cash needed to close based on their personal situations. Many participants were aware of the trade-off between the cash to close and the interest rate and corresponding monthly loan payment. When they chose the higher interest rate, they understood it would result in a higher monthly payment. They made this choice however, because they knew they did not have access to the needed cash to close. Conversely, other participants were willing to pay the higher closing costs to lower the monthly payment. Even with increasingly complicated decisions, participants continued to be able to use the disclosures to make certain multi-factored trade-offs and gave rational and personal explanations of their choices.

Thus, the Bureau believes that providing information to consumers about the comparable, alternative loan that does not include discount points and origination points or fees so that consumers can compare these loans to loans that include such points or fees and have lower interest rates facilitates consumers' ability to choose the trade-off that best fits their needs. As discussed above, for retail transactions, a creditor will be deemed to be making the loan available if, any time the creditor provides a quote specific to the consumer for a loan that includes discount points and origination points or fees, the creditor also provides a quote for a comparable, alternative loan that does not include those discount points and origination points or fees (unless the consumer is unlikely to qualify for the loan). The interest rate on the loan that does not include discount points and origination points or fees provides a baseline interest rate for the consumer. By having the interest rate on this loan as the baseline, consumers may better understand the trade-off that the creditor is providing to the consumer for paying discount points

and origination points or fees in exchange for a lower interest rate.

In addition, to further achieve the goal of enhancing consumer understanding of the trade-offs of making upfront payments in return for a reduced interest rate, the Bureau is also considering and solicits comment on whether there should be a requirement after application that a creditor disclose to a consumer a loan that does not include discount points and origination points or fees. As discussed in part II.E above, the Bureau issued a proposal to combine certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan under TILA and RESPA. Under that proposal, the Bureau proposed to require creditors to provide a "Loan Estimate" not later than the third business day after the creditor receives the consumer's application. See proposed § 1026.19(e) under the TILA-RESPA Integration Proposal. This Loan Estimate would contain information about the loan to which the Loan Estimate relates. The first page of the Loan Estimate would contain, among other things, information about the interest rate, the regular periodic payments, and the amount of money the consumer would need at closing including the total amount of closing costs. The second page of the Loan Estimate would contain, among other things, a detailed list of the closing costs. See proposed § 1026.37(f) under the TILA-RESPA Integration Proposal.

The Bureau solicits comment on whether it would be useful for the consumer if, at the time a creditor first provides a Loan Estimate for a loan that includes discount points and origination points or fees, the creditor also were required to provide either a complete Loan Estimate, or just the first page of the Loan Estimate, for a comparable, alternative loan that does not include discount points and origination points or fees. Thus, if the Loan Estimate the creditor initially provides to the consumer not later than the third business day after the creditor receives the consumer's application describes a loan that includes discount points and origination points or fee, the creditor also would be required to disclose a second Loan Estimate (or at least the first page of the Loan Estimate) at that time to the consumer that describes the comparable, alternative loan that does not include discount points and origination points or fees. The Bureau specifically solicits comment on whether receiving this second Loan Estimate from the same creditor would be helpful to the consumer in understanding the trade-off

in the reduction in the interest rate that the consumer is receiving in exchange for paying discount points and origination points or fees, and helpful to the consumer in deciding which loan to choose.

The Bureau expects that, if this alternative were adopted, it would not become effective until the rules mandating the Loan Estimate are finalized. Until the Loan Estimate is finalized, creditors are required to provide two different disclosure forms to consumers applying for a mortgage, namely the mortgage loan disclosures required under TILA and the GFE required under RESPA. The Bureau believes that it would create information overload for consumers to receive two disclosure forms for the loan that includes discount points and origination points or fees, and two disclosure forms for the comparable, alternative loan that does not include discount points and origination points or fees.

Competitive Trade-Off

Proposed § 1026.36(d)(2)(ii)(C) provides that no discount points and origination points or fees may be imposed on the consumer in connection with a transaction subject to proposed § 1026.36(d)(2)(ii)(A) unless there is a bona fide reduction in the interest rate compared to the interest rate for the comparable, alternative loan that does not include discount points and origination points or fees required to be made available to the consumer under § 1026.36(d)(2)(ii)(A). In addition, for any rebate paid by the creditor that will be applied to reduce the consumer's settlement charges, the creditor must provide a bona fide rebate in return for an increase in the interest rate compared to the interest rate for the loan that does not include discount points and origination points or fees required to be made available to the consumer under § 1026.36(d)(2)(ii)(A). As discussed in more detail below, the Bureau has evaluated three primary types of approaches to implement a requirement that the trade-off be "bona fide."

The Bureau solicits comment on whether the Bureau should adopt a "bona fide" requirement to help ensure that all consumers receive a competitive market trade-off between the interest rate and the payment of discount points and origination points or fees or whether, alternatively, market forces are sufficient to ensure that consumers generally receive such competitive trade-offs. As discussed above, the requirement to make available a loan that does not include discount points and origination points or fees informs

consumers of the baseline interest rates on the loans that do not include discount points and origination points or fees so that consumers can make informed decisions on the trade-offs presented by creditors. In addition, as discussed above, consumer testing conducted by the Bureau on closed-end mortgage disclosures suggests that some consumers do understand aspects of the trade-off between paying upfront discount points and origination points or fees and paying a higher interest rate. The Bureau believes that, in general, creditors will need to incorporate competitive pricing into their pricing policies to attract consumers that do understand this trade-off and shop for the best pricing. Nonetheless, the Bureau recognizes that there will be some consumers who are less sophisticated in terms of understanding the trade-off, and creditors may be able to present those consumers less competitive pricing than what is in the creditor's pricing policy. Thus, the Bureau solicits comment on whether a "bona fide" requirement is necessary to ensure that all consumers receive a competitive market trade-off between the interest rate and the payment of discount points and origination points or fees.

In addition, the Bureau seeks comment on how it might structure such a "bona fide" requirement, if one is appropriate. In considering this issue, the Bureau has evaluated the following three primary types of approaches to structuring the bona fide trade-off requirements: (1) A pricing-policy approach; (2) a minimum rate reduction approach; and (3) a market-based benchmark approach.

Pricing-policy approach. A pricing-policy approach would require that, in transactions where the requirement to make available a loan that does not include discount points and origination points or fees would apply, a creditor also must meet the following four requirements:

- First, the creditor would be required to establish a pricing policy that sets forth the amount of discount points and origination points or fees that each consumer would pay or the amount of the "rebate" that each consumer would receive, as applicable, for each interest rate on each loan product available to the consumer. The term "rebate" refers to an amount contributed by the creditor to pay some or all of the consumer's transaction costs, generally resulting from the consumer's agreeing to accept a "premium" (above par) interest rate.
- Second, the creditor would be allowed to change its pricing policy

periodically, but may not do so to provide less favorable pricing for the purpose of a consumer's particular transaction. The term "pricing" would mean the interest rate applicable to a loan and the corresponding discount points and origination points or fees a consumer would pay or the amount of the rebate that the consumer would receive, as applicable, for the interest rate applicable to the loan.

- Third, at the time the interest rate on the transaction is set (or "locked"), the pricing offered to the consumer must be no less favorable than the pricing established by the creditor's current pricing policy.

- Fourth, at the time the interest rate on the transaction is set, the interest rate offered to the consumer in return for paying discount points and origination points or fees must be lower than the interest rate for the loan that does not include discount points and origination points or fees.

Under such an approach, a creditor would not be required to charge all consumers the same amount of discount points and origination points or fees or provide all consumers the same amount of rebate, as applicable, at each interest rate for each loan product. A creditor's pricing policy could still set forth specific pricing adjustments for determining the amount of discount points and origination points or fees or the amount of the rebate, as applicable, for consumers at each rate for each loan, based on factors such as the consumer's risk profile (such as the consumer's credit score) and the characteristics of the loan or the property securing the loan (such as the loan-to-value ratio, or whether the property will be owner-occupied). The pricing adjustments, however, would need to be set forth with specificity in the pricing policy. These pricing adjustments could be changed periodically, for example, for market or other reasons, but may not be changed to provide less favorable pricing for the purpose of a consumer's particular transaction.

Also, under such an approach, creditors would still be allowed to provide more favorable pricing to a particular consumer than the pricing set forth in the creditor's current pricing policy. This would preserve consumers' ability to negotiate better pricing with creditors. For example, upon receiving a rate quote from a creditor, a consumer could inform the creditor that a competitor is offering a lower rate for the consumer paying the same amount of discount points and origination points or fees. The creditor could agree to match the lower rate under this approach.

The Bureau recognizes that, with this flexibility, a creditor could potentially circumvent the purpose of this approach by setting forth less competitive pricing in its pricing policy but then regularly departing from the policy to provide more favorable pricing to particular consumers, especially more sophisticated consumers. On the other hand, the Bureau believes that several factors could militate against a creditor doing this. Processing frequent exceptions to the pricing policy may be inefficient for a creditor; expose creditors to risks, such as potential violations of fair lending laws; and would call into question whether the creditor has complied with the requirement under this approach to set forth its pricing policy. In addition, competition may discipline creditors to offer competitive rates. The Bureau specifically requests comment on whether such an approach should be adopted, as well as on its advantages and disadvantages. The Bureau also requests comment specifically on the burdens this approach would create for creditors to retain records necessary to document the pricing policy applicable to each consumer's transaction.

Minimum rate reduction. The Bureau also requests comment on an alternative approach under which the consumer must receive a minimum reduction in the interest rate for each point paid (compared to the interest rate that is applicable to the loan that does not include discount points and origination points or fees where fees would be converted to points). The Bureau is aware that Fannie Mae will purchase or securitize loans only if the total points and fees (converted into points) do not exceed five points. Fannie Mae excludes "bona fide" discount points for this calculation and specifies that, to be bona fide, each discount point must result in at least a .25 percent reduction in the interest rate. Similarly, the rule could specify that for each point paid by the consumer in discount points and origination points or fees (where fees would be converted to points), the consumer must receive a reduction in the interest rate of at least a certain portion of a percentage point, e.g., .125 of a percentage point, compared to the interest rate that is applicable to the loan that does not include discount points and origination points or fees.

However, the Bureau is concerned that mandating such a minimum reduction in the interest rate for each point paid could unduly constrict pricing of mortgage products. The Bureau understands that creditors often use the dollar amount of the premium that the creditor expects to receive from

the secondary market for a loan at a particular rate as a factor in its determination of the reduction in the interest rate given for each point paid. The Bureau understands that these premiums do not move in a linear manner. Thus, depending on the premiums that are paid by the secondary market for each interest rate, the amount of reduction in the interest rate may be .125 of a percentage point for the first point paid, but may be .25 of a percentage point for the second point paid. In addition, the amount of reduction in the interest rate for each point paid by the consumer in discount points and origination points or fees also could vary for a number of other reasons, such as by product type (e.g., 30-year fixed-rate loans versus adjustable rate loans).

Market-based benchmarks. The Bureau has also considered whether an objective measure for determining whether a creditor is providing a competitive market trade-off in the interest rate on a loan that includes discount points and origination points or fees, as compared to established industry standards, could be achieved by reference to current, or at least recent, trade-offs actually provided to consumers.

In the Board's 2011 Ability to Repay (ATR) Proposal, the Board proposed a definition of "bona fide discount points" for use in determining whether a loan is a "qualified mortgage." Under the 2011 ATR Proposal, a creditor can make a "qualified mortgage," which provides the creditor with protections against potential liability under the general ability-to-repay standard set forth in that proposal.⁶⁵ Also, under the 2011 ATR Proposal, a qualified mortgage generally may not have "points and fees," as that term is defined in the Board's proposal, that exceed three percent of the total loan amount.⁶⁶

The 2011 ATR Proposal provided exceptions to the calculation of points and fees for certain bona fide discount points, which were defined as "any percent of the loan amount" paid by the consumer that reduces the interest rate or time-price differential applicable to the mortgage loan by an amount based on a calculation that: (1) Is consistent with established industry practices for determining the amount of reduction in

the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer; and (2) accounts for the amount of compensation that the creditor can reasonably expect to receive from secondary market investors in return for the mortgage loan.⁶⁷

As discussed by the Board in its 2011 ATR Proposal, the value of a rate reduction in a particular mortgage transaction on the secondary market is based on many complex factors, which interact in a variety of complex ways.⁶⁸ These factors may include, among others:

- The product type, such as whether the loan is a fixed-rate or adjustable-rate mortgage, or has a 30-year term or a 15-year term.
- How much the mortgage-backed securities (MBS) market is willing to pay for a loan at that interest rate and the liquidity of an MBS with loans at that rate.
- How much the secondary market is willing to pay for excess interest on the loan that is available for capitalization outside of the MBS market.
- The amount of the guaranty fee required to be paid by the creditor to the investor.⁶⁹

The Bureau recognizes, however, that it may not be appropriate to mandate the same market-based approach (or any other approach to bona fide reductions in the interest rate) in both the ATR context and this context given the differences between the purposes and scope of the requirements. For ATR purposes, a discount point must be "bona fide" to be excluded from the three-percent points and fees limit on qualified mortgages.⁷⁰ For this rulemaking, the Bureau is considering adopting a mandatory trade-off for any transaction that is subject to the requirement that a creditor make available a loan without discount points and origination points or fees. In addition, the bona fide trade-off in this context includes discount points and origination points or fees, which is broader than the inclusion in the 2011 ATR Proposal of just discount points. The same approach may not be

⁶⁷ The ATR proposal was implementing new TILA section 129C(b)(2)(C)(iv), as added by Dodd-Frank Act section 1412, which mandates that, to be bona fide discount points, "the amount of the interest rate reduction purchased is reasonably consistent with established industry norms and practices for secondary mortgage market transactions."

⁶⁸ 76 FR 27390, 27467 (May 11, 2011).

⁶⁹ *Id.*

⁷⁰ The 2011 ATR Proposal would not prohibit a creditor from charging discount points that are not bona fide, but such points would count towards the points-and-fees limit.

⁶⁵ 76 FR 27390 (May 11, 2011); *see also* section 1412 of the Dodd-Frank Act (adding new TILA section 129C(b), which sets forth the statutory standards for a "qualified mortgage").

⁶⁶ 76 FR 27390, 27396 (May 11, 2011); *see also* section 1412 of the Dodd-Frank Act (adding new TILA section 129C(b)(2)(A)(vii), which sets the three percent cap for a "qualified mortgage").

appropriate for both contexts for a number of reasons, including the fact that the inclusion of origination points or fees may introduce different complexities.

Another variation of the market-based approach would be to measure whether a trade-off is bona fide through reference to regularly obtained, robust, and reliable data on the trade-offs currently being afforded, possibly by conducting a survey of actual market terms. According to this variation, the trade-off available from a particular creditor would be measured against this benchmark to determine whether it is deemed competitive for purposes of this rule. At present, the Bureau knows of no existing survey or other source of such data and, therefore, assumes that pursuing such an approach would require that the Bureau establish such a survey or other source of data for these purposes.

The Bureau is concerned that it may be difficult to effectively implement this variation of the market-based approach in a manner that adequately accounts for the impacts of all the factors that affect the value that the secondary market places on a rate reduction for a particular transaction. In addition, the Bureau recognizes that a determination whether a creditor is providing a competitive market trade-off in the interest rate on a loan that is based on actual market trade-offs in the recent past might not be reflective of future trade-offs, given that the MBS market varies frequently.

The Bureau requests comment on the feasibility of using this variation of a market-based benchmark to determine whether a creditor is providing a competitive market trade-off in the interest rate on a loan that includes discount points and origination points or fees compared to industry standards. More generally, the Bureau solicits comment on whether any market-based benchmark should be pursued in this rulemaking and, if so, how it should be structured.

36(d)(2)(ii)(A)

The Bureau's Proposal

As discussed in more detail above, the Bureau proposes in new § 1026.36(d)(2)(ii)(A) restrictions on discount points and origination points or fees in a closed-end consumer credit transaction secured by a dwelling, if any loan originator will receive from any person other than the consumer compensation in connection with the transaction. Specifically, in these transactions, a creditor or loan originator organization may not impose

on the consumer any discount points and origination points or fees in connection with the transaction unless the creditor makes available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees; the creditor need not make available the alternative, comparable loan, however, if the consumer is unlikely to qualify for such a loan.

Scope. To provide guidance on the scope of the transactions to which proposed § 1026.36(d)(2)(ii) applies, the Bureau is proposing comment 36(d)(2)(ii)-1 to provide examples of transactions to which § 1026.36(d)(2)(ii) applies, and examples of transactions to which § 1026.36(d)(2)(ii) does not apply. Specifically, proposed comment 36(d)(2)(ii)-1.i provides the following three examples of transactions in which the prohibition in proposed § 1026.36(d)(2)(ii) applies: (1) For transactions that do not involve a loan originator organization, the creditor pays compensation in connection with the transaction (e.g., a commission) to individual loan originators that work for the creditor; (2) the creditor pays a loan originator organization compensation in connection with a transaction, regardless of how the loan originator organization pays compensation to individual loan originators that work for the organization; and (3) the loan originator organization receives compensation directly from the consumer in a transaction and the loan originator organization pays individual loan originators that work for the organization compensation in connection with the transaction. Proposed comment 36(d)(2)(ii)-1.ii provides the following two examples of transactions where the prohibition in proposed § 1026.36(d)(2)(ii) does not apply: (1) For transactions that do not involve a loan originator organization, the creditor pays individual loan originators that work for the creditor only in the form of a salary, hourly wage, or other compensation that is not tied to the particular transaction; and (2) the loan originator organization receives compensation directly from the consumer in a transaction and the loan originator organization pays individual loan originators that work for the organization only in the form of a salary, hourly wage, or other compensation that is not tied to the particular transaction.

Proposed comment 36(d)(2)(ii)-1.iii clarifies the relationship of proposed § 1026.36(d)(2)(ii) to the provisions prohibiting dual compensation in proposed § 1026.36(d)(2)(i). This proposed comment clarifies that § 1026.36(d)(2)(ii) does not override any

of the prohibitions on dual compensation set forth in § 1026.36(d)(2)(i). For example, § 1026.36(d)(2)(ii) does not permit a loan originator organization to receive compensation in connection with a transaction both from a consumer and from a person other than the consumer.

Loan product where consumer will not pay discount points and origination points or fees. Proposed comment 36(d)(2)(ii)(A)-3 would provide guidance on identifying the comparable, alternative loan product that does not include discount points and origination points or fees. As explained in proposed comment 36(d)(2)(ii)(A)-3, in some cases, the creditor's pricing policy may not contain an interest rate for which the consumer will neither pay discount points and origination points or fees nor receive a rebate. For example, assume that a creditor's pricing policy only provides interest rates in $\frac{1}{8}$ percent increments. Assume also that under the creditor's current pricing policy, the pricing available to a consumer for a particular loan product would be for the consumer to pay a 5.0 percent interest rate with .25 discount point, pay a 5.125 percent interest rate and receive .25 point in rebate, or pay a 5.250 percent interest rate and receive a 1.0 point in rebate. This creditor's pricing policy does not contain a rate for this particular loan product where the consumer would neither pay discount points and origination points or fees nor receive a rebate from the creditor. In such cases, proposed comment 36(d)(2)(ii)(A)-3 clarifies that the interest rate for a loan that does not include discount points and origination points or fees would be the interest rate for which the consumer does not pay discount points and origination points or fees and the consumer would receive the smallest possible amount of rebate from the creditor. Thus, in the example above, the interest rate for that particular loan product that does not include discount points and origination points or fees is the 5.125 percent rate with .25 point in rebate.

Make available. Proposed comment 36(d)(2)(ii)(A)-1 would provide guidance on how creditors may meet the requirement in § 1026.36(d)(2)(ii)(A) to make available the required comparable, alternative loan that does not include discount points and origination points or fees. Specifically, proposed comment 36(d)(2)(ii)(A)-1.i provides guidance for transactions that do not involve a loan originator organization. In this case, a creditor will be deemed to have made available to the consumer a comparable, alternative loan that does not include discount points and origination points

or fees if, any time the creditor provides any oral or written estimate of the interest rate, the regular periodic payments, the total amount of the discount points and origination points or fees, or the total amount of the closing costs specific to a consumer for a transaction that would include discount points and origination points or fees, the creditor also provides an estimate of those same types of information for a comparable, alternative loan that does not include discount points and origination points or fees, unless a creditor determines that a consumer is unlikely to qualify for such a loan. A creditor using this safe harbor is required to provide the estimate for the loan that does not include discount points and origination points or fees only if the estimate for the loan that includes discount points and origination points or fees is received by the consumer prior to the estimated disclosures required within three business days after application pursuant to the Bureau's regulations implementing the Real Estate Settlement Procedures Act (RESPA). See proposed comment 36(d)(1)(A)-1.i.A.

Proposed comment 36(d)(2)(ii)(A)-1.i.B clarifies that a creditor using this safe harbor is required to provide information about the loan that does not include discount points and origination points or fees only when the information about the loan that includes discount points or origination points or fees is specific to the consumer. Advertisements would be excluded from this requirement. See comment 2(a)(2)-1.ii.A. If the information about the loan that includes discount points or origination points or fees is an advertisement under § 1026.24, the creditor is not required to provide the quote for the loan that does not include discount points and origination points or fees. For example, if prior to the consumer submitting an application, the creditor provides a consumer an estimated interest rate and monthly payment for a loan that includes discount points and origination points or fees, and the estimates were based on the estimated loan amount and the consumer's estimated credit score, then the creditor must also disclose the estimated interest rate and estimated monthly payment for the loan that does not include discount points and origination points or fees. In contrast, if the creditor provides the consumer with a preprinted list of available rates for different loan products that include discount points and origination points or fees, the creditor is not required to provide the information about the loans

that do not include discount points and origination points or fees under this safe harbor. Nonetheless, as discussed in more detail below, the Bureau solicits comment on whether the advertising rules in § 1026.24(d) should be revised as well.

Under this safe harbor, proposed comment 36(d)(2)(ii)(A)-1.i.C clarifies that "comparable, alternative loan" means that the two loans for which estimates are provided as discussed above have the same terms and conditions, other than the interest rate, any terms that change solely as a result of the change in the interest rate (such as the amount of regular periodic payments), and the amount of any discount points and origination points or fees. The Bureau believes that, for a consumer to compare loans meaningfully and usefully, it is important that the only terms and conditions that are different between the loan that includes discount points and origination points or fees and the loan that does not include discount points and origination points or fees are: (1) The interest rates applicable to the loans; (2) any terms that change solely as a result of the change in the interest rate (such as the amount of regular periodic payments); and (3) the fact that one loan includes discount points and origination points or fees and the other loan does not. Proposed comment 36(d)(2)(ii)(A)-4 provides guidance on the meaning of "regular periodic payment" and indicates that this term means payments of principal and interest (or interest only, depending on the loan features) specified under the terms of the loan contract that are due from the consumer for two or more unit periods in succession. The Bureau believes that limiting the differences between the two loans will allow consumers to focus consumer choice on core loan terms and help consumers understand better the trade-off between the two loans in terms of paying discount points and origination points or fees in exchange for a lower interest rate. In addition, proposed comment 36(d)(2)(ii)(A)-1.i.C clarifies that a creditor using this safe harbor must provide the estimate for the loan that does not include discount points and origination points or fees in the same manner (*i.e.*, orally or in writing) as provided for the loan that does include discount points and origination points or fees. For both written and oral estimates, both of the written (or both of the oral) estimates must be given at the same time.

Also, as clarified by proposed comment 36(d)(2)(ii)(A)-1.i.E, a creditor using this safe harbor must disclose

estimates of the interest rate, the regular periodic payments, the total amount of the discount points and origination points or fees, and the total amount of the closing costs for the loan that does not include discount points and origination points or fees only if the creditor disclosed estimates for those types of information for the loan that includes discount points and origination points or fees. For example, if a creditor provides estimates of the interest rate and monthly payments for a loan that includes discount points and origination points or fees, the creditor using the safe harbor must provide estimates of the interest rate and monthly payments for the loan that does not include discount points and origination points or fees, such as saying "your estimated interest rate and monthly payments on this loan product where you will not pay discount points and origination points or fees to the creditor or its affiliates is [x] percent, and \$[xx] per month." On the other hand, if the creditor provides an estimate of only the interest rate for the loan that includes discount points and origination points or fees and does not provide an estimate of the regular periodic payments for that loan, the creditor using the safe harbor is required only to provide an estimate of the interest rate for the loan that does not include discount points and origination points or fees and is not required to provide an estimate of the regular periodic payments for the loan without discount points and origination points or fees.

Proposed comment 36(d)(2)(ii)(A)-1.ii would specify guidance for transactions that involve a loan originator organization. In this case, a creditor will be deemed to have made available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees if the creditor communicates to the loan originator organization the pricing for all loans that do not include discount points and origination points or fees. Separately, mortgage brokers are prohibited under § 1026.36(e) from steering consumers into a loan just to maximize the broker's commission. The rule sets forth a safe harbor for complying with provisions prohibiting steering if the broker presents to the consumer three loan options that are specified in the rule. One of these loan options is the loan with the lowest total dollar amount for discount points and origination points or fees. Thus, mortgage brokers that are using the safe harbor must present to the consumer the loan with the lowest interest rate that

does not include discount points and origination points or fees. The Bureau believes that most mortgage brokers are using the safe harbor to comply with the provision prohibiting steering, so most consumers in transactions that involve mortgage brokers would be informed of the loan with the lowest interest rate that do not include discount points and origination points or fees.

The Bureau solicits comments generally on the safe harbor approaches set forth in proposed comment 36(d)(2)(ii)(A)-1, and specifically on the effectiveness of these approaches to ensure that consumers are informed of the options to obtain loans that do not include discount points and origination points or fees. As discussed in more detail above, the Bureau specifically requests comment on whether there should be a requirement after application that a creditor disclose to a consumer a loan that does not include discount points and origination points or fees. The Bureau specifically solicits comment on whether it would be useful for the consumer if, at the time a creditor first provides a Loan Estimate for a loan that includes discount points and origination points or fees, the creditor also were required to provide either a complete Loan Estimate, or just the first page of the Loan Estimate, for a comparable, alternative loan that does not include discount points and origination points or fees.

In addition, as discussed in more detail above, through the proposal, the Bureau intends to facilitate consumer shopping by enhancing the ability of consumers to make comparisons using loans that do not include discount points and origination points or fees available from different creditors as a basis for comparison. Nonetheless, the Bureau is concerned that by the time a consumer receives a quote from a particular creditor for a loan that does not include discount points and origination points or fees, the consumer may have already completed his or her shopping in comparing loans from different creditors. Thus, as discussed in more detail above, the Bureau specifically solicits comment on whether the advertising rules in § 1026.24 should be revised to enable consumers to make comparisons using loans that do not include discount points and origination points or fees available from different creditors as a basis for comparison.

Transactions for which a consumer is unlikely to qualify. Proposed comment 36(d)(2)(ii)(A)-2 provides guidance on how a creditor may determine whether a consumer is likely not to qualify for a comparable, alternative loan that does

not include discount points and origination points or fees. Specifically, this proposed comment provides that the creditor must have a good-faith belief that a consumer will not qualify for a loan that has the same terms and conditions as the loan that includes discount points and origination points or fees, other than the interest rate, any terms that change solely as a result of the change in the interest rate (such as the amount of regular periodic payments) and the fact that the consumer will not pay discount points and origination points or fees. Under this proposed comment, the creditor's belief that the consumer is likely not to qualify for such a loan must be based on the creditor's current pricing and underwriting policy. In making this determination, the creditor may rely on information provided by the consumer, even if it subsequently is determined to be inaccurate.

36(d)(2)(ii)(B)

Definition of Discount Points and Origination Points or Fees

Under proposed § 1026.36(d)(2)(ii)(B), the term "discount points and origination points or fees" for purposes of § 1026.36(d) and (e) means all items that would be included in the finance charge under § 1026.4(a) and (b) and any fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2) that are payable at or before consummation by the consumer to a creditor or a loan originator organization, except for (1) interest, including any per-diem interest, or the time-price differential; (2) any bona fide and reasonable third-party charges not retained by the creditor or loan originator organization; and (3) seller's points and premiums for property insurance that are excluded from the finance charge under § 1026.4(c)(5), (c)(7)(v) and (d)(2). Proposed comment 36(d)(2)(ii)(B)-4 provides that, for purposes of § 1026.36(d)(2)(ii)(B), the phrase "payable at or before consummation by the consumer to a creditor or a loan originator organization" includes amounts paid by the consumer in cash at or before closing or financed as part of the transaction and paid out of the loan proceeds. The Bureau notes that § 1026.36(d)(3) provides that for purposes of § 1026.36(d), affiliates must be treated as a single person. Thus, for purposes of the definition of discount points and origination points or fees, charges that are payable by a consumer to a creditor's affiliate or the affiliate of a loan originator organization are

deemed to be payable to the creditor or loan originator organization, respectively. See proposed comment 36(d)(2)(ii)-3.

The Bureau believes the definition of discount points and origination points or fees is consistent with the description of the discount points, origination points, or fees referenced in the statutory ban in TILA section 129B(c)(2)(B)(ii), which was added by section 1403 of the Dodd-Frank Act. 12 U.S.C. 1639b(c)(2)(B)(ii). Specifically, TILA section 129B(c)(2)(B)(ii) uses the phrase "upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator)." The Bureau interprets the phrase "upfront payment of discount points, origination points, or fees, however denominated" generally to mean finance charges (except for interest) that are imposed in connection with the mortgage transaction that are payable at or before consummation by the consumer. The Bureau believes that Congress did not intend to cover charges that are payable by the consumer in comparable cash real estate transactions, such as real estate broker fees, where these charges are imposed regardless of whether the consumer engages in a credit transaction. The provision prohibiting consumers from paying upfront discount points and origination points or fees amends TILA, which generally regulates credit transactions, and not the underlying real estate transactions that are in connection with the extensions of credit.

The proposed definition of discount points and origination points or fees also includes an exception for any bona fide and reasonable third-party charges not retained by the creditor, loan originator organization, or any affiliate of either, consistent with TILA section 129B(c)(2)(B)(ii). The Bureau believes that this exception for bona fide and reasonable third-party charges means that Congress presumptively intended to include such third-party charges in the definition of "discount points, origination points, or fees" where they are retained by the creditor, mortgage originator, or affiliates of either. In addition, the exception for fees that are not "retained" by the creditor is consistent with the current comment 36(d)(1)-7 (re-designated as proposed comment 36(d)(2)(i)-2.i) and the Bureau's position that the definition of "discount points, origination points, or fees" includes upfront payments when the consumer either pays in cash or finances these payments from loan

proceeds because in either instance, the creditor, mortgage originator, or affiliates retain such payments. The proposed definition of discount points and origination points or fees reflects proposed changes that the Bureau set forth in the TILA-RESPA Integration Proposal to the definition of finance charge for purposes of mortgage transactions. Specifically, in the TILA-RESPA Integration Proposal, the Bureau proposes to add new § 1026.4(g) to specify that § 1026.4(a)(2) and (c) through (e), other than § 1026.4(c)(2), (c)(5), (c)(7)(v), and (d)(2), do not apply to closed-end transactions secured by real property or a dwelling. Thus, under the TILA-RESPA Integration Proposal, the term finance charge for purposes of closed-end transactions secured by real property or a dwelling would mean all items that would be included in the finance charge under § 1026.4(a) and (b) and fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2) except for charges for late payments or for delinquency, default or other similar occurrences, seller's points, and premiums for property insurance that are excluded from the finance charge under § 1026.4(c)(2), (c)(5), (c)(7)(v) and (d)(2). In the supplementary information to the TILA-RESPA Integration Proposal, the Bureau solicits comment on the definition of finance charge generally in § 1026.4 as it relates to closed-end mortgage transactions, and specifically proposed § 1026.4(g). To the extent that the Bureau revises the definition of finance charge as it relates to closed-end mortgage transaction in response to the TILA-RESPA Integration Proposal, the Bureau expects to make corresponding changes to the definition of discount points and origination points or fees.

Proposed comment 36(d)(2)(ii)(B)-1 provides guidance generally on the definition of discount points and origination points or fees as set forth in proposed § 1026.36(d)(2)(ii)(B). This proposed comment clarifies that, for purposes of proposed § 1026.36(d)(2)(ii)(B), "items included in the finance charge under § 1026.4(a) and (b)" means those items included under § 1026.4(a) and (b), without reference to any other provisions of § 1026.4. Nonetheless, proposed § 1026.36(d)(2)(ii)(B)(3) specifies that items that are excluded from the finance charge under § 1026.4(c)(5), (c)(7)(v) and (d)(2) are also excluded from the definition of discount points and origination points or fees. For example, property insurance premiums may be excluded from the finance charge if the

conditions set forth in § 1026.4(d)(2) are met, and these premiums also may be excluded if they are escrowed. See § 1026.4(c)(7)(v), (d)(2). Under proposed § 1026.36(d)(2)(ii)(B)(3), these premiums are also excluded from the definition of discount points and origination points or fees. In addition, charges in connection with transactions that are payable in a comparable cash transaction are not included in the finance charge. See comment 4(a)-1. For example, property taxes imposed to record the deed evidencing transfer from the seller to the buyer of title to the property are not included in the finance charge because they would be paid even if no credit were extended to finance the purchase. Thus, these charges would not be included in the definition of discount points and origination points or fees.

The proposed definition of discount points and origination points or fees also excludes any bona fide and reasonable third-party charges not retained by the creditor or loan originator organization. Proposed comment 36(d)(2)(B)-2 provides guidance on this exception. Specifically, proposed comment 36(d)(2)(B)-2 notes that § 1026.36(d)(2)(ii)(B) generally includes any fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2). Section 1026.4(a)(2) discusses fees charged by a "third party" that conducts the loan closing. For purposes of § 1026.4(a)(2), the term "third party" includes affiliates of the creditor or the loan originator organization. Nonetheless, for purposes of the definition of discount points and origination points or fees, the term "third party" does not include affiliates of the creditor or the loan originator. Thus, fees described in § 1026.4(a)(2) would be included in the definition of discount points and origination points or fees if they are charged by affiliates of the creditor or the loan originator. Nonetheless, fees described in § 1026.4(a)(2) would not be included in such definition if they are charged by a third party that is not an affiliate of the creditor or any loan originator organization, pursuant to the exception in § 1026.36(d)(2)(ii)(B)(2).

The proposed comment also recognizes that, in some cases, amounts received for payment for third-party charges may exceed the actual charge because, for example, the creditor cannot determine with accuracy what the actual charge will be before consummation. In such a case, the difference retained by the creditor or loan originator organization is not

deemed to fall within the definition of discount points and origination points or fees if the third-party charge imposed on the consumer was bona fide and reasonable, and also complies with State and other applicable law. On the other hand, if the creditor or loan originator organization marks up a third-party charge (a practice known as "upcharging"), and the creditor or loan originator organization retains the difference between the actual charge and the marked-up charge, the amount retained falls within the definition of discount points and origination points or fees.

Proposed comment 36(d)(2)(ii)(B)-2 provides two illustrations for this guidance. The first illustration assumes that the creditor charges the consumer a \$400 application fee that includes \$50 for a credit report and \$350 for an appraisal that will be conducted by a third party that is not the affiliate of the creditor or the loan originator organization. Assume that \$50 is the amount the creditor pays for the credit report to a third party that is not affiliated with the creditor or with the loan originator organization. At the time the creditor imposes the application fee on the consumer, the creditor is uncertain of the cost of the appraisal because the appraiser charges between \$300 and \$350 for appraisals. Later, the cost for the appraisal is determined to be \$300 for this consumer's transaction. Assume, however, that the creditor uses average charge pricing in accordance with Regulation X. In this case, the \$50 difference between the \$400 application fee imposed on the consumer and the actual \$350 cost for the credit report and appraisal is not deemed to fall within the definition of discount points and origination points or fees, even though the \$50 is retained by the creditor. The second illustration specifies that, using the same example as described above, the \$50 difference would fall within the definition of discount points and origination points or fees if the appraisers from whom the creditor chooses charge fees between \$250 and \$300.

Proposed comment 36(d)(2)(ii)(B)-3 provides that, if at the time a creditor must comply with the requirements in proposed § 1026.36(d)(2)(ii) the creditor does not know whether a particular charge will be paid to its affiliate or an affiliate of the loan originator organization or will be paid to a third-party that is not the creditor's affiliate or an affiliate of the loan originator organization, the creditor must assume that the charge will be paid to its affiliates or an affiliate of the loan originator organization, as applicable,

for purposes of complying with the requirements in § 1026.36(d)(2)(ii). For example, assume that a creditor typically uses three title insurance companies, one of which is an affiliate of the creditor and two are not affiliated with the creditor or the loan originator organization. If the creditor does not know at the time it must establish available credit terms for a particular consumer pursuant to proposed § 1026.36(d)(2)(ii) whether the title insurance services will be performed by the affiliate of the creditor, the creditor must assume that the title insurance services will be conducted by the affiliate for purposes of complying with the requirements in § 1026.36(d)(2)(ii).

The Bureau solicits comment generally on the proposed definition of discount points and origination points or fees. As discussed in more detail above, the Bureau requests comment on the scope of the definition of discount points and origination points or fees and its impact on the ease with which consumers can compare loans that do not include discount points and origination points or fees from different creditors.

36(d)(2)(ii)(C)

Proposed § 1026.36(d)(2)(ii)(C) provides that no discount points and origination points or fees may be imposed on the consumer in connection with a transaction subject to proposed § 1026.36(d)(2)(ii)(A) unless there is a bona fide reduction in the interest rate compared to the interest rate for the comparable, alternative loan that does not include discount points and origination points or fees required to be made available to the consumer under § 1026.36(d)(2)(ii)(A). In addition, for any rebate paid by the creditor that will be applied to reduce the consumer's settlement charges, the creditor must provide a bona fide rebate in return for an increase in the interest rate compared to the interest rate for the loan that does not include discount points and origination points or fees required to be made available to the consumer under § 1026.36(d)(2)(ii)(A). As discussed in detail above, the Bureau is seeking comment on whether such a bona fide requirement is necessary and, if so, what form the requirement should take.

36(e) Prohibition on Steering

36(e)(3) Loan Options Presented

Section 1026.36(e)(1) provides that a loan originator may not direct or "steer" a consumer to consummate a transaction based on the fact that the originator will receive greater compensation from the creditor in that

transaction than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer's interest. Section 1026.36(e)(2) provides a safe harbor that loan originators may use to comply with the prohibition set forth in § 1026.36(e)(1). Specifically, § 1026.36(e)(2) provides that a transaction does not violate § 1026.36(e)(1) if the consumer is presented with loan options that meet certain conditions set forth in § 1026.36(e)(3) for each type of transaction in which the consumer expressed an interest. The term "type of transaction" refers to whether: (1) A loan has an annual percentage rate that cannot increase after consummation; (2) a loan has an annual percentage rate that may increase after consummation; or (3) a loan is a reverse mortgage.

As set forth in § 1026.36(e)(3), in order for a loan originator to qualify for the safe harbor in § 1026.36(e)(2), the loan originator must obtain loan options from a significant number of the creditors with which the originator regularly does business and must present the consumer with the following loan options for each type of transaction in which the consumer expressed an interest: (1) The loan with the lowest interest rate; (2) the loan with the lowest total dollar amount for origination points or fees and discount points; and (3) a loan with the lowest interest rate without negative amortization, a prepayment penalty, a balloon payment in the first seven years of the loan term, shared equity, or shared appreciation, or, in the case of a reverse mortgage, a loan without a prepayment penalty, shared equity, or shared appreciation. In accordance with current § 1026.36(e)(3)(ii), the loan originator must have a good faith belief that the options presented to the consumer as discussed above are loans for which the consumer likely qualifies.

The Bureau's Proposal

Discount points and origination points or fees. As discussed above, to qualify for the safe harbor in § 1026.36(e)(2), a loan originator must present to a consumer particular loan options, one of which is the loan with the lowest total dollar amount for "origination points or fees and discount points" for which the consumer likely qualifies. See § 1026.36(e)(3)(C). For consistency, the Bureau proposes to revise § 1026.36(e)(3)(C) to use the terminology "discount points and origination points or fees," which is a defined term in proposed § 1026.36(d)(2)(ii)(B).

In addition, the Bureau proposes to amend 1026.36(e)(3)(C) to address the situation where two or more loans have the same total dollar amount of discount points and origination points or fees. This situation is likely to occur in transactions that are subject to proposed § 1026.36(d)(2)(ii). As discussed above, proposed § 1026.36(d)(2)(ii)(A) requires, as a prerequisite to a creditor, loan originator organization, or affiliate of either imposing any discount points and origination points or fees on a consumer in a transaction, that the creditor also make available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan. For transactions that involve a loan originator organization, a creditor will be deemed to have made available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees if the creditor communicates to the loan originator organization the pricing for all loans that do not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan. See proposed comment 36(d)(2)(ii)(A)-1. Thus, each creditor with whom a loan originator regularly does business generally will be communicating pricing to the loan originator for all loans that do not include discount points and origination points or fees.

Proposed § 1026.36(e)(3)(C) provides that with respect to the loan with the lowest total dollar amount of discount points and origination points or fees, if two or more loans have the same total dollar amount of discount points and origination points or fees, the creditor must disclose the loan with the lowest interest rate that has the lowest total dollar amount of discount points and origination points or fees for which the consumer likely qualifies. For example, for transactions that are subject to proposed § 1026.36(d)(2)(ii), the loan originator must disclose the loan with the lowest rate that does not include discount points and origination points or fees for which the consumer likely qualifies. This proposed guidance will help ensure that loan originators are not steering consumers into loans to maximize the originator's compensation.

The loan with the lowest interest rate. As discussed above, to qualify for the safe harbor in § 1026.36(e)(2), a loan originator must present to a consumer particular loan options, one of which is the loan with the lowest interest rate for which the consumer likely qualifies. See § 1026.36(e)(3)(A). Mortgage creditors

and other industry representatives have asked for additional guidance on how to identify the loan with the lowest interest rate for which a consumer likely qualifies as set forth in § 1026.36(e)(3)(A), given that a consumer generally can obtain a lower rate by paying discount points. To provide additional guidance, the Bureau proposes to amend comment 36(e)(3)–3 to clarify that the loan with the lowest interest rate for which the consumer likely qualifies is the loan with the lowest rate the consumer can likely obtain, regardless of how many discount points the consumer must pay to obtain it.

36(f) Loan Originator Qualification Requirements

Section 1402(a)(2) of the Dodd-Frank Act added TILA section 129B, which imposes new requirements for mortgage originators, including requirements for them to be licensed, registered, and qualified, and to include their identification numbers on loan documents. 15 U.S.C. 1639b.

TILA section 129B(b)(1)(A) authorizes the Bureau to issue regulations requiring mortgage originators to be registered and licensed in compliance with State and Federal law, including the SAFE Act, 12 U.S.C. 5101. TILA section 129B(b)(1)(A) also authorizes the Bureau's regulations to require mortgage originators to be "qualified." As discussed in the section-section analysis of § 1026.36(a)(1), above, for purposes of TILA section 129B(b) the term "mortgage originator" includes natural persons and organizations. Moreover, for purposes of TILA section 129B(b), the term includes creditors, notwithstanding that the definition in TILA section 103(cc)(2) excludes creditors for certain other purposes.

The SAFE Act imposes licensing and registration requirements on individuals. Under the SAFE Act, loan originators who are employees of a depository institution or a Federally regulated subsidiary of a depository institution are subject to registration, and other loan originators are generally required to obtain a State license. Regulation H, 12 CFR part 1008, which implements SAFE Act standards applicable to State licensing, provides that a State is not required to impose licensing requirements on loan originators who are employees of a bona fide non-profit organization. 12 CFR 1008.103(e)(7). Individuals who are subject to SAFE Act registration or State licensing are required to obtain a unique identification number from the NMLSR, which is a system and database for

registering, licensing, and tracking loan originators.

SAFE Act licensing is implemented by States. To grant an individual a SAFE Act-compliant loan originator license, the State must determine that the individual has never had a loan originator license revoked; has not been convicted of enumerated felonies within specified timeframes; has demonstrated financial responsibility, character, and fitness; has completed eight hours of pre-licensing classes that have been approved by the NMLSR; has passed a written test approved by the NMLSR; and has met net worth or surety bond requirements. Licensed loan originators must take eight hours of continuing education classes approved by the NMLSR and must renew their licenses annually. Some States impose additional or higher minimum standards for licensing of individual mortgage loan originators under their SAFE Act-compliant licensing regimes. Separately from their SAFE Act-compliant licensing regimes, most States also require licensing or registration of loan originator organizations.

SAFE Act registration generally requires depository institution employee loan originators to submit to the NMLSR identifying information and information about their employment history and certain criminal convictions, civil judicial actions and findings, and adverse regulatory actions. The employee must also submit fingerprints to the NMLSR and authorize the NMLSR and the employing depository institution to obtain a criminal background check and information related to certain findings and sanctions against the employee by a court or government agency. Regulation G, 12 CFR part 1007, which implements SAFE Act registration requirements, imposes an obligation on the employing depository institution to have and follow policies to ensure compliance with the SAFE Act. The policies must also provide for the depository institution to review employee criminal background reports and to take appropriate action consistent with Federal law. 12 CFR 1007.104(h).

Proposed § 1026.36(f) implements, as applicable, TILA section 129B(b)(1)(A)'s mortgage originator licensing, registration, and qualification requirements by requiring a loan originator for a consumer credit transaction to meet the requirements described above. Proposed § 1026.36(f) tracks the TILA requirement that mortgage originators comply with State and Federal licensing and registration

requirements, including those of the SAFE Act. Proposed comment 36(f)–1 notes that the definition of loan originator includes individuals and organizations and, for purposes of § 1026.36(f), includes creditors. Comment 36(f)–2 clarifies that § 1026.36(f) does not affect the scope of individuals and organizations that are subject to State and Federal licensing and registration requirements. The remainder of § 1026.36(f) sets forth standards that loan originator organizations must meet to comply with the TILA requirement that they be qualified, as discussed below. Section 1026.36(f) clarifies that the requirements do not apply to government agencies and State housing finance agencies, employees of which are not required to be licensed under the SAFE Act. This differentiation is made pursuant to the Bureau's authority under TILA section 105(a) to effectuate the purposes of TILA, which as provided in TILA section 129B(a)(2) include assuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive. The Bureau does not believe that it is proper to apply the proposed qualification requirements to these individuals, because such agencies directly regulate and control the manner of all of their loan origination activities, thereby providing consumers adequate protection from these types of harm.

36(f)(1)

Proposed § 1026.36(f)(1) requires loan originator organizations to comply with applicable State law requirements for legal existence and foreign qualification, meaning the requirements that govern the legal creation of the organization and the authority of the organization to transact business in another State. Proposed comment 36(f)(1)–1 states, by way of example, that the provision encompasses requirements for incorporation or other type of formation and for maintaining an agent for service of process. This requirement would help ensure that consumers are able to seek remedies against loan originator organizations that fail to comply with requirements for legal formation and, when applicable, for operating as foreign businesses.

36(f)(2)

Proposed § 1026.36(f)(2) requires loan originator organizations to ensure that their individual loan originators are in compliance with SAFE Act licensing and registration requirements. Proposed comment 36(f)(2)–1 notes that the loan

originator organization can comply with the requirement by verifying information that is available on the NMLSR consumer access Web site.

36(f)(3)

Proposed § 1026.36(f)(3) provides actions that a loan originator organization must take for its individual loan originators who are not required to be licensed, and are not licensed, pursuant to the SAFE Act and State SAFE Act implementing laws. Individual loan originators who are not required to be licensed generally include employees of depository institutions and organizations that a State has determined to be bona fide non-profit organizations, in accordance with criteria in Regulation H. 12 CFR 1008.103(e)(7).

The proposed requirements in § 1026.36(f)(3)(ii) apply to unlicensed individual loan originators two of the core standards that apply to individuals who are subject to SAFE Act State licensing requirements: the criminal background standards and the financial responsibility, character, and general fitness standards. Proposed § 1026.36(f)(3)(iii) also requires loan originator organizations to provide periodic training to these individual loan originators, a requirement that is analogous to but, as discussed below, more flexible than the continuing education requirement that applies to individuals who have SAFE Act-compliant State licenses.

The SAFE Act's application of the less stringent registration standards to employees of depository institutions, as well as Regulation H's provision for States to exempt from State licensing employees of bona fide non-profit organizations, are based in part on an assumption that these institutions carry out basic screening of and provide basic training to their employee loan originators to comply with prudential regulatory requirements or to ensure a minimum level of protection of and service to their borrowers. The proposed requirements in § 1026.36(f)(3) would help ensure that all individual loan originators meet core standards of integrity and competence, regardless of the type of loan originator organization for which they work.

The proposal does not require employers of unlicensed loan originator individuals to obtain the covered information and make the required determinations on a periodic basis. Instead, such employers would be required to obtain the information and make the determinations under the criminal, financial responsibility, character, and general fitness standards

before an individual acts as a loan originator in a covered consumer credit transaction. However, the Bureau invites public comment on whether such determinations should be required on a periodic basis or whether the employer of an unlicensed loan originator should be required to make subsequent determinations only when it obtains information that indicates the individual may no longer meet the applicable standards.

The Bureau is not proposing to apply to employees of depository institutions and bona fide non-profit organizations the more detailed requirements to pass a standardized test and to be covered by a surety bond that apply to individuals seeking a SAFE Act-compliant State license. The Bureau has not found evidence that consumers who obtain mortgage loans from depository institutions and bona fide non-profit organizations face risks that are not adequately addressed through existing safeguards and proposed safeguards in this proposed rule. However, the Bureau will continue to monitor the market to consider whether additional measures are warranted.

36(f)(3)(i)

Proposed § 1026.36(f)(3)(i) provides that the loan originator organization must obtain, for each individual loan originator who is not licensed under the SAFE Act, a State and national criminal background check, a credit report from a nationwide consumer reporting agency in compliance, where applicable, with the requirements of section 604(b) of the Fair Credit Reporting Act (15 U.S.C. 1681b), and information about any administrative, civil, or criminal findings by any court or government agency. Proposed comment 36(f)(3)(i)-1 clarifies that loan originator organizations that do not have access to this information in the NMLSR (generally, bona fide non-profit organizations) could satisfy the requirement by obtaining a criminal background check from a law enforcement agency or commercial service. Such a loan originator organization could satisfy the requirement to obtain information about administrative, civil, or criminal determinations by requiring the individual to provide it with this information. The Bureau notes that the information in the NMLSR about administrative, civil, or criminal determinations about an individual is generally supplied to the NMLSR by the individual, rather than by a third party. The Bureau invites public comment on whether loan originator organizations that do not have access to this

information in the NMLSR should be permitted to satisfy the requirement by requiring the individual loan originator to provide it directly to the loan originator organization or if, instead, there are other means of obtaining the information that are more reliable or efficient.

36(f)(3)(ii)

Proposed § 1026.36(f)(3)(ii) specifies the standards that a loan originator organization must apply in reviewing the information it is required to obtain. The standards are the same as those that State agencies must apply in determining whether to grant an individual a SAFE Act-compliant loan originator license. Proposed comment 36(f)(3)(ii)-1 clarifies that the scope of the required review includes the information required to be obtained under § 1026.36(f)(3)(i) as well information the loan originator organization has obtained or would obtain as part of its customary hiring and personnel management practices, including information from application forms, candidate interviews, and reference checks.

First, under proposed § 1026.36(f)(3)(ii)(A), a loan originator organization must determine that the individual loan originator has not been convicted (or pleaded guilty or *nolo contendere*) to a felony involving fraud, dishonesty, a breach of trust, or money laundering at any time, or any other felony within the preceding seven-year period. Depository institutions already apply similar standards in complying with the SAFE Act registration requirements under 12 CFR 1007.104(h) and other applicable Federal requirements, which generally prohibit employment of individuals convicted of offenses involving dishonesty, money laundering, or breach of trust. For depository institutions, the incremental effect of the proposed standard generally would be to expand the scope of disqualifying crimes to include felonies other than those involving dishonesty, money laundering, or breach of trust if the conviction was in the previous seven years. The Bureau does not believe that depository institutions or bona fide non-profit organizations currently employ many individual loan originators who would be disqualified by the proposed provision, but the proposed provision would give consumers confidence that individual loan originators meet common minimum criminal background standards, regardless of the type of institution or organization for which they work. The proposed description of potentially disqualifying convictions is

the same as that in the SAFE Act provision that applies to applicants for State licenses and includes felony convictions in foreign courts. The Bureau recognizes that records of convictions in foreign courts may not be easily obtained and that many foreign jurisdictions do not classify crimes as felonies. The Bureau invites public comment on what, if any, further clarifications the Bureau should provide for this provision.

Second, under proposed § 1026.36(f)(3)(ii)(B), a loan originator organization must determine that the individual loan originator has demonstrated financial responsibility, character, and general fitness to warrant a determination that the individual loan originator will operate honestly, fairly, and efficiently. This standard is identical to the standard that State agencies apply to applicants for SAFE Act-compliant loan originator licenses, except that it does not include the requirement to determine that the individual's financial responsibility, character, and general fitness "such as to command the confidence of the community." The Bureau believes that responsible depository institutions and bona fide non-profit organizations already apply similar standards when hiring or transferring any individual into a loan originator position. The proposed requirement formalizes this practice and ensures that the determination considers reasonably available, relevant information so that, as with the case of the proposed criminal background standards, consumers can be confident that all individual loan originators meet common minimum qualification standards for financial responsibility, character, and general fitness. Proposed comment 36(f)(3)(ii)(B)-1 clarifies that the review and assessment need not include consideration of an individual's credit score but must include consideration of whether any of the information indicates dishonesty or a pattern of irresponsible use of credit or of disregard of financial obligations. As an example, the comment states that conduct revealed in a criminal background report may show dishonest conduct, even if the conduct did not result in a disqualifying felony conviction. It also distinguishes delinquent debts that arise from extravagant spending from those that arise, for example, from medical expenses. The Bureau's view is that an individual with a history of dishonesty or a pattern of irresponsible use of credit or of disregard of financial obligations should not be in a position to interact

with or influence consumers in the loan origination process, during which consumers must decide whether to assume a significant financial obligation and determine which of any presented mortgage options is appropriate for them.

The Bureau recognizes that, even with guidance in the proposed comment, any standard for financial responsibility, character, and general fitness inherently includes a subjective component. During the Small Business Review Panel process, some SERs expressed concern that the proposed standard could lead to uncertainty whether a loan originator organization was meeting the standard. The proposed standard excludes the phrase "such as to command the confidence of the community" to reduce the potential for this uncertainty. Nonetheless, in light of the civil liability imposed under TILA, the Bureau invites public comment on how to address this concern while also ensuring that the loan originator organization's review of information is sufficient to protect consumers. For example, if a loan originator organization reviews the required information and documents a rational explanation for why relevant negative information does not show that the standard is violated, should the provision provide a presumption that the loan originator organization has complied with the requirement?

36(f)(3)(iii)

In addition to the screening requirements discussed above, proposed § 1026.36(f)(3)(iii) requires loan originator organizations to provide periodic training to its individual loan originators who are not licensed under the SAFE Act. The training must cover the Federal and State law requirements that apply to the individual loan originator's loan origination activities. The proposed requirement is analogous to, but more flexible than, the continuing education requirement that applies to loan originators who are subject to SAFE Act licensing. Whereas the SAFE Act requires licensed individuals to take eight hours of preapproved classes every year, the proposed requirement is intended to be flexible to accommodate the wide range of loan origination activities in which covered loan originator organizations engage and for which covered individuals are responsible. For example, the training provision applies to a large depository institution providing complex mortgage loan products as well as a non-profit organization providing only basic home purchase assistance loans secured by a second lien on a dwelling. The

proposed provision also recognizes that covered individuals already possess a wide range of knowledge and skill levels. Accordingly, it would require loan originator organizations to provide training to close any gap in the individual loan originator's knowledge of Federal and State law requirements that apply to the individual's loan origination activities.

The proposed requirement also differs from the analogous SAFE Act requirement in that it does not include a requirement to provide training on "ethical standards," beyond those that amount to State or Federal legal requirements. In light of the civil liability imposed under TILA, the Bureau invites public comment on whether there exist loan originator ethical standards that are sufficiently concrete and widely applicable such that loan originator organizations would be able to determine what subject matter must be included in the required training, if the Bureau were to include ethical standards in the training requirement.

Proposed comment 36(f)(3)(iii)-1 includes explanations of the training requirement and also describes the flexibility available under § 1026.36(f)(3)(iii) regarding how the required training is delivered. It clarifies that training may be delivered by the loan originator organization or any other party through online or other technologies. In addition, it states that training that a Federal, State, or other government agency or housing finance agency has approved or deemed sufficient for an individual to originate loans under a program sponsored or regulated by that agency is presumptively sufficient to meet the proposed requirement. It further states that training approved by the NMLSR to meet the continuing education requirement applicable to licensed loan originators is sufficient to meet the proposed requirement to the extent that the training covers the types of loans the individual loan originator originates and applicable Federal and State laws and regulations. The proposed comment recognizes that many loan originator organizations already provide training to their individual loan originators to comply with requirements of prudential regulators, funding agencies, or their own operating procedures. Thus, the proposed comment clarifies that § 1026.36(f)(3)(iii) does not require training that is duplicative of training that loan originator organizations are already providing if that training meets the standard in § 1026.36(f)(3)(iii). These clarifications are intended to respond to questions that SERs raised

during the Small Business Review Panel process discussed above.

36(g) NMLSR Identification Number on Loan Documents

TILA section 129B(b)(1)(A), which was added by Dodd-Frank Act section 1402(b), authorizes the Bureau to issue regulations requiring mortgage originators to include on all loan documents any unique identifier issued by the NMLSR (also referred to as an NMLSR ID). Individuals who are subject to SAFE Act registration or State licensing are required to obtain an NMLSR ID, and many organizations also obtain NMLSR IDs pursuant to State or other requirements. Proposed § 1026.36(g) incorporates the requirement that mortgage originators must include their NMLSR ID on loan documents while providing several clarifications. The Bureau believes that the purpose of the statutory requirement is not only to permit consumers to look up the loan originator's record on the consumer access Web site of the NMLSR (www.nmlsconsumeraccess.org) before proceeding further with a mortgage transaction, but also to help ensure accountability of loan originators both before and after a transaction has been originated.

36(g)(1)

Proposed § 1026.36(g)(1)(i) and (ii) provides that loan originators must include both their NMLSR IDs and their names on loan documents, because without the associated names, a consumer may not understand whom or what the NMLSR ID number serves to identify. Having the loan originator's name may help consumers understand that they have the opportunity to assess the risks associated with a particular loan originator in connection with the transaction, which in turn promotes the informed use of credit (consistent with TILA section 105(a)'s provision for additional requirements that are necessary or proper to effectuate the purposes of TILA or to facilitate compliance with TILA). These provisions also clarify, consistent with the statutory requirement that mortgage originators include "any" NMLSR ID, that the requirement applies if the organization or individual loan originator has ever been issued an NMLSR ID. Proposed § 1026.36(g)(1) also provides that the NMLSR IDs must be included each time any of these documents are provided to a consumer or presented to a consumer for signature. Proposed comment 36(g)(1)-1 notes that for purposes of § 1026.36(g), creditors are not excluded from the definition of "loan originator."

Proposed comment 36(g)(1)-2 clarifies that the requirement applies regardless of whether the organization or individual loan originator is required to obtain an NMLSR ID under the SAFE Act or otherwise. Proposed § 1026.36(g)(1)(ii) recognizes that there may be transactions in which more than one individual meets the definition of a loan originator and clarifies that the individual loan originator whose NMLSR ID must be included is the individual with primary responsibility for the transaction at the time the loan document is issued.

In its 2012 TILA-RESPA Integration Proposal, the Bureau is proposing to integrate TILA and RESPA mortgage disclosure documents, in accordance with section 1032(f) of the Dodd-Frank Act, 12 U.S.C. 5532(f). That separate rulemaking also addresses inclusion of NMLSR IDs on the integrated disclosures it proposes, as well as the possibility that in some circumstances more than one individual may meet the criteria for whose NMLSR ID must be included. To ensure harmonization between the two rules, proposed comment 36(g)(1)(ii)-1 states that under these circumstances, an individual loan originator may comply with the requirement in § 1026.36(g)(1)(ii) by complying with the applicable provision governing disclosure of NMLSR IDs in rules issued by the Bureau pursuant to Dodd-Frank Act section 1032(f).

36(g)(2)

Proposed § 1026.36(g)(2) identifies the documents that must include loan originators' NMLSR IDs as the application, the disclosure provided under section 5(c) of the Real Estate Settlement Procedures Act of 1974 (RESPA), the disclosure provided under TILA section 128, the note or loan contract, the security instrument, and the disclosure provided to comply with section 4 of RESPA. Proposed comment 36(g)(2)-1 clarifies that the NMLSR ID must be included on any amendment, rider, or addendum to the note or loan contract or security instrument. These clarifications are provided in response to concerns that SERs expressed in the Small Business Review Panel process that the statutory reference to "all loan documents" would lead to uncertainty as to what is or is not considered a "loan document." The proposed scope of the requirement's coverage is intended to ensure that loan originators' NMLSR IDs are included on documents that include the terms or prospective terms of the transaction or borrower information that the loan originator may use to identify loan terms that are

potentially available or appropriate for the consumer. To the extent that any document not listed in § 1026.36(g)(2) is arguably a "loan document," differentiation as to which documents must include loan originators' NMLSR IDs is consistent with TILA section 105(a), which allows the Bureau to make exceptions that are necessary or proper to effectuate the purposes of TILA or to facilitate compliance with TILA.

A final rule implementing the proposed requirements to include NMLSR IDs on loan documents may be issued, and may generally become effective, prior to the effective date of a final rule implementing the Bureau's 2012 TILA-RESPA Integration Proposal. If so, then the requirement to include the NMLSR ID would apply to the current Good Faith Estimate, Settlement Statement, and TILA disclosure until the issuance of the integrated disclosures. The Bureau recognizes that such a sequence of events might cause loan originator organizations to have to incur the cost of adjusting their systems and procedures to accommodate the NMLSR IDs on the current disclosures, even though those disclosures will be replaced in the future by the integrated disclosures. Accordingly, the Bureau invites public comment on whether the effective date of the provisions regarding inclusion of the NMLSR IDs on the RESPA and TILA disclosures should be delayed until the date that the integrated disclosures are issued.

36(g)(3)

Proposed § 1026.36(g)(3) defines "NMLSR identification number" as a number assigned by the NMLSR to facilitate electronic tracking of loan originators and uniform identification of, and public access to, the employment history of, and the publicly adjudicated disciplinary and enforcement actions against, loan originators. The definition is consistent with the definition of "unique identifier" in section 1503(12) of the SAFE Act, 12 U.S.C. 5102(12).

36(h) Prohibition on Mandatory Arbitration Clauses and Waivers of Certain Consumer Rights

Section 1414 of the Dodd-Frank Act added TILA section 129C(e), which prohibits certain transactions secured by a dwelling from requiring arbitration or any other non-judicial procedure as the method for resolving disputes arising from the transaction. The same provision provides that a consumer and creditor or their assignees may nonetheless agree, after a dispute arises, to use arbitration or other non-judicial

procedure to resolve the dispute. It further provides, however, that no covered transaction secured by a dwelling, and no related agreement between the consumer and creditor, may limit a consumer's ability to bring a claim in connection with any alleged violation of Federal law. As a result, even a post-dispute agreement to use arbitration or other non-judicial procedure must not limit a consumer's right to bring a claim in connection with any alleged violation of Federal law, thus the consumer must be able to bring any such claim through the agreed-upon non-judicial procedure. The provision does not address State law causes of action. Proposed § 1026.36(h) codifies these statutory provisions.

36(i) Prohibition on Financing Single-Premium Credit Insurance

Dodd-Frank Act section 1414 added TILA section 129C(d), which generally prohibits a creditor from financing any premiums or fees for credit insurance in connection with certain transactions secured by a dwelling. The same provision provides that the prohibition does not apply to credit insurance for which premiums or fees are calculated and paid in full on a monthly basis. The prohibition applies to credit life, credit disability, credit unemployment, credit property insurance, and other similar products. It does not apply, however, to credit unemployment insurance for which the premiums are reasonable, the creditor receives no compensation, and the premiums are paid pursuant to another insurance contract and not to the creditor's affiliate. Proposed § 1026.36(i) codifies these statutory provisions. Rather than repeating Dodd-Frank Act section 1414's list of covered credit insurance products, it cross-references the existing description of insurance products in § 1026.4(d)(1) and (3). The Bureau does not intend any substantive change to the statutory provision's scope of coverage. The Bureau believes that these provisions are straightforward enough that they require no further clarification. The Bureau requests comment, however, on whether any issues raised by the provision require clarification and, if so, how they should be clarified. The Bureau also solicits comment on when the provision should become effective, for example, 30 days following publication of the final rule, or at a later time.

36(j)

Scope of § 1026.36

The Bureau proposes to transfer § 1026.36(f) to new § 1026.36(j). Moving

the section accommodates new § 1026.36(f), (g), (h) and (i). The Bureau also proposes to amend § 1026.36(j) to reflect the scope of coverage for the proposals implementing TILA sections 129B (except for (c)(3)) and 129C(d) and (e), as added by sections 1402, 1403, 1414(d) and (e) of the Dodd-Frank Act as discussed further below.

The Bureau proposes to implement the scope of products covered in TILA section 129C(d) and (e) (the new arbitration and single-premium credit insurance provisions proposed in § 1026.36(h) and (i)) by amending § 1026.36(j) to state that § 1026.36(h) and (i) applies both to HELOCs subject to § 1026.40 and closed-end consumer credit transactions, secured by the consumer's principal dwelling. The Bureau further proposes to implement the scope of coverage in TILA section 129B(b) (the new qualification, document identification and compliance procedure requirements proposed in new § 1026.36(f) and (g)) by amending § 1026.36(j) to include § 1026.36(f) and (g) with the coverage applicable to § 1026.36(d) and (e). That is, § 1026.36(d), (e), (f) and (g) applies to closed-end consumer credit transactions secured by a dwelling (as opposed to the consumer's principal dwelling). The Bureau does not propose amending the scope of transactions covered by § 1026.36(d) and (e).

The Bureau also proposes to make technical revisions to comment 36-1 reflecting these scope-of-coverage amendments proposed in § 1026.36(j). The Bureau relies on its interpretive authority under TILA section 105(a) to the extent there is ambiguity in TILA sections 129B (except for (c)(3)) and 129C(d) and (e), as added by sections 1402, 1403, 1414(d) and (e) of the Dodd-Frank Act, regarding which provisions apply to different types of transactions.

Consumer Credit Transaction Secured by a Dwelling

The definition of "mortgage originator" in TILA section 103(cc)(2) applies to activities related to a "residential mortgage loan" only. TILA section 103(cc)(5) defines "residential mortgage loan" as:

any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling, other than a consumer credit transaction under an open end credit plan or, for purposes of sections 129B and 129C and section 128(a) (16), (17), (18), and (19), and sections 128(f) and 130(k), and any regulations promulgated thereunder, an extension of credit relating to a plan described in section 101(53D) of title 11, United States Code.

The Bureau does not propose to use the statutory term "residential mortgage loan" in § 1026.36. Section 1026.36 uses the term "consumer credit transaction" throughout and proposed § 1026.36(j) qualifies the scope of § 1026.36's provisions. The Bureau believes that changing the terminology of "consumer credit transaction" to "residential mortgage loan" is unnecessary because the same meaning will be preserved.

Dwelling

The Bureau believes the definition of "dwelling" in § 1026.2(a)(19) is consistent with TILA section 103(cc)(5)'s use of the term in the definition of "residential mortgage loan." Section 1026.2(a)(19) defines "dwelling" to mean "a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence." The Bureau interprets the term "dwelling" to also include dwellings in various stages of construction. Construction loans are often secured by dwellings in this fashion. Indeed, draws to fund construction are usually released in phases as the dwelling comes into existence and secures the draws. Thus, a construction loan secured by an improvement through various stages of construction that will be used as a residence is secured by a "dwelling." The Bureau proposes to maintain this definition of dwelling.

VI. Implementation

A. This Proposal

Section 1400(c)(1) of the Dodd-Frank Act mandates that the Bureau prescribe implementing regulations in final form by January, 21, 2013 (*i.e.*, the date that is 18 months after the "designated transfer date") for regulations that are required under title XIV of the Dodd-Frank Act, and the Bureau must set effective dates of these regulations no later than one year from their date of issuance. The regulations proposed in this notice for which proposed rule text is set forth, while implementing amendments under title XIV of the Dodd-Frank Act, are not regulations required under title XIV.⁷¹ Pursuant to

⁷¹ As noted above in the section-by-section analysis, this proposal would implement TILA sections 129B(b)(1), (c)(1), and (c)(2), and 129C(d) and (e). The only provisions of TILA section 129B that are required to be implemented by regulations are those in section 129B(b)(2) and (c)(3). Section 129B(b)(2), for which the Bureau has not set forth proposed rule text but which the Bureau may

section 1400(c)(2) of the Dodd-Frank Act, the final rule issued under this proposal will establish its effective date, which need not be within one year of issuance.⁷²

The Bureau recognizes the importance of the changes to be made by the Bureau's final rule for consumer protection and the need to put these changes into place for consumers. For example, mandating that creditors make available a loan without discount points and origination points or fees may help ensure that consumers can shop effectively among different creditors and get a reasonable value for discount points and origination points or fees. In addition, an individual loan originator who has been properly screened and trained to present the type of loan that the individual loan originator sells is a clear benefit to consumers. The Bureau believes consumers should have the benefit of the Dodd-Frank Act's additional protections and requirements as soon as practical.

The Bureau also recognizes, however, that loan originators and creditors will need time to make systems changes and to retrain their staff to address the Dodd-Frank Act provisions implemented through the Bureau's final rule, including the requirement to make available in certain circumstances a loan without discount points and origination points or fees. Moreover, certain creditors and loan originator organizations will need to conduct training and screening for individual loan originators. The Bureau further recognizes that mortgage creditors and loan originators will need to make changes to address a number of other requirements relating to other Dodd-Frank Act provisions, some of which, unlike the requirements set out in the proposed rule text for this rulemaking, are required by the Dodd-Frank Act to take effect within one year after issuance of final implementing rules. The Bureau believes that ensuring that industry has sufficient time to make the necessary changes ultimately will benefit consumers through better industry compliance.

The Bureau expects to issue a final rule under this proposal by January 21, 2013 because the statutory provisions it implements otherwise will take effect automatically on that date. The Bureau also expects to issue several other final rules by January 21, 2013 to implement

implement in the final rule, is discussed in more detail in part VI.B, below.

⁷² If the Bureau does not issue implementing regulations by January 21, 2013, however, the Dodd-Frank Act amendments of title XIV generally will go into effect on January 21, 2013. See Dodd-Frank Act section 1400(c)(3).

other provisions of title XIV of the Dodd-Frank Act. The Bureau solicits comment on an appropriate implementation period for the final rule, in light of the competing considerations discussed above. The Bureau is especially mindful, however, of the importance of affording consumers the benefits of the additional protections in this proposal as soon as practical and therefore seeks detailed comment, and supporting information, on the nature and length of implementation processes that this rulemaking will necessitate.

B. TILA Section 129B(b)(2)

As noted above, this proposal does not contain specific proposed rule text to implement TILA section 129B(b)(2). That section provides that the Bureau "shall prescribe regulations requiring depository institutions to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions, and subsidiaries of such institutions, and the employees of such institutions or subsidiaries with the requirements of this section and the registration procedures established under section 1507 of the [SAFE Act]." 15 U.S.C. 1639b(b)(2). Nonetheless, the Bureau may adopt such rule text at the same time as the final rule under this proposal. Accordingly, it is describing the rule text it is considering in detail and invites interested parties to provide comment.

Regulations to implement TILA section 129B(b)(2) are required by title XIV. Accordingly, under Dodd-Frank Act section 1400(c)(1), the Bureau must prescribe those regulations no later than January 21, 2013, and those regulations must take effect no later than one year after they are issued. The Bureau notes, however, that TILA section 129B(b)(2) has no practical effect on depository institutions in the absence of implementing regulations because the statute imposes no requirement directly on any person other than the Bureau itself (to make regulations requiring depository institutions to adopt the referenced procedures).

If the Bureau were to make the substantive requirements of this rulemaking implementing TILA section 129B effective more than one year after issuance of the final rule and also were to adopt regulations requiring depository institutions to establish the referenced procedures (which must take effect within one year of their issuance), depository institutions might appear to be required to establish and maintain procedures to ensure compliance with substantive regulatory requirements that

have not yet taken effect.⁷³ This incongruous result would not impose any practical requirements on depository institutions until the substantive regulatory requirements take effect. Nevertheless, the Bureau is concerned that depository institutions may experience considerable uncertainty and compliance burden in attempting to reconcile a currently effective requirement for procedures with its corresponding, but not yet effective, substantive requirements. Therefore, the Bureau sees no practical reason to put into effect a requirement for procedures, with no practical consequences and possible negative consequences for depository institutions, until the substantive requirements to which it relates take effect.

On the other hand, if the Bureau were to make the substantive requirements of this rulemaking implementing TILA section 129B effective one year or less after issuance, the Bureau could require depository institutions simultaneously to establish and maintain procedures to ensure compliance with those substantive requirements without creating the incongruity discussed above. The Bureau is aware that depository institutions generally establish and maintain procedures to ensure compliance with all regulatory requirements to which they are subject, as a matter of standard compliance practice. Thus, the Bureau believes that regulations implementing TILA section 129B(b)(2), when adopted by the Bureau, will impose a relatively routine and familiar obligation on depository institutions and therefore could consist of a straightforward rule paralleling the statutory language.

Specifically, the Bureau expects that such a rule would require depository institutions to establish and maintain procedures reasonably designed to assure and monitor the compliance of themselves, their subsidiaries, and the employees of both with the requirements of § 1026.36(d), (e), (f), and (g). The rule would provide further that the required procedures must be appropriate to the nature, size, complexity, and scope of the mortgage credit activities of the depository institution and its subsidiaries. Finally, consistent with the definitions in

⁷³ TILA section 129B(b)(2) mandates that the Bureau issue regulations to require procedures to assure and monitor compliance with "this section," which is a reference to section 129B, not the regulations implementing section 129B. But Dodd-Frank Act section 1400(c)(2) provides that the statutory provisions in title XIV take effect when the final regulations implementing them take effect, provided such regulations are issued by January 21, 2013.

section 2(18) of the Dodd-Frank Act, 12 U.S.C. 5301(18), the rule would define “depository institution” and “subsidiary” for this purpose to have the same meanings as in section 3 of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. 1813.

The Bureau notes that the definitions in section 2(18) of the Dodd-Frank Act should not necessarily determine the meanings of the ambiguous terms in TILA section 129B(b)(2). The Dodd-Frank Act definitions apply, “[a]s used in this Act,” not necessarily as used in another statute, TILA, being amended by the Dodd-Frank Act. In addition, the Dodd-Frank Act definitions do not apply if “the context otherwise requires.” One of the substantive requirements to which TILA section 129B(b)(2) applies concerns the registration procedures under section 1507 of the SAFE Act. The SAFE Act provides that, for purposes of the SAFE Act: “The term ‘depository institution’ has the same meaning as in [12 U.S.C. 1813], and includes any credit union.” 12 U.S.C. 5102(2). It may therefore be appropriate in this context to apply the SAFE Act definition of “depository institution” either as an interpretation of TILA section 129B(b)(2) or as an exercise of the Bureau’s authority under TILA section 105(a). Applying the SAFE Act definition in this way could facilitate compliance by aligning the definition of “depository institution” applicable to the procedures requirement under TILA section 129B(b)(2) with the definition of “depository institution” applicable under the SAFE Act. Applying the SAFE Act definition in this way also could be necessary or proper to effectuate the purpose stated in TILA section 129B(a)(2) of assuring that consumers are offered and receive residential mortgage loans that are not unfair, deceptive, or abusive.

The Bureau also notes that Regulation G, which implements the SAFE Act, contains a requirement that all covered financial institutions (including banks, savings associations, Farm Credit System institutions, and certain subsidiaries) adopt and follow certain policies and procedures related to SAFE Act requirements. 12 CFR 1007.104. Accordingly, a regulation implementing TILA section 129B(b)(2) to require procedures could also apply to credit unions, as well as Farm Credit System institutions, as an exercise of the Bureau’s authority under TILA section 105(a). Extending the TILA section 129B(b)(2) procedures requirement in this way may facilitate compliance by aligning the scope of the entities subject to the TILA and SAFE Act procedures

requirements. Further, such an extension may be necessary or proper to effectuate the purpose stated in TILA section 129B(a)(2) of assuring that consumers are offered and receive residential mortgage loans that are not unfair, deceptive, or abusive.

The Bureau further notes that under Regulation G only certain subsidiaries (those that are “covered financial institutions”) are required by 12 CFR 1007.104 to adopt and follow written policies and procedures designed to assure compliance with Regulation G. Accordingly, it may be appropriate to apply the duty to assure and monitor compliance of subsidiaries and their employees under TILA section 129B(b)(2) only to subsidiaries that are covered financial institutions under Regulation G. Exercising TILA 105(a) authority to make an adjustment or exception in this way may facilitate compliance by aligning the scope of the subsidiaries covered by the TILA and SAFE Act procedures requirements.

Finally, extending the scope of a regulation requiring procedures even further, to apply to other loan originators that are not covered financial institutions under Regulation G (such as independent mortgage companies), would help ensure consistent consumer protections and a level playing field. Exercising TILA section 105(a) authority in this way may be necessary or proper to effectuate the purpose stated in TILA section 129B(a)(2) of assuring that consumers are offered and receive residential mortgage loans that are not unfair, deceptive, or abusive.

The Bureau therefore solicits comment on whether a regulation requiring procedures to comply with TILA section 129B also should apply only to depository institutions as defined in section 3 of the FDIA, or also to credit unions, other covered financial institutions subject to Regulation G, or any other loan originators such as independent mortgage companies. Additionally, the Bureau solicits comment on whether it should apply the duty to assure and monitor compliance of subsidiaries and their employees only with respect to subsidiaries that are covered financial institutions under Regulation G. With respect to all of the foregoing, the Bureau also solicits comment on whether any of the potential exercises of TILA section 105(a) authority should apply with respect to procedures concerning only SAFE Act registration, or with respect to procedures for all the duty of care requirements in TILA section 129B(b)(1), or with respect to procedures for all the requirements of TILA section 129B, including those

added by section 1402 of the Dodd-Frank Act.

The Bureau also recognizes that a depository institution’s failure to establish and maintain the required procedures under the implementing regulation would constitute a violation of TILA, thus potentially resulting in significant civil liability risk to depository institutions under TILA section 130. 15 U.S.C. 1640. The Bureau anticipates concerns on the part of depository institutions regarding their ability to avoid such liability risk and therefore seeks comment on the appropriateness of establishing a safe harbor that would demonstrate compliance with the rule requiring procedures. For example, such a safe harbor might provide that a depository institution is presumed to have met the requirement for procedures if it, its subsidiaries, and the employees of it and its subsidiaries do not engage in a pattern or practice of violating § 1026.36(d), (e), (f), or (g).

The Bureau may adopt such a rule requiring procedures at the same time as the final rule under this proposal. If the effective date of the substantive requirements in that final rule is more than one year after issuance, the Bureau could adopt the requirement for procedures but clarify that having no procedures satisfies the procedures requirement until such time as the rule’s substantive requirements to which the procedures must relate take effect. Alternatively, the Bureau could refrain from issuing the rule requiring procedures until such time as it can take effect at the same time as the substantive requirements without the need for such a clarification. The Bureau solicits comment, however, on whether the requirement for procedures is straightforward enough to allow implementation by a regulation such as that described above. Alternatively, the Bureau seeks comment on whether the regulation prescribed under TILA section 129B(b)(2) should contain any specific guidance on the necessary procedures beyond that described above.

VII. Dodd-Frank Act Section 1022(b)(2)

In developing the proposed rule, the Bureau has considered potential benefits, costs, and impacts, and has consulted or offered to consult with the prudential regulators, the Department of Housing and Urban Development (HUD), and the Federal Trade Commission (FTC) regarding consistency with any prudential,

market, or systemic objectives administered by such agencies.⁷⁴

In this rulemaking, the Bureau proposes to amend Regulation Z to implement amendments to TILA made by the Dodd-Frank Act. The proposed amendments to Regulation Z implement Dodd-Frank Act sections 1402 (new duties of mortgage originators concerning proper qualification, registration, and related requirements), 1403 (limitations on loan originator compensation to reduce steering incentives for residential mortgage loans), and 1414(d) and (e) (restrictions on the financing of single-premium credit insurance products and mandatory arbitration agreements in residential mortgage loan transactions).⁷⁵ The proposed rule and commentary would also provide clarification of certain provisions in the existing Loan Originator Final Rule, including guidance on the application of those provisions to certain profit-sharing plans and the appropriate analysis of other payments made to loan originators.

As discussed in part II above, in 2010, the Board and Congress acted to address concerns that certain loan originator compensation arrangements could be difficult for consumers to understand and had the potential to create incentives to steer consumers to transactions with different terms, such as higher interest rates. The proposed rule would continue the protections provided in the Loan Originator Final Rule and implement the additional provisions Congress included in the Dodd-Frank Act that, as described above, to further improve the transparency of mortgage loan originations, enhance consumers' ability to understand loan terms, and afford additional protections to consumers.

A. Provisions To Be Analyzed

The analysis below considers the benefits, costs, and impacts of the following major proposed provisions:

⁷⁴ Specifically, section 1022(b)(2)(A) of the Dodd-Frank Act calls for the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services; the impact on depository institutions and credit unions with \$10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act; and the impact on consumers in rural areas.

⁷⁵ This rulemaking also solicits comment on implementing, possibly in the final rule, new TILA section 129B(b)(2), which was added by Dodd-Frank Act section 1402 and requires the Bureau to prescribe regulations requiring certain loan originators to establish and maintain various procedures. This rulemaking does not implement new TILA section 129B(c)(3) which was added by Dodd-Frank Act section 1403.

1. New restrictions on discount points and origination points or fees in closed-end consumer credit transactions secured by a dwelling where any person other than the consumer will compensate a loan originator in connection with the transaction. Specifically, in these transactions, a creditor or loan originator organization may not impose on the consumer any upfront discount points and origination points or fees in connection with the transaction unless the creditor makes available to the consumer a comparable, alternative loan that does not include discount points and origination points and fees, unless the consumer is unlikely to qualify for such a loan. The term "comparable, alternative loan" would mean that the two loans have the same terms and conditions, other than the interest rate, any terms that change solely as a result of the change in the interest rate (such as the amount of the regular periodic payments), and the amount of any discount points and origination points or fees.

2. Clarification of the applicability of the prohibition on payment and receipt of loan originator compensation based on the transaction's terms to employer contributions to qualified profit-sharing and other defined contribution or benefit plans in which individual loan originators participate, and to payment of bonuses under a profit-sharing plan or a contribution to a non-qualified plan.

3. New requirements for loan originators, including requirements related to their licensing, registration, and qualifications, and a requirement to include their identification numbers and names on loan documents.

With respect to each major proposed provision, the analysis considers the benefits and costs to consumers and covered persons. The analysis also addresses certain alternative provisions that were considered by the Bureau in the development of the proposed rule.

The data with which to quantify the potential benefits, costs, and impacts of the proposed rule are generally limited. For example, a lack of data regarding the specific distribution of loan products offered to consumers limits the precise estimation of the benefits of increased consumer choice. In light of these data limitations, the analysis below provides a mainly qualitative discussion of the benefits, costs, and impacts of the proposed rule. General economic principles, together with the limited data that are available, provide insight into these benefits, costs, and impacts. Wherever possible, the Bureau has made quantitative estimates based on these principles and the data available.

The Bureau requests comments on the analysis of the potential benefits, costs, and impacts of the proposed rule.

B. Baseline for Analysis

The amendments to TILA in sections 1402, 1403, and 1414(d) and (e) of the Dodd-Frank Act take effect automatically on January 21, 2013, unless final rules implementing those requirements are issued on or before that date and provide for a different effective date.⁷⁶ Specifically, new TILA section 129B(c)(2), which was added by section 1403 of the Dodd-Frank Act and restricts the ability of a creditor, the mortgage originator, or the affiliates of either to collect from the consumer upfront discount points, origination points, or fees in a transaction in which the mortgage originator receives from a person other than the consumer an origination fee or charge, will take effect automatically unless the Bureau exercises its authority to waive or create exemptions from this prohibition. New TILA section 129B(b)(1) requires each mortgage originator to be qualified and include unique identification numbers on loan documents. TILA section 129B(c)(1) prohibits mortgage originators in residential mortgage loans from receiving compensation that varies based on loan terms. TILA section 129C(d) creates prohibitions on single-premium credit insurance, and TILA section 129C(e) provides restrictions on mandatory arbitration agreements. These statutory amendments to TILA also take effect automatically in the absence of the Bureau's regulation.

In some instances, the provisions of the proposed rule would provide substantial benefits compared to allowing the TILA amendments to take effect automatically, by providing exemptions to certain statutory provisions. In particular, the Dodd-Frank Act prohibits consumer payment of upfront points and fees in all loan transactions where someone other than the consumer pays a loan originator compensation tied to the transaction (e.g., a commission). Pursuant to its authority under the Dodd-Frank Act to create exemptions from this prohibition when doing so would be in the interest of consumers and in the public interest, the Bureau's proposed rule would permit consumers to pay upfront points and fees when the creditor also makes available a loan that does not include discount points and origination points or fees (or when the consumer is

⁷⁶ Sections 129B(b)(2) and 129B(c)(3) of TILA, as added by sections 1402 and 1403 of the Dodd-Frank Act, however, do not impose requirements on mortgage originators until Bureau implementing regulations take effect.

unlikely to qualify for such loan). In proposing to use its exemption authority, the Bureau is attempting to capture the benefits to consumers from a loan that does not include discount points and origination points or fees (which would be the only loan available if the statute went into effect without use of exception authority), while preserving consumers' ability to choose, and creditors' and loan originator organizations' ability to offer, other loan options.

In other instances, the provisions of the proposed rule would implement the statute more directly. Thus, many costs and benefits of the provisions of the proposed rule would arise largely or entirely from the Dodd-Frank Act and not from the Bureau's proposed provisions. In these cases, the benefits of the proposed rule derive from providing additional clarification of certain elements of the statute. The proposed rule would reduce the compliance burdens on covered persons by, for example, reducing costs for attorneys and compliance officers as well as potential costs of over-compliance and unnecessary litigation. Moreover, the costs that these provisions would impose beyond those imposed by the Dodd-Frank Act itself are likely to be minimal.

Section 1022 of the Dodd-Frank Act permits the Bureau to consider the benefits, costs, and impacts of the proposed rule relative to the most appropriate baseline. This consideration can encompass an assessment of the benefits, costs, and impacts of the proposed rule solely compared to the state of the world in which the statute takes effect without implementing regulations. For the provisions of the proposed rule where the Bureau is using its exemption authority with respect to an otherwise self-effectuating statute, the Bureau believes that the benefits, costs, and impacts are best measured against such a post-statutory baseline. For the provisions that largely implement the statute or clarify ambiguity in the statute or existing regulations, a pre-statute baseline is used to discuss the benefits, costs and impacts of the proposed rule.

Additionally, the provisions of the proposed rule and commentary that clarify or provide additional guidance on provisions of the Loan Originator Final Rule should not impose additional costs or require changes to the business practices, systems, and operations of covered persons, and in particular those of small entities, beyond those that would already have occurred in order to

comply with the current rule.⁷⁷ The additional clarity offered by the proposed rule and commentary should in fact lower compliance burden by reducing confusion, expenditures made to interpret the current rule (such as hiring counsel or contacting the regulating or supervising agencies with questions), and diminishing the risk of inadvertent non-compliance.

C. Coverage of the Proposed Rule

The proposed rule applies to loan originators and table-funded creditors (*i.e.*, those who take an application, arrange, offer, negotiate, or otherwise obtain an extension of consumer credit for compensation or other monetary gain). The new qualification, document identification, and compliance procedure requirements also apply to creditors that finance transactions from their own resources. Like current § 1026.36(d) and (e), the proposed new qualification, document identification, and compliance procedure requirements apply to closed-end consumer credit transactions secured by a dwelling (as opposed to the consumer's principal dwelling). The proposed new arbitration and single-premium credit insurance provisions apply to both HELOCs subject to § 1026.40 and closed-end consumer credit transactions secured by the consumer's principal dwelling.

D. Potential Benefits and Costs of the Proposed Rule to Consumers and Covered Persons

1. Restrictions on Discount Points and Origination Points or Fees With the Requirement of Making Available a Comparable, Alternative Loan

The Dodd-Frank Act prohibits consumer payment of upfront points and fees in all residential mortgage loan transactions (as defined in the Dodd-Frank Act) except those where no one other than the consumer pays a loan originator compensation tied to the transaction (*e.g.*, a commission). Pursuant to its authority under the Dodd-Frank Act to create exemptions from this prohibition when doing so would be in the interest of consumers and in the public interest, the Bureau is proposing to require that before a creditor or loan originator organization may impose discount points and origination points or fees on a consumer where someone other than the consumer pays a loan originator transaction-specific compensation, the creditor must make available to the consumer a comparable, alternative loan that does

not include discount points and origination points or fees. (Making available the comparable, alternative loan is not necessary if the consumer is unlikely to qualify for such a loan.)

In retail transactions, a creditor will be deemed to be making available the comparable, alternative loan that does not include discount points and origination points or fees if, any time prior to a loan application, a creditor that gives a quote specific to the consumer for a loan that includes discount points and origination points or fees also provides a quote for a comparable, alternative loan that does not include those points and fees. (Making available the comparable, alternative loan is not necessary if the consumer is unlikely to qualify for such a loan.)⁷⁸

In transactions that involve mortgage brokers, a creditor will be deemed to be making available the comparable, alternative loan that does not include discount points and origination points or fees if the creditor provides mortgage brokers with the pricing for all of the creditor's comparable, alternative loans that do not include those points and fees. Mortgage brokers then would provide quotes to consumers for the loans that do not include discount points and origination points or fees when presenting different loan options to consumers.

Because the Bureau is using its exemption authority with respect to the otherwise self-effectuating provisions regarding points and fees, the analysis measures the benefits, costs, and impacts of this provision of the proposed rule relative to the enactment of the statute alone, *i.e.*, it uses a post-statute baseline. The two portions of the provision are discussed separately: the elimination of restrictions on charging of points and fees in certain transactions is discussed first, followed by the requirement to make available the comparable, alternative loan.

⁷⁸ The proposed rule also solicits comment on: (1) Whether the rule should instead prohibit a creditor from making available a loan that includes discount points and origination points or fees if the consumer does not also qualify for the comparable, alternative loan that does not include points and fees; (2) whether to revise the Regulation Z advertising rules to require that advertisements that disclose information about loans that include discount points and origination points or fees also include information about the comparable, alternative loans to further facilitate shopping by consumers for loans from different creditors; and (3) whether the creditor should be required to provide a Loan Estimate (*i.e.*, the combined TILA-RESPA disclosure proposed by the Bureau in its TILA-RESPA Integration Proposal), or the first page of the Loan Estimate, for the loan that does not include discount points and origination points or fees to the consumer after application.

⁷⁷ Entities would likely incur some costs, however, in reviewing the new rule and commentary.

a. Restrictions on Discount Points and Origination Points or Fees

Potential Benefits and Costs to Consumers

In any mortgage transaction, the consumer has the option to prepay the loan and exit the existing contract. This option to repay has some inherent value to the consumer and imposes a cost on the creditor.⁷⁹ In particular, consumers usually pay for part of this option through one of three alternative means: (1) “discount points,” which are the current payment of the value of future interest; (2) a “prepayment penalty,” which is a payment of the same market value deferred until the time at which the loan balance is actually repaid; or (3) a higher coupon rate on the loan.

In many instances, creditors or loan originators will charge consumers an origination point or fee. This upfront payment is meant to cover the labor and material costs the originator incurs from processing the loan. Here too, the loan originator could offer the consumer a loan with a higher interest rate in order to recover the creditor’s costs. In this sense, discount points and origination points or fees are similar; from the consumer’s perspective, they are various upfront charges the consumer may pay where the possibility may exist to trade some or all of this payment in exchange for a higher interest rate.

By permitting discount points under certain circumstances, the Bureau’s proposed rule offers all consumers greater choice over the terms of the coupon payments on their loan and a choice between paying discount points or a higher rate for the purchase of the prepayment option embedded in the loan.⁸⁰ The purchase of discount points,

⁷⁹ Should they expect to pay the balance of their loan prior to maturity, consumers can purchase from creditors the sole right to choose the date of this payoff. This right is valuable and its price is the market value such a sale creates for creditors in regard to the date of this potential payoff. Bond markets often exhibit an exactly opposite trade, in which the borrower cedes to the creditor the choice of time at which the creditor can require, if it chooses, the borrower to remit the remaining value of the bond. Bonds including such trades are termed “callable.”

⁸⁰ The two options are not mutually exclusive. In some transactions, consumers may pay for the embedded option through more than one of the methods outlined. Donald Keenan & James J Kau, *An Overview of the Option-Theoretic Pricing of Mortgages*, 6 Journal of Housing Research 217 (1995) (providing an overview of options embedded in residential mortgages); James J Kau, Donald Keenan, Walter Muller & James Epperson, *A Generalized Valuation Model for Fixed-Rate Mortgages with Default and Prepayment*, 11 Journal of Real Estate Finance & Economics 5 (1995) (providing a traditional method to value these options numerically); Robert R. Jones and David Nickerson, *Mortgage Contracts, Strategic Options and Stochastic Collateral*, 24 Journal of Real Estate

however, is essentially a calculated best guess by a consumer given an uncertain outcome. In this context, the purchase of discount points will not necessarily result in a benefit to the consumer after the consummation of the transaction. Rational consumers presumably purchase discount points because they expect to make loan payments for a long enough period to make a positive return. The occurrence of unanticipated events, however, could induce these consumers to pay off their loan after a shorter period, resulting in a realized loss.⁸¹

Greater choice over loan terms and greater choice over how to pay for the prepayment option should, under normal circumstances, increase the *ex ante* welfare of consumers. However, the degree to which individual consumers benefit will depend on their individual circumstances and their relative degree of financial acuity.⁸² Any *ex post* changes in aggregate benefits and changes in the overall volume of available credit also depend on consumers’ circumstances and abilities.

The choice over the means by which consumers compensate creditors for the prepayment option is of particular potential benefit to consumers who currently enjoy high liquidity but who either face prospects of diminished liquidity in the future or are more sensitive to the risk posed by a high variance in their future income or wealth. Examples of such consumers include retiring or older individuals wishing to secure their future housing,

Finance & Economics 35 (2002) (generating numerical values, in current dollars, for option-embedded mortgages in a continuous-time environment).

⁸¹ Similarly, consumers who expect to pay their loans over a period sufficiently short as to make the purchase of discount loans unattractive may find it better at the end of this expected period to continue to pay their mortgage and, consequently, suffer an unanticipated loss from refraining from the purchase of points. Yan Chang & Abdullah Yavas, *Do Borrowers Make Rational Choices on Points and Refinancing?*, 37 Real Estate Economics 635 (2009) (offering empirical evidence that consumers in their sample data remain in their current fixed-rate mortgages for too short a time to recover their initial investment in discount points). Other empirical evidence, however, conflicts with these results in regard to both the frequency and magnitude of losses. Simple numerical calculations that take into account taxes, local volatility in property values, and returns on alternative assets highlight the difficulty in drawing conclusions from much of the empirical data.

⁸² In situations where consumers are unaware of their own circumstance or their own relative financial acuity, some creditors may be able to benefit. For example, an unethical creditor may persuade those consumers unaware of their lower relative financial ability to make incorrect decisions regarding purchasing points. The outcome of this type of adverse selection will, of course, be reversed when consumers have a more accurate knowledge of their financial abilities than does the creditor.

individuals who are otherwise predisposed to use their wealth for a one-time payment, consumers with relocation funds available, and consumers offered certain rebates by developers or other sellers.

Relative to permitting the statutory provision to go into effect unaltered, the Bureau’s proposed rule regarding upfront points and fees also provides the potential for an additional benefit to consumers when adverse selection in the mortgage market compounds the costs of uncertainty over early repayment. Consumers who buy discount points credibly signal to creditors that the expected maturity of their loans is longer than those loans taken out by consumers not purchasing points. Credible signaling by an individual consumer in this circumstance would result in the consumer being offered a rate below that obtained by purchasing discount points in a more efficient market. When creditors confirm the relationship between individual purchases of discount points and the rapidity of individual prepayment, they respond by offering a lower average rate on each class of mortgages over which creditors have discretion in pricing.⁸³

If having to understand and decide among loans with different points and fees combinations imposes a burden on some consumers, the existence of the increased choice made available by this provision may itself be a cost.⁸⁴ In these circumstances, the Bureau’s proposed exercise of its exemption authority would have the cost of not reducing this confusion, relative to the statute. However, the proposed rule also includes, and solicits comment on, a “bona fide” requirement to ensure that consumers receive value in return for paying discount points and origination points or fees and different options for structuring such a requirements. Implementing a requirement that the payment of discount points and origination points or fees be bona fide may benefit these consumers who, in the absence of such a provision, would incur these costs from the increased choice. In essence, by guaranteeing that any points and fees be bona fide, the proposed rule would offer some additional protection for these consumers.

⁸³ Conversely, the elimination of the option to pay upfront points and fees could, depending on the extant risk in creditors’ portfolios and their perceptions of differential risk between neighborhoods, seriously reduce the access to mortgage credit for some portion of consumers.

⁸⁴ In certain economic models, increased choice may not lead to improvements in consumer welfare.

Potential Benefits and Costs to Covered Persons

The ability to charge discount points and origination points or fees is a substantial benefit to loan originators and remains so even under the Bureau's requirement that, as a prerequisite for any such charge, creditors make available a comparable, alternative loan that does not include discount points and origination points or fees (except where the consumer is unlikely to qualify for the loan).⁸⁵ Based on the assumption that the costs of originating a comparable, alternative loan that does not include discount points and origination points or fees are sufficiently small (relative to the revenue from all mortgage funding), the proposed rule would create three significant benefits for creditors.

First, the conditional permission to charge discount points and origination points or fees allows creditors to increase their returns on mortgage funding by offering different loan terms to consumers having different preferences and posing different risks.

Second, creditors have the option to share risk with consumers. As noted above, discount points are one way for creditors to recoup some portion of the implicit value of the prepayment option from consumers and the primary means by which a creditor can hedge losses from potential consumer prepayment. The proposed rule's allowance of the payment of points in circumstances other than the limited circumstances permitted under the Dodd-Frank Act preserves the ability of creditors to share a loan's prepayment risk, created by the prepayment option embedded in the loan, with consumers. Regardless of whether discount points are actually exchanged in any particular mortgage transaction, the ability to offer such points to consumers is a valuable option to the creditor.⁸⁶

A third benefit for creditors arises since adverse selection exists in the mortgage market, which compounds the risks borne from early repayment. Allowing consumers to purchase discount points, at least in part, allows them to signal to the creditor that they

⁸⁵ Since the Bureau's proposed provisions on both loan originator compensation and the conditional ability to charge upfront points and fees should, if adopted, effectively eliminate a loan originator's ability to engage in steering or similar practices possible under moral hazard, the analysis here will focus on only those benefits and costs which are unrelated to moral hazard.

⁸⁶ In contrast, the prohibition on payment of upfront points and fees in the Dodd-Frank Act under most circumstances would ensure that the value of the option to share risk through discount points is lost to both the creditor and the consumer in those circumstances.

expect to make payments on their loan for a longer period than other consumers who choose not to purchase such points. Creditors gain from that information and will respond to such differences in behavior.⁸⁷ Increasing a creditor's ability to measure more finely the prepayment risk posed by an individual consumer allows him or her to more finely "risk-price" loans across consumers posing different risk. By charging different loan rates to consumers who pose different degrees of risk, the creditor will earn a greater overall return from funding mortgage loans.⁸⁸

Both creditors, and by the preceding analysis, consumers benefit from the role of discount points as a credible signal and, consequently, the economic efficiency of the mortgage markets is enhanced.⁸⁹ The Bureau believes that this private means for reducing the risk that the mortgage loan (a liability for the consumer) can pose to the assets of the creditor is a significant source of efficiency in the mortgage market. In addition, mindful of the state of the United States housing and mortgage markets, the proposed rule also lowers the chances of any potential disruptions to those markets that might arise from implementing the Dodd-Frank Act provisions without change, which would be significantly different than current regulations. This should help promote the recovery and stability of those markets.

b. Requirement That All Creditors Make Available a Comparable, Alternative Loan

The Bureau is proposing to require that before a creditor or loan originator organization may impose discount points and origination points or fees on a consumer where someone other than the consumer pays a loan originator transaction-specific compensation, the creditor must make available to the

⁸⁷ Credible signaling in such a situation, from the creditor's perspective, distinguishes two groups of consumers—one with low prepayment risk who purchase discount points, and the second a group not purchasing discount points and, consequently, expect to prepay their loan more rapidly than average—in what would otherwise be a pool of consumers who are perceived by the creditor to exhibit an equivalent measure of prepayment risk.

⁸⁸ In this situation where the efficiency of the market is only impaired by adverse selection, this increase in creditor returns is independent of whether the creditor sells loans in the secondary market or chooses to engage in hedging to hold these mortgages in portfolio.

⁸⁹ Conversely, the elimination of the payment of upfront points and fees to the extent provided in the Dodd-Frank Act could, depending on the extant risk in creditors' portfolios and various characteristics of property by neighborhood, seriously reduce the access to mortgage credit for some portion of consumers.

consumer a comparable, alternative loan that does not include discount points and origination points or fees. (Making available the comparable, alternative loan is not necessary if the consumer is unlikely to qualify for such a loan.)

In transactions that do not involve a mortgage broker, the proposed rule would provide a safe harbor if, any time prior to application that the creditor provides a consumer an individualized quote for a loan that includes discount points and origination points or fees, the creditor also provides a quote for a comparable, alternative loan that does not include such points or fees. In transactions that involve mortgage brokers, the proposed rule would provide a safe harbor under which creditors provide mortgage brokers with the pricing for all of their comparable, alternative loans that do not include discount points and origination points or fees. Mortgage brokers then would provide quotes to consumers for the loans that do not include discount points and origination points or fees when presenting different loan options to consumers.

Relative to the post-statute baseline, this provision on its own has no or very limited effect on the market. As described, in the absence of the proposed rule, virtually the only mortgage transactions allowed would be loans without any upfront discount points, or origination points and fees; under the proposed rule, creditors are required in most instances to make these loans available. Any differences that arise in prices, quantities or product mix available in the market that are attributable to changes in the legal environment, therefore arise from the exemption allowing discount points, and origination points and fees, rather than from this requirement.

Nevertheless, the Bureau has chosen to discuss the benefits, costs and impacts from mandating that creditors make available the comparable, alternative loan (except where a consumer is unlikely to qualify for such a loan). With the Bureau's exemption authority, one alternative could be to completely eliminate the Dodd-Frank Act's prohibitions and allow the payment of upfront points and fees with no restrictions. (The Bureau has chosen not to present that alternative.) The following analysis discusses the benefits, costs and impacts of the current proposed rule relative to the alternative (which would mirror the status quo) where no such requirement for a comparable, alternative loan would be in place.

Potential Benefits and Costs to Consumers

Eliminating the prohibition on upfront points and fees creates greater choice for consumers over the means by which the consumer may compensate the creditor in exchange for the prepayment option in the mortgage. The preceding analysis discussed that greater choice should, under normal circumstances, create an *ex ante* welfare gain for consumers. The *ex post* (or realized) gains to consumers, however, may or may not exceed the corresponding frequency of realized losses.

Consumer choice is further expanded by the requirement that a creditor or loan originator organization generally make available the comparable, alternative loan to a consumer as a prerequisite to the creditor or loan originator organization imposing discount points and origination points or fees on the consumer in a transaction. In particular, the ability to choose this loan may be of particular benefit to those consumers having a relatively lower ability to accurately interpret loan terms. The simpler loan terms may help these consumers understand the total cost of the loan and select the mortgage most suited to them.⁹⁰

Consumers may also benefit from the proposed rule if the greater prevalence of comparable, alternative loans and their rates makes terms of mortgage loans clearer and more observable for all mortgage products. A creditor's communication regarding its rate on a particular comparable, alternative loan may act as a benchmark or "focal point" for the purpose of comparing rates on all additional mortgage products available from this creditor. Such a focal point may anchor the consumer's assessment of the relative costs of each type of mortgage product available from that creditor. The comparable, alternative loan, as a result, conveys to consumers information about the value of discount points and origination points or fees on all other products offered by a given creditor and, under certain circumstances, across all creditors.⁹¹ The availability of this benchmark, consequently, enhances the ability of all

consumers, and particularly those having a relatively low degree of financial sophistication, to more accurately compare the terms of alternative mortgage products offered by a creditor and select that product that best suits the consumer's needs.

The magnitude of the benefits to consumers from having the rate on comparable, alternative loans available as a benchmark would depend, in part, on the volume of transactions in such mortgages.⁹² A higher volume of transactions reduces the likelihood that the rate posted by any individual creditor reflects idiosyncrasies specific to that creditor. By reducing the expected deviation of the rate posted by a given creditor from the average rate posted by all creditors, a higher transaction volume results in an improvement in the accuracy with which a consumer can compare the rates on all loans offered by a given creditor. A lower volume, conversely, decreases such accuracy.

The Bureau believes that transactions without discount points and origination points or fees will be at a sufficiently high level to make the information conveyed by its average rate of significant value to consumers. This belief is founded on two factors. First, loans that do not include discount points and origination points or fees are currently offered and transacted in volumes comparable to several other types of mortgage loans. Second, the Bureau's proposed rule would give consumers certainty that this mortgage is generally available from virtually any creditor. Since current transactions volumes in this mortgage are comparable to those of many other mortgage products, this certainty about its universal availability, combined with its simplicity, should cause a level of consumer demand for the comparable, alternative mortgage sufficiently high to ensure sufficient transaction volumes.

Providing a useful means by which to compare rates also provides a potentially significant additional benefit to consumers.⁹³ Widespread availability of the current rate on the comparable, alternative loan should also lower the costs of comparing the rate on any mortgage product across creditors, owing to the correlation of costs and hence of rates among creditors. If so,

this would encourage additional shopping by consumers. Additional shopping by consumers over alternative creditors would, in turn, enhance the degree of competition among creditors, further driving down prices and increasing consumer welfare.⁹⁴

Potential Benefits and Costs to Covered Persons

Under the proposal, a creditor generally must make available a comparable, alternative loan to a consumer as a prerequisite to the creditor or loan originator organization imposing any discount points and origination points or fees on the consumer in a transaction (unless the consumer is unlikely to qualify for the comparable, alternative loan.) The proposed requirement would, in theory, have the potential to impose finance-related costs on creditors, particularly those whose size may preclude them from accessing either the secondary mortgage market or hedging (derivatives) markets.⁹⁵ Selling loans into the secondary market or investing in certain derivatives allows firms to lower the risk of their portfolios. Large and mid-sized creditors are able profitably to engage in these activities. In particular, the large number of fixed-income securities and hedging instruments available to these creditors should allow them to mitigate their financial risks.

The Bureau has considered whether future economic conditions could conceivably occur in which secondary market investors have no or low demand for comparable, alternative loans, rendering these products illiquid. In these circumstances, the volume of originations of such mortgages would drastically decrease with a concurrent rise in rates on the comparable, alternative loans, and a potential for increased exposure to credit and prepayment risk borne by creditors with limited asset diversification. Illiquidity in financial markets as a whole could inflict severe effects on creditors with portfolios consisting primarily of comparable, alternative loans. However, several factors mitigate the likelihood of

⁹⁰ Susan Woodward and Robert Hall (2012), *Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory and Mortgage-Market Evidence*, forthcoming *American Economic Review: Papers and Proceedings* (documenting the existence of such consumers in domestic mortgage markets).

⁹¹ The Bureau recognizes that rates on loans that do not include discount points and or origination points or fees may still not be perfectly comparable given that different creditors may have different additional charges. However, the rates on comparable, alternative loans should be correlated among creditors and informative.

⁹² Higher transactions volumes in any product increase the accuracy and value of the information provided by its market price.

⁹³ When a distribution of financial acuity and abilities exists among consumers market transparency may exacerbate any existing cross-subsidization between consumers. As a result, it is possible that some consumers gain more relative to others.

⁹⁴ Under certain plausible circumstances, such additional shopping would also encourage entry by creditors into previously localized mortgage markets.

⁹⁵ The potential for these additional finance-related costs would likely be greater under the alternative discussed in part V. Under that alternative, some creditors will lose additional profits derived from loans they can no longer make because the consumer does not qualify for the comparable, alternative loan. Creditors in general will need to take the time to ensure that they make the comparable, alternative loan available, that they provide quotes for it where applicable, and that they assess the consumer's qualification for it.

this event. Most historical experience, along with the size, liquidity, and pace of innovation in the United States mortgage markets, make such an event unlikely. For example, some of the earliest secondary market innovations involved structuring mortgage securities with different tranches of prepayment risk.⁹⁶ These securities would offer investors the opportunity to voluntarily purchase alternative exposures to the prepayment risk arising from any underlying pool of mortgages.

Another potential concern of creditors, closely related to the issues of liquidity discussed above, is the possibility that the rates on comparable, alternative loans could reach certain discrete thresholds such as the cutoff for higher-rate mortgages or the threshold rate that triggers HOEPA coverage. In such cases, creditors may face a limited ability to sell these loans. To the extent that creditors hold these new loans in portfolio, they will face some additional risk.⁹⁷ Here too, considerations of several important features of the credit markets mitigate concerns for those creditors who could be adversely affected in these cases. First, creditors should be able to price comparable, alternative loans at values that maintain their compliance with regulations but allow them to attain a desired degree of aggregate risk in their portfolios of assets. Second, the volume of originations at such high rates would inevitably decline under all situations except that of a completely inelastic demand by consumers. Since each loan with discount points or origination points or fees is a substitute for the comparable, alternative loan, a sufficiently high relative price on the comparable, alternative loan will make them unattractive to most consumers.

In considering the benefits, costs, and impacts, the Bureau notes that neither the alternative of allowing points and fees without restriction nor the elimination of all points and fees would on balance provide benefits to all consumers as a group. As a consequence, any conclusion about the comparative benefits and costs to consumers must be based on a comparison of two mutually exclusive classes of consumers: (1) Those who benefit more from the adoption of an

unrestricted points and fees proposal, relative to the prohibition of all points and fees; and (2) those who benefit more from the elimination of all points and fees offers. Both groups should benefit from the current proposed rule where a creditor who wishes to make available to a consumer a menu of loans with terms including points and/or fees generally must also make available to this consumer the comparable, alternative loan that does not include discount points and origination points or fees. The costs of the proposed rule should be minimal assuming the likely scenario that a sufficiently efficient market for comparable, alternative loans (in the presence of other types of mortgage products) would exist and that the potential costs of making available the comparable, alternative loan is not be too high for a significant proportion of creditors.

2. Compensation Based on Transaction Terms

Compensation rules, which restrict the means by which a loan originator receives compensation, are a practical way to mitigate potential harm to consumers arising from the opportunities for moral hazard on the part of loan originators.⁹⁸ Similar to the current regulation regarding loan originator compensation (*i.e.*, the Loan Originator Final Rule or, more simply, the “current rule”), the Dodd-Frank Act mitigates consumer harm by targeting the means by which loan originators can unfairly increase remuneration for their services.

The Dodd-Frank Act generally mirrors the current rule’s general prohibition on compensating an individual loan originator based on the terms of a “transaction.” Although the statute and the current rule are clear that an individual loan originator cannot be compensated differently based on the terms of his or her transactions, they do not expressly address whether the individual loan originator may be compensated based on the terms of multiple transactions, taken in the aggregate, of multiple loan originators employed by the same creditor or loan originator organization.

⁹⁸ Moral hazard, in the current context of mortgage origination, depends fundamentally on the advantage the loan originator has in knowing the least expensive loan terms acceptable to creditors and greater overall knowledge of the functioning of mortgage markets. Holden Lewis, “Moral Hazard” Helps Shape Mortgage Mess, Bankrate (Apr. 18, 2007), available at: http://www.bankrate.com/brm/news/mortgages/20070418_subprime_mortgage_morality_a1.asp (providing a practitioner description of the costs of such moral hazard on the current mortgage and housing industries).

Through its outreach and the inquiries the Board and the Bureau have received about the application of the current regulation to qualified and non-qualified plans,⁹⁹ the Bureau believes that confusion exists about the application of the current regulation to compensation in the form of bonuses paid under profit-sharing plans (which under the proposed commentary is deemed to include so called “bonus pools” and “profit pools”) and employer contributions to qualified and non-qualified defined benefit and contribution plans. As discussed in the section-by-section analysis, these types of compensation are often indirectly based on the aggregate transaction terms of multiple individual loan originators employed by the same creditor or loan originator organization, because aggregate transaction terms (*e.g.*, the average interest rate spread of the individual loan originators’ transactions in a particular calendar year over the creditor’s minimum acceptable rate) affects revenues, which in turn affects profits, and which, in turn, influences compensation decisions where profits are taken into account.

The proposed rule and commentary would address this confusion by clarifying the scope of the compensation restrictions in current § 1026.36(d)(1)(i). In so clarifying the compensation restrictions, the proposed rule treats different types of compensation structures differently based on an analysis of the potential steering incentives created by the particular structure. The proposed rule would permit employers to make contributions to qualified plans (which, as explained in the proposed commentary, include defined benefit and contribution plans that satisfy the qualification requirements of IRC section 401(a) or certain other IRC sections), even if the contributions were made out of mortgage business profits. The proposed rule also would permit bonuses under non-qualified profit-sharing plans, profit pools, and bonus pools and employer contributions to non-qualified defined benefit and contribution plans if: (1) The mortgage business revenue component of the total revenues of the company or business unit to which the profit-sharing plan applies, as applicable, is below a certain threshold, even if the payments or contributions were made out of mortgage business profits (the Bureau is proposing

⁹⁹ As noted in the section-by-section analysis, the Bureau issued CFPB Bulletin 2012–2 in response to the questions it received regarding the applicability of the current regulation to qualified plans and non-qualified plans, and this regulation is intended in part to provide further clarity on such issues.

⁹⁶ Some of the earliest securitizations were so called Collateralized Mortgage Obligations created by Freddie Mac in the late 1980s. See Brochure, Freddie Mac, *Direct Access Retail Remic Tranches* (2008), available at: http://www.freddiemac.com/mbs/docs/freddiedarts_brochure.pdf; Frank Fabozzi, Chuck Ramsey, and Frank Ramirez, *Collateralized Mortgage Obligations: Structures and Analysis* (Frank J Fabozzi Assocs., 1994).

alternative threshold amounts of 50 and 25 percent); or (2) the individual loan originator has been the loan originator for five or fewer transactions during the preceding 12-month period, *i.e.*, a “de minimis” test for individuals who originate a very small number of transactions per year. The proposed rule, however, would reaffirm the current rule and not permit individual loan originators to be compensated based on the terms of their individual transactions.

Compensation in the form of bonuses paid under profit-sharing plans and employer contributions to qualified and non-qualified defined benefit and contribution plans is normally based on the profitability of the firm.¹⁰⁰ As with compensation paid to the individual loan originator concurrently with loan origination, compensation paid pursuant to a profit-sharing plan is designed to provide individual loan originators and other employees with greater performance incentives and to align their interests with those of the owners of the institution employing them.¹⁰¹ When moral hazard exists, however, such profit-sharing could lead to misaligned incentives on the part of individual loan originators with respect to consumers. The magnitude of adverse incentives arising from profit-sharing in creating gains to the owners of the loan originator organization or creditor, however, depends on several circumstances.¹⁰² These include the number of individual loan originators employed by the creditor or loan originator organization that contributes to the funds available for profit-sharing, the means by which shares of the profits are distributed to the individual loan originators in the same firm, and the

ability of owners to monitor loan quality on an ongoing basis.

Potential Benefits and Costs to Covered Persons

As described above, considering the benefits, costs and impacts of this provision requires the understanding of current industry practice against which to measure any changes. As discussed, the Bureau believes, based on outreach to and inquiries received from industry, that confusion exists about the application of the current regulation to compensation in the form of bonuses paid under profit-sharing plans, bonus pools, and employer contributions to qualified and non-qualified plans. In light of this confusion, the Bureau believes that industry practice likely varies and therefore any determination of the costs and benefit of the proposed rule depend critically on assumptions about current firm practices.

Firms that currently offer incentive-based compensation arrangements for individual loan originators that would continue to be allowed under the proposed rule should incur neither costs nor benefits from the proposed rule. Notably, the proposed rule would clarify that employer contributions to qualified plans in which individual loan originators participate are permitted under the current rule.¹⁰³ Such firms can continue to benefit from these arrangements, which have the potential to motivate individual productivity; to reduce potential intra-firm moral hazard by aligning the interests of individual originators with those of their employer; and to reduce the potential for increased costs arising from adverse selection in the retention of more productive employees. Firms that do not offer such plans would benefit, with the increased clarity of the proposed rule, from the opportunity to do so should they so choose.¹⁰⁴

Firms that did not change their compensation practices in response to the current rule and that currently offer compensation arrangements that would be prohibited under the proposed rule would incur costs. These include costs from changing internal accounting practices, re-negotiating the remuneration terms in the contracts of existing employees and any other

industry practice related to these methods of compensation. For these firms, the prohibition on compensation based on transaction terms may contribute to adverse selection among individual loan originators, a possible lower average quality of individual loan originators in such a firm, higher retention costs, and possibly lower profits.¹⁰⁵ The specific numerical threshold also implies that some loan originators may now suffer the disadvantage of facing competitors with fewer restrictions on compensation. These potential differential effects may be greater for small creditors and loan originator organizations, and loan originator organizations that originate loans as their exclusive, or primary, line of business. The Bureau seeks comments and data on the current compensation practices of those firms at or above the thresholds.

Potential Benefits and Costs to Consumers

The proposed rule would benefit most consumers by clarifying the current regulation to address, and mitigate, the steering incentives inherent in the nature of profit-sharing plans and other types of compensation that are directly or indirectly based on the terms of multiple transactions of multiple individual loan originators. Limiting such incentive-based compensation for many firms limits the potential for steering consumers into more expensive loans. The Bureau’s approach permits bonuses under profit-sharing plans, contributions to qualified plans, and contributions to non-qualified plans only where the steering incentives are sufficiently attenuated (*i.e.*, the nexus between the transaction terms and the compensation is too indirect).

3. Qualification Requirements for Loan Originators

Section 1402 of Dodd-Frank amends TILA to impose a duty on loan originators to be “qualified” and, where applicable, registered or licensed as a loan originator under State law and the Federal SAFE Act. Employees of depositories, certain of their subsidiaries, and nonprofit organizations currently do not have to meet the SAFE Act standards that apply to licensing, such as taking pre-licensure classes, passing a test, meeting

¹⁰⁰ Payments to qualified retirement plans include, for example, employer contributions to employee 401(k) plans.

¹⁰¹ Bengt Holmstrom, *Moral Hazard and Observability*, 10 *Bell Journal of Economics* 74 (1979) (providing the first careful analysis of the effects such compensation methods have on employee incentives).

¹⁰² For example, when the compensation to each loan originator depends upon on the aggregate efforts of multiple originators (rather than directly on the individual loan originator’s own performance) then that individual’s efforts have increasingly little influence on the compensation the individual receives through a profit-sharing plan. As a result, each individual reduces his or her effort. This “free-riding” behavior has been extensively analyzed: Surveys of these analyses appear in Martin L. Weitzman, *Incentive Effects of Profit Sharing, in Trends in Business Organization: Do Participation and Cooperation Increase Competitiveness?* (Kiel Inst. of World Econ. 1995), available at: <http://ws1.ad.economics.harvard.edu/faculty/weitzman/files/IncentiveEffectsProfitSharing.pdf>.

¹⁰³ As noted earlier, the Bureau issued CFPB Bulletin 2012–2, which stated that the practice is permitted under the current rule, but the bulletin was issued as guidance pending the adoption of final rules on loan originator compensation.

¹⁰⁴ Some firms may choose not to offer such compensation. In certain circumstances an originating institution (perhaps unable to invest in sufficient management expertise) will see reduced profitability from adopting incentive-based compensation.

¹⁰⁵ Analysis of Call Report data from depository institutions and credit unions indicates that among depository institutions, roughly 6 percent are likely to exceed the 50 percent threshold and 30 percent are likely to exceed the 25 percent threshold. The largest impact would be on thrifts, whose business model historically has centered on residential mortgage lending.

character and fitness standards, having no felony convictions within the previous seven years, or taking annual continuing education classes. To implement the Dodd-Frank-Act's requirement that entities employing or retaining the services of individual loan originators be "qualified," the proposed rule would require entities whose individual loan originators are not subject to SAFE Act licensing, including depositories and bona fide nonprofit loan originator entities, to: (1) Ensure that their individual loan originators meet character and fitness and criminal background standards equivalent to the licensing standards that the SAFE Act applies to employees of non-bank loan originators; and (2) provide appropriate training to their individual loan originators commensurate with the mortgage origination activities of the individual. The proposed rule would mandate training appropriate for the actual lending activities of the individual loan originator and would not impose a minimum number of training hours. In developing this provision, the Bureau used its discretion. As such, the benefits and costs of this provision are discussed relative to a pre-statute baseline.¹⁰⁶

Potential Benefits and Costs to Consumers

Consumers will inevitably make subjective evaluations of the expertise of any loan originators with whom they consult. A consumer's knowledge that all originators possess a minimal level of such expertise would be of significant assistance to the accuracy of that evaluation and to the consumer's confidence in the originator with whom they initially begin negotiations. Consumers, who are generally considered to prefer certainty, will benefit to the extent that the current provisions increase such consumer confidence. Consumers incur no new direct costs created by the current proposal; any increases that originators may pass on to consumers will be de minimis.

Potential Benefits and Costs to Covered Persons

The increased requirements for institutions that employ individuals not licensed under the SAFE Act would further assure that the individual loan originators in their employ satisfy those levels of expertise and standards of probity as specified in the current

proposed rule.¹⁰⁷ This would have a positive effect by tending to reduce any potential liability they incur in future mortgage transactions and to enhance their reputation among consumers. An increase in consumer confidence in the expertise and experience of loan originators may possibly increase the number of consumers willing to engage in these transactions.

In addition, relative to current market conditions, the proposed rule would create a more level "playing field" between non-banking institutions and depository and non-profit institutions with regard to the enhanced training requirements and background checks that would be required of the latter institutions. This may help mitigate any possible adverse selection in the market for individual originators, in which non-banking institutions employ and retain only the most qualified individuals while those of more modest expertise seek employment by depository and non-profit institutions.

For depository institutions, the enhanced requirements related to findings from a criminal background check may cause certain loan originators to no longer be able to work at these institutions. It also slightly limits the pool of employees from which to hire, relative to the pool from which they can hire under existing requirements. Following an initial transition period where firms will have to perform the background check on current employees, these costs should be minimal. Similarly, the additional credit check for current loan originators at depository institutions, and the ongoing requirement will result in some minimal increased costs. Non-banking institutions not currently subject to the SAFE Act will have to incur the costs of both the criminal background check and the credit check.

4. Potential Benefits and Costs From Other Provisions

Mandatory Arbitration: Section 1414 of the Dodd-Frank Act added section 129C(e) to TILA. Section 129C(e) prohibits terms in any residential mortgage loan (as defined in the Dodd-Frank Act) or related agreement from requiring arbitration or any other non-judicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction. The proposed rule implements this statutory provision of the Dodd-Frank Act. Relative to a pre-statute baseline,

mortgage-related agreements can no longer reflect such terms. Consumers who desire access to the judicial system over disputes will not be prohibited from having such access. Some creditors and other parties will have to incur any additional costs of such legal actions above the costs associated with arbitration. Based on its outreach, the Bureau believes that to the extent terms that would be prohibited are currently included in any transactions covered by the statute, they are most likely to be included in contracts for open-ended mortgage credit. The Bureau requests comment on the prevalence of contracts with such terms for the purposes of the analysis under Section 1022 of the Dodd-Frank Act.

Creditor Financing of "Single Premium" Credit Insurance: Dodd-Frank Act section 1414 added section 129C(f) to TILA. Section 129C(f) pertains to a creditor financing credit insurance fees for the consumer. Although the provision permits insurance premiums to be calculated and paid in full per month, this provision prohibits a creditor from financing any fees, including premiums, for credit insurance in closed- and certain open-end loan transactions secured by a dwelling. The proposed rule implements the relevant statutory provision of the Dodd-Frank Act. The structure of these transactions is often harmful to consumers, and as such the proposed rule should benefit consumers.

5. Additional Potential Benefits and Costs

Covered persons would have to incur some costs in reviewing the proposed rule and adapting their business practices to any new requirements. The Bureau notes that many of the provisions of the current rule do not require significant changes to current practice and therefore these costs should be minimal for most covered persons.

The Bureau has considered whether the proposed rule would lead to a potential reduction in access to consumer financial products and services. The Bureau notes that many of the provisions of the current rule do not require significant changes to current consumer financial products or providers' practices. Firms will not have to incur substantial operational costs. As result, the Bureau does not anticipate any material impact on consumer access to mortgage credit.

¹⁰⁶ Use of the post-statute baseline used earlier in this analysis would be uninformative since even post statute but in the absence of the proposal, the definition of "qualified" would still be unclear.

¹⁰⁷ Under Regulation G, depository institutions must already obtain criminal background checks for their individual loan originator employees and review them for compliance under Section 19 of the FDIA.

E. Potential Specific Impacts of the Proposed Rule

1. Depository Institutions and Credit Unions With \$10 Billion or Less in Total Assets, As Described in Section 1026¹⁰⁸

Overall, the impact on smaller creditors of the Bureau's proposed rule would depend on several factors, the most important of which involve: (1) The ability of such creditors to manage any additional risk or loss of return the requirement generally to make available a comparable, alternative loan potentially imposes on the overall risk and return of their current portfolios; (2) the effects of the requirements on their return to equity and capital costs relative to larger competitors; and (3) their ability to recover, in a timely matter, any costs of processing loans. As previously discussed, the additional risk to the portfolios of any but the smallest creditors, from the requirement to make available the comparable, alternative loan (unless the consumer is unlikely to qualify), is likely to be small for the same reasons that apply to the portfolio risk of larger institutions and other investors.

Certain circumstances could, however, create a greater potential for adverse effects on small creditors, relative to their larger rivals, from originating large volumes of comparable, alternative loans. These circumstances occur if the financial capacity of the small creditor affects both its cost of raising capital and its ability to hedge risk. Should such an institution be unable effectively to hedge prepayment and credit risk with larger rivals or through the markets (*e.g.*, the firm has substantial fixed costs of accessing the secondary market), then the general requirement to make available a comparable, alternative loan in specified circumstances could cause it greater costs, relative to its size, than those that larger institutions would incur.

Under the proposed rule, smaller creditors may originate and hold more loans that do not include discount points and origination points or fees. These creditors may have fewer funds available from origination revenues to fund loan origination operations and, if they are unable to easily borrow, the general requirement to make available the comparable, alternative loan may result in greater costs. In all the cases described, however, these costs would

¹⁰⁸ Approximately 50 banks with under \$10 billion in assets are affiliates of large banks with over \$10 billion in assets and subject to Bureau supervisory authority under Section 1025. However, these banks are included in this discussion for convenience.

necessarily be considerably smaller than those that they would suffer, for similar reasons, under the Dodd-Frank Act prohibition against the origination of mortgages with upfront discount points and origination points or fees under most circumstances.

2. Impact on Consumers in Rural Areas

Consumers in rural areas are unlikely to experience benefits or costs from the proposed rule that are different from those benefits and costs experienced by consumers in general. Consumers in rural areas who obtain mortgage loans from mid-size to large creditors would experience virtually the same costs and benefits as do any others who use such creditors. Those consumers in rural areas who obtain mortgages from small local banks and credit unions may face slightly different benefit and costs. As noted above, the provisions of the proposed rule conditionally allowing upfront points and fees may expose some consumers to the risk that a more informed creditor will use these terms to its advantage. This may be less likely to occur in cases of smaller, more local creditors.

To the extent that the requirement that a creditor generally must make available a make available comparable, alternative loans as a prerequisite to the creditor or loan originator organization imposing discount points and origination points or fees on consumers would raise the cost of credit, these impacts are most likely at smaller creditors. Rural consumers using such creditors may face these marginally increased costs. However, these effects would derive from the provisions of the Dodd-Frank Act if they were permitted to go into effect; if anything, the proposed rule would alleviate burden from small creditors by permitting them to make available loans with discount points and origination points or fees, subject to certain conditions.

F. Additional Analysis Being Considered and Request for Information

The Bureau will further consider the benefits, costs and impacts of the proposed provisions and additional alternatives before finalizing the proposed rule. As noted above, there are a number of areas where additional information would allow the Bureau to better estimate the benefits, costs, and impacts of this proposed rule and more fully inform the rulemaking. The Bureau asks interested parties to provide comment or data on various aspects of the proposed rule, as detailed in the section-by-section analysis. The most significant of these include information or data addressing:

- The potential impact on all types of loan originators of the proposed restrictions on the methods by which a loan originator is remunerated in a transaction;

- The potential impact on mortgage lenders, including depository and non-depository institutions, of the requirement that all creditors must make available a comparable, alternative mortgage loan to a consumer that does not include discount points and origination points and fees, unless the consumer is unlikely to qualify for such a loan.

Information provided by interested parties regarding these and other aspects of the proposed rule may be considered in the analysis of the costs and benefits of the final rule.

To supplement the information discussed in in this preamble and any information that the Bureau may receive from commenters, the Bureau is currently working to gather additional data that may be relevant to this and other mortgage related rulemakings. These data may include additional data from the NMLSR and the NMLSR Mortgage Call Report, loan file extracts from various creditors, and data from the pilot phases of the National Mortgage Database. The Bureau expects that each of these datasets will be confidential. This section now describes each dataset in turn.

First, as the sole system supporting licensure/registration of mortgage companies for 53 agencies for States and territories and mortgage loan originators under the SAFE Act, NMLSR contains basic identifying information for non-depository mortgage loan origination companies. Firms that hold a State license or registration through NMLSR are required to complete either a standard or expanded Mortgage Call Report (MCR). The Standard MCR includes data on each firm's residential mortgage loan activity including applications, closed loans, individual mortgage loan originator activity, line of credit, and other data repurchase information by state. It also includes financial information at the company level. The expanded report collects more detailed information in each of these areas for those firms that sell to Fannie Mae or Freddie Mac.¹⁰⁹ To date, the Bureau has received basic data on the firms in the NMLSR and de-identified data and tabulations of data from the NMLSR Mortgage Call Report. These data were used, along with data

¹⁰⁹ More information about Mortgage Call Report can be found at: <http://mortgage.nationwidelicencingsystem.org/slr/common/mcr/Pages/default.aspx>.

from HMDA, to help estimate the number and characteristics of non-depository institutions active in various mortgage activities. In the near future, the Bureau may receive additional data on loan activity and financial information from the NMLSR including loan activity and financial information for identified creditors. The Bureau anticipates that these data will provide additional information about the number, size, type, and level of activity for non-depository creditors engaging in various mortgage origination activities. As such, it supplements the Bureau's current data for non-depository institutions reported in HMDA and the data already received from NMLSR. For example, these new data will include information about the number and size of closed-end first and second loans originated, fees earned from origination activity, levels of servicing, revenue estimates for each firm and other information. The Bureau may compile some simple counts and tabulations and conduct some basic statistical modeling to better model the levels of various activities at various types of firms. In particular, the information from the NMLSR and the MCR may help the Bureau refine its estimates of benefits, costs, and impacts for updates to loan originator compensation rules, revisions to the GFE and HUD-1 disclosure forms, changes to the HOEPA thresholds, changes to requirements for appraisals, and proposed new servicing requirements and the new ability to pay standards.

Second, the Bureau is working to obtain a random selection of loan-level data from a handful of creditors. The Bureau intends to request loan file data from creditors of various sizes and geographic locations to construct a representative dataset. In particular, the Bureau will request a random sample of "GFEs" and "HUD-1" forms from loan files for closed-end mortgage loans. These forms include data on some or all loan characteristics including settlement charges, origination charges, appraisal fees, flood certifications, mortgage insurance premiums, homeowner's insurance, title charges, balloon payment, prepayment penalties, origination charges, and credit charges or points. Through conversations with industry, the Bureau believes that such loan files exist in standard electronic formats allowing for the creation of a representative sample for analysis.

Third, the Bureau may also use data from the pilot phases of the National Mortgage Database (NMDB) to refine its proposals and/or its assessments of the benefits costs and impacts of these proposals. The NMDB is a

comprehensive database, currently under development, of loan-level information on first lien single-family mortgages. It is designed to be a nationally representative sample (one percent) and contains data derived from credit reporting agency data and other administrative sources along with data from surveys of mortgage borrowers. The first two pilot phases, conducted over the past two years, vetted the data-development process, successfully pretested the survey component and produced a prototype dataset. The initial pilot phases validated that credit repository data are both accurate and comprehensive and that the survey component yields a representative sample and a sufficient response rate. A third pilot is currently being conducted with the survey being mailed to holders of five thousand newly originated mortgages sampled from the prototype NMDB. Based on the 2011 pilot, a response rate of 50 percent or higher is expected. These survey data will be combined with the credit repository information of non-respondents and then de-identified. Credit repository data will be used to minimize non-response bias, and attempts will be made to impute missing values. The data from the third pilot will not be made public. However, to the extent possible, the data may be analyzed to assist the Bureau in its regulatory activities and these analyses will be made publicly available.

The survey data from the pilots may be used by the Bureau to analyze borrowers' shopping behavior regarding mortgages. For instance, the Bureau may calculate the number of borrowers who use brokers, the number of lenders contacted by borrowers, how often and with what patterns potential borrowers switch lenders, and other behaviors. Questions may also assess borrowers' understanding of their loan terms and the various charges involved with origination. Tabulations of the survey data for various populations and simple regression techniques may be used to help the Bureau with its analysis.

In addition to the comment solicited elsewhere in this proposed rule, the Bureau requests commenters to submit data and to provide suggestions for additional data to assess the issues discussed above and other potential benefits, costs, and impacts of the proposed rule. The Bureau also requests comment on the use of the data described above. Further, the Bureau seeks information or data on the proposed rule's potential impact on consumers in rural areas as compared to consumers in urban areas. The Bureau also seeks information or data on the

potential impact of the proposed rule on depository institutions and credit unions with total assets of \$10 billion or less as described in Dodd-Frank Act section 1026 as compared to depository institutions and credit unions with assets that exceed this threshold and their affiliates.

VIII. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), as amended by SBREFA, requires each agency to consider the potential impact of its regulations on small entities, including small businesses, small not-for-profit organizations, and small governmental units. 5 U.S.C. 601 *et seq.* The RFA generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 603, 604. The Bureau is also subject to certain additional procedures under the RFA involving the convening of a panel to consult with small entity representatives (SERs) prior to proposing a rule for which an IRFA is required. 5 U.S.C. 609.

The Bureau has not certified that the proposed rule would not have a significant economic impact on a substantial number of small entities within the meaning of the RFA. Accordingly, the Bureau convened and chaired a Small Business Review Panel to consider the impact of the proposed rule on small entities that would be subject to that rule and to obtain feedback from representatives of such small entities. The Small Business Review Panel for this rulemaking is discussed below in part VIII.A.

The Bureau is publishing an IRFA. Among other things, the IRFA estimates the number of small entities that will be subject to the proposed rule and describes the impact of that rule on those entities. The IRFA for this rulemaking is set forth below in part VIII.B.

A. Small Business Review Panel

Under section 609(b) of the RFA, as amended by SBREFA and the Dodd-Frank Act, the Bureau seeks, prior to conducting the IRFA, information from representatives of small entities that may potentially be affected by its proposed rules to assess the potential impacts of that rule on such small entities. 5 U.S.C. 609(b). Section 609(b) sets forth a series of procedural steps with regard to obtaining this information. The Bureau first notifies

the Chief Counsel for Advocacy (Chief Counsel) of the SBA and provides the Chief Counsel with information on the potential impacts of the proposed rule on small entities and the types of small entities that might be affected. 5 U.S.C. 609(b)(1). Not later than 15 days after receipt of the formal notification and other information described in section 609(b)(1) of the RFA, the Chief Counsel then identifies the SERs, the individuals representative of affected small entities for the purpose of obtaining advice and recommendations from those individuals about the potential impacts of the proposed rule. 5 U.S.C. 609(b)(2). The Bureau convenes a review panel for such rule consisting wholly of full-time Federal employees of the office within the Bureau responsible for carrying out the proposed rule, the Office of Information and Regulatory Affairs (OIRA) within the OMB, and the Chief Counsel. 5 U.S.C. 609(b)(3). The Small Business Review Panel reviews any material the Bureau has prepared in connection with the Small Business Review Panel process and collects the advice and recommendations of each individual SER identified by the Bureau after consultation with the Chief Counsel on issues related to sections 603(b)(3) through (b)(5) and 603(c) of the RFA.¹¹⁰ 5 U.S.C. 609(b)(4). Not later than 60 days after the date the Bureau convenes the Small Business Review Panel, the panel reports on the comments of the SERs and its findings as to the issues on which the Small Business Review Panel consulted with the SERs, and the report is made public as part of the rulemaking record. 5 U.S.C. 609(b)(5). Where appropriate, the Bureau modifies the rule or the IRFA in light of the foregoing process. 5 U.S.C. 609(b)(6).

In May 2012, the Bureau provided the Chief Counsel with the formal notification and other information required under section 609(b)(1) of the RFA. To obtain feedback from SERs to inform the Small Business Review Panel

pursuant to sections 609(b)(2) and 609(b)(4) of the RFA, the Bureau, in consultation with the Chief Counsel, identified 6 categories of small entities that may be subject to the proposed rule for purposes of the IRFA: Commercial banks, savings institutions, credit unions, mortgage brokers, real estate credit entities (non-depository lenders), and certain non-profit organizations. Section 3 of the IRFA, in part VIII.B.3, below, describes in greater detail the Bureau's analysis of the number and types of entities that may be affected by the proposed rule. Having identified the categories of small entities that may be subject to the proposed rule for purposes of an IRFA, the Bureau then, in consultation with the Chief Counsel, selected 17 SERs to participate in the Small Business Review Panel process. As described in chapter 7 of the Small Business Review Panel Report, described below, the SERs selected by the Bureau in consultation with the Chief Counsel included representatives from each of the categories identified by the Bureau and comprised a diverse group of individuals with regard to geography and type of locality (*i.e.*, rural, urban, suburban, or metropolitan areas).

On May 9, 2012, the Bureau convened the Small Business Review Panel pursuant to section 609(b)(3) of the RFA. Afterwards, to collect the advice and recommendations of the SERs under section 609(b)(4) of the RFA, the Small Business Review Panel held an outreach meeting/teleconference with the SERs on May 23, 2012. To help the SERs prepare for the outreach meeting beforehand, the Small Business Review Panel circulated briefing materials prepared in connection with section 609(b)(4) of the RFA that summarized the proposals under consideration at that time, posed discussion issues, and provided information about the SBREFA process generally.¹¹¹ All 17 SERs participated in the outreach meeting either in person or by telephone. The Bureau then held two teleconference calls with the SERs on June 7 and June 8, 2012, in which a potential provision under consideration requiring that origination fees in certain transactions not vary with the size of the loan was further discussed. At the request of

several SERs and in light of the additional calls, the Small Business Review Panel extended the SERs deadline to submit written feedback, which was originally June 4, 2012, to June 11, 2012. The Small Business Review Panel received written feedback from 11 of the representatives.¹¹²

On July 11, 2012,¹¹³ the Small Business Review Panel submitted to the Director of the Bureau, Richard Cordray, the Small Business Review Panel Report that includes the following: Background information on the proposals under consideration at the time; Information on the types of small entities that would be subject to those proposals and on the SERs who were selected to advise the Small Business Review Panel; a summary of the Small Business Review Panel's outreach to obtain the advice and recommendations of those SERs; a discussion of the comments and recommendations of the SERs; and a discussion of the Small Business Review Panel findings, focusing on the statutory elements required under section 603 of the RFA. 5 U.S.C. 609(b)(5).¹¹⁴

In preparing this proposed rule and the IRFA, the Bureau has carefully considered the feedback from the SERs participating in the Small Business Review Panel process and the findings and recommendations in the Small Business Review Panel Report. The section-by-section analysis of the proposed rule in part V, above, and the IRFA discuss this feedback and the specific findings and recommendations of the Small Business Review Panel, as applicable. The Small Business Review Panel process provided the Small Business Review Panel and the Bureau with an opportunity to identify and explore opportunities to minimize the burden of the rule on small entities while achieving the rule's purposes. It is important to note, however, that the Small Business Review Panel prepared the Small Business Review Panel Report at a preliminary stage of the proposal's development and that the Small Business Review Panel Report—in particular, the Small Business Review Panel's findings and recommendations—should be considered in that light. Also, any options identified in the Small Business Review Panel Report for reducing the

¹¹⁰ As described in the IRFA in part VIII.B, below, sections 603(b)(3) through (b)(5) and section 603(c) of the RFA, respectively require a description of and, where feasible, provision of an estimate of the number of small entities to which the proposed rule will apply; a description of the projected reporting, record keeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. 5 U.S.C. 603(b)(3), 603(b)(4), 603(b)(5), 603(c).

¹¹¹ The Bureau posted these materials on its Web site and invited the public to email remarks on the materials. See U.S. Consumer Fin. Prot. Bureau, *Small Business Review Panel for Residential Mortgage Loan Origination Standards Rulemaking: Outline of Proposals Under Consideration and Alternative Considered* (May 9, 2012) (Outline of Proposals), available at: http://files.consumerfinance.gov/f/201205_cfpb_MLO_SBREFA_Outline_of_Proposals.pdf.

¹¹² This written feedback is attached as Appendix A to the Small Business Review Panel Final Report discussed below.

¹¹³ The Panel extended its deliberations in order to allow full consideration and incorporation of the written comments of the SERs that were submitted pursuant to the extended deadline.

¹¹⁴ Small Business Review Panel Final Report, *supra* note 36.

proposed rule's regulatory impact on small entities were expressly subject to further consideration, analysis, and data collection by the Bureau to ensure that the options identified were practicable, enforceable, and consistent with TILA, the Dodd-Frank Act, and their statutory purposes. The proposed rule and the IRFA reflect further consideration, analysis, and data collection by the Bureau.

B. Initial Regulatory Flexibility Analysis

Under RFA section 603(a), an IRFA "shall describe the impact of the proposed rule on small entities." 5 U.S.C. 603(a). Section 603(b) of the RFA sets forth the required elements of the IRFA. Section 603(b)(1) requires the IRFA to contain a description of the reasons why action by the agency is being considered. 5 U.S.C. 603(b)(1). Section 603(b)(2) requires a succinct statement of the objectives of, and the legal basis for, the proposed rule. 5 U.S.C. 603(b)(2). The IRFA further must contain a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply. 5 U.S.C. 603(b)(3). Section 603(b)(4) requires a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the types of professional skills necessary for the preparation of the report or record. 5 U.S.C. 603(b)(4). In addition, the Bureau must identify, to the extent practicable, all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule. 5 U.S.C. 603(b)(5). The Bureau, further, must describe any significant alternatives to the proposed rule that accomplish the stated objectives of applicable statutes and that minimize any significant economic impact of the proposed rule on small entities. 5 U.S.C. 603(b)(6). Finally, as amended by the Dodd-Frank Act, RFA section 603(d) requires that the IRFA include a description of any projected increase in the cost of credit for small entities, a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and that minimize any increase in the cost of credit for small entities (if such an increase in the cost of credit is projected), and a description of the advice and recommendations of representatives of small entities relating to the cost of credit issues. 5 U.S.C. 603(d)(1); Dodd-Frank Act section 1100G(d)(1).

1. Description of the Reasons Why Agency Action Is Being Considered

As discussed in the Background, part II above, in the wake of the financial crisis, the Board in 2010 issued the Loan Originator Final Rule, which has been transferred to the Bureau. The Loan Originator Final Rule addressed many concerns regarding the lack of transparency, consumer confusion, and steering incentives created by certain residential loan originator compensation structures. The Dodd-Frank Act included a number of provisions that substantially paralleled, but also added further provisions to, the Loan Originator Final Rule. The Board noted in adopting the Loan Originator Final Rule that the Dodd-Frank Act would necessitate further rulemaking to implement the additional provisions of the legislation not reflected by the regulation. These provisions are new TILA sections 129B(b)(1) (requiring each mortgage originator to be qualified and include unique identification numbers on loan documents), (c)(1) and (c)(2) (prohibiting steering incentives including prohibiting mortgage originators from receiving compensation that varies based on loan terms and from receiving origination charges or fees from persons other than the consumer except in certain circumstances), and 129C(d) and (e) (prohibiting financing of single-premium credit insurance and providing restrictions on mandatory arbitration agreements), as added by sections 1402, 1403, 1414(d) and (e) of the Dodd-Frank Act. The Bureau is also proposing to clarify certain provisions of the existing Loan Originator Final Rule to provide additional guidance and reduce uncertainty. The Bureau is also soliciting comment on implementing the requirement in TILA section 129B(b)(2), as added by section 1402 of the Dodd-Frank Act, that it prescribe regulations requiring certain entities to establish and maintain certain procedures, a requirement that may be included in the final rule.

The Dodd-Frank Act and TILA authorize the Bureau to adopt implementing regulations for the statutory provisions provided by sections 1402, 1403, and 1414(d) and (e) of the Dodd-Frank Act. The Bureau is using this authority to propose regulations in order to provide creditors and loan originators with clarity about their statutory obligations under these provisions. The Bureau is also proposing to adjust or provide exemptions to the statutory requirements, including the obligations of small entities, in certain circumstances. The Bureau is taking this

action in order to ease burden when doing so would not sacrifice adequate protection of consumers.

The new statutory requirements relating to qualification and compensation take effect automatically on January 21, 2013, as written in the statute, unless final rules are issued on or prior to that date that provide for a later effective date.¹¹⁵

2. Statement of the Objectives of, and Legal Basis for, the Proposed Rule

The objectives of this rulemaking are: (1) To revise current § 1026.36 and commentary to implement substantive requirements in new TILA sections 129B(b), (c)(1), and (c)(2) and 129C(d) and (e), as added by sections 1402, 1403, and 1414(d) and (e) of the Dodd-Frank Act; (2) to clarify ambiguities between current § 1026.36 and the new TILA amendments; (3) to adjust existing rules governing compensation to individual loan originators to account for Dodd-Frank Act amendments to TILA; and (4) to provide greater clarity, guidance, and flexibility on several issues.

To address consumer confusion over the relationship between certain upfront loan charges and loan interest rates, the proposal would require that, in certain circumstances, before the creditor or loan originator organization may impose upfront discount points, origination points, or origination fees on a consumer, the creditor must make available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees that are retained by the creditor, loan originator organization, or an affiliate of either. (Making available the comparable, alternative loan is not necessary if the consumer is unlikely to qualify for such a loan.) The proposed use of the Bureau's exception authority under TILA section 129B(c)(2)(B)(ii) to allow creditors and loan originator organization to impose discount points and origination points or fees provided that the creditor makes available a comparable, alternative loan, as described above, will implement TILA section 129B(c)(2)(B) and make it easier for consumers to understand terms and evaluate pricing options while preserving their ability to make and receive the benefit of some upfront payments of points and fees. In addition to reducing consumer confusion, the proposal would also avoid a radical restructuring of existing mortgage market pricing structures that may

¹¹⁵ See Small Business Review Panel Report for a detailed discussion of the issues related to the effective dates of the rules in this rulemaking.

result from strict implementation of the Dodd-Frank Act and thus would promote stability in the mortgage market.

The proposal would also implement certain other Dodd-Frank Act requirements applicable to both closed-end and open-end mortgage credit. Specifically, the proposed provisions would codify TILA section 129C(d), which creates prohibitions on financing of premiums for single-premium credit insurance. The proposed provisions would also implement TILA section 129C(e), which restricts agreements requiring consumers to submit any disputes that may arise to mandatory arbitration, thereby preserving consumers' ability to seek redress through the court system after a dispute arises. The proposal also solicits comment on implementing TILA section 129B(b)(2), which requires the Bureau to prescribe regulations requiring depository institutions to establish and monitor compliance of such depository institutions, the subsidiaries of such institutions, and the employees of both with the requirements of TILA section 129B and the registration procedures established under section 1507 of the SAFE Act.

In addition to creating new substantive requirements, the Dodd-Frank Act extended previous efforts by lawmakers and regulators to strengthen loan originator qualification requirements and regulate industry compensation practices. New TILA section 129B(b) imposes a duty on loan originators to be "qualified" and, where applicable, registered or licensed as a loan originator under State law and the Federal SAFE Act and to include unique identification numbers on loan documents. The proposal would implement this section and expand consumer protections by requiring entities whose individual loan originators are not subject to SAFE Act licensing requirements, including depositories and bona fide nonprofit loan originator entities, to: (1) Ensure that their individual loan originators meet character and fitness and criminal background standards equivalent to the licensing standards that the SAFE Act applies to employees of non-bank loan originators; and (2) provide appropriate training to their individual loan originators commensurate with the mortgage origination activities of the individual.

Furthermore, the proposal would adjust existing rules governing compensation to individual loan originations in connection with closed-end mortgage transactions to account for Dodd-Frank Act amendments to TILA

and provide greater clarity and flexibility. Specifically, the proposed provisions would preserve, with some refinements, the prohibition on the payment or receipt of commissions or other loan originator compensation based on the terms of the transaction (other than loan amount) and on loan originators being compensated simultaneously by both consumers and other parties in the same transaction. To further reduce potential steering incentives for loan originators created by certain compensation arrangements, the proposed rule would also clarify and revise restrictions on pooled compensation, profit-sharing, and bonus plans for loan originators, depending on the potential for incentives to steer consumers to different transaction terms.

Finally, the proposal would make two changes to the current record retention provisions of § 1026.25 of TILA. The proposed provisions would: (1) Require a creditor to maintain records of the compensation paid to a loan originator organization or the creditor's individual loan originators, and the governing compensation agreement, for three years after the date of payment; and (2) require a loan originator organization to maintain records of the compensation it receives from a creditor, a consumer, or another person and that it pays to its individual loan originators, as well as the compensation agreement that governs those receipts or payments, for three years after the date of the receipts or payments. In addition, creditors would be required to make and maintain, for three years, records to show that they made available to a consumer a comparable, alternative loan when required by the proposed rule and complied with the requirement that where discount points and origination points or fees are charged, there be a bona fide reduction in the interest rate compared to the interest rate for the comparable, alternative loan. By ensuring that records associated with loan originator compensation are retained for a time period commensurate with the statute of limitations for causes of action under TILA section 130 and are readily available for examination, these proposed modifications to the existing recordkeeping provisions will prevent circumvention or evasion of TILA and facilitate compliance.

The legal basis for the proposed rule is discussed in detail in the legal authority analysis in part IV and in the section-by-section analysis in part V, above.

3. Description and, Where Feasible, Provision of an Estimate of the Number of Small Entities To Which the Proposed Rule Will Apply

For purposes of assessing the impacts of the proposals under consideration on small entities, "small entities" are defined in the RFA to include small businesses, small non-profit organizations, and small government jurisdictions. 5 U.S.C. 601(6). A "small business" is determined by application of SBA regulations and reference to the North American Industry Classification System ("NAICS") classifications and size standards.¹¹⁶ 5 U.S.C. 601(3). A "small organization" is any "not-for-profit enterprise which is independently owned and operated and is not dominant in its field." 5 U.S.C. 601(4). A "small governmental jurisdiction" is the government of a city, county, town, township, village, school district, or special district with a population of less than 50,000. 5 U.S.C. 601(5).

During the Small Business Review Panel process, the Bureau identified six categories of small entities that may be subject to the proposed rule for purposes of the RFA:

- Commercial banks (NAICS 522110);
 - Savings institutions (NAICS 522120);¹¹⁷
 - Credit unions (NAICS 522130);
 - Firms providing real estate credit (NAICS 522292);
 - Mortgage brokers (NAICS 522310);
- and
- Small non-profit organizations.

Commercial banks, savings institutions, and credit unions are small businesses if they have \$175 million or less in assets. Firms providing real estate credit and mortgage brokers are small businesses if their average annual receipts do not exceed \$7 million.

A small non-profit organization is any not-for-profit enterprise that is independently owned and operated and is not dominant in its field. Small non-profit organizations engaged in loan origination typically perform a number of activities directed at increasing the supply of affordable housing in their communities. Some small non-profit organizations originate mortgage loans for low and moderate-income individuals while others purchase loans originated by local community development lenders.

The following table provides the Bureau's estimated number of affected and small entities by NAICS Code and engagement in loan origination:

¹¹⁶ The current SBA size standards are available on the SBA's Web site at <http://www.sba.gov/content/table-small-business-size-standards>.

¹¹⁷ Savings institutions include thrifts, savings banks, mutual banks, and similar institutions.

Category	NAICS Code	Total entities	Small entities	Entities that originate any mortgage loans ^b	Small entities that originate any mortgage loans
Commercial Banking	522110	6,596	3,764	^a 6,362	^a 3,597
Savings Institutions	522120	1,145	491	^a 1,138	^a 487
Credit Unions	522130	7,491	6,569	^a 4,359	^a 3,441
Real Estate Credit ^{c,e}	522292	2,515	2,282	2,515	^a 2,282
Mortgage Brokers ^e	522310	8,051	8,049	^d N/A	^d N/A
Total	25,798	21,155	14,374	9,807

Source: HMDA, Bank and Thrift Call Reports, NCUA Call Reports, NMLSR Mortgage Call Reports.

^a For HMDA reporters, loan counts from HMDA 2010. For institutions that are not HMDA reporters, loan counts projected based on Call Report data fields and counts for HMDA reporters.

^b Entities are characterized as originating loans if they make one or more loans. If loan counts are estimated, entities are counted as originating loans if the estimated loan count is greater than one.

^c NMLSR Mortgage Call Report ("MCR") for Q1 and Q2 of 2011. All MCR reporters that originate at least one loan or that have positive loan amounts are considered to be engaged in real estate credit (instead of purely mortgage brokers). For institutions with missing revenue values revenues were imputed using nearest neighbor matching of the count of originations and the count of brokered loans.

^d Mortgage Brokers do not originate (back as a creditor) loans.

^e Data do not distinguish nonprofit from for-profit organizations, but Real Estate Credit and Mortgage Brokers categories presumptively include nonprofit organizations.

4. Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Proposed Rule, Including an Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and the Type of Professional Skills Necessary for the Preparation of the Report

(1) Reporting Requirements

The proposed rule does not impose new reporting requirements.

(2) Recordkeeping Requirements

Regulation Z currently requires creditors to create and maintain records to demonstrate their compliance with provisions that apply to the compensation paid to or received by a loan originator. As discussed above in part V, the proposed rule would require creditors to retain these records for a three-year period, rather than for a two-year period as currently required. The Bureau is soliciting comment on extending the record retention period to five years. The proposed rule would apply the same requirement to organizations when they act as a loan originator in a transaction, even if they do not act as a creditor in the transaction. The proposed recordkeeping requirements, however, would not apply to individual loan originators. In addition, creditors would be required to make and maintain records for three years to show that they made available to a consumer a comparable, alternative loan when required by this proposed rule and complied with the requirement that where discount points and origination points or fees are charged, there be bona fide reduction in the interest rate compared to the interest rate for the comparable, alternative loan. The Bureau is also soliciting comment on

extending this record retention period to five years.

As discussed in the section-by-section analysis, the Bureau recognizes that extending the record retention requirement for creditors from two years for specific information related to loan originator compensation and discount points and origination points and fees, as currently provided in Regulation Z, to three years may result in some increase in costs for creditors. The Bureau believes, however, that creditors should be able to use existing recordkeeping systems to maintain the records for an additional year at minimal cost. Similarly, although loan originator organizations may incur some costs to establish and maintain recordkeeping systems, loan originator organizations may be able to use existing recordkeeping systems that they maintain for other purposes at minimal cost. During the Small Business Review Panel process, the SERs were asked about their current record retention practices and the potential impact of the proposed enhanced record retention requirements. Of the few SERs who provided feedback on the issue, one creditor stated that it maintained detailed records of compensation paid to all of its employees and that a regulator already reviews its compensation plans regularly, and another creditor reported that it did not believe the proposed record retention requirement would require it to change its current practices. Therefore, the Bureau does not believe that the record retention requirements will create undue burden for small entity creditors and loan originator organizations.

(3) Compliance Requirements

The proposal contains both specific proposed provisions with regulatory or

commentary language (proposed provisions) as well as requests for comment on modifications where regulatory or commentary language was not specifically included (additional proposed modifications). The possible compliance costs for small entities from each major component of the proposed rule are presented below. In most cases, the Bureau presents these costs against a pre-statute baseline. As noted above in the section 1022(b)(2) analysis in part VII above, provisions where the Bureau has used its exemption authority are discussed relative to the statutory provisions (a post-statute baseline). The analysis below considers the benefits, costs, and impacts of the following major proposed provisions on small entities:

1. Upfront points and fees
 2. Compensation based on transaction's terms
 3. Qualification for mortgage originators
- (a) Upfront Points and Fees

The Dodd-Frank Act prohibits consumer payment of upfront points and fees in all residential mortgage loan transactions (as defined in the Dodd-Frank Act) except those where no one other than the consumer pays a loan originator compensation tied to the transaction (e.g., a commission). As discussed in the Background and section-by-section analysis, the Bureau is proposing to require that before a creditor or loan originator may impose discount points and origination points or fees on a consumer, the creditor must make available to the consumer a comparable, alternative loan that does not include such points or fees. (Making available the comparable, alternative loan is not necessary if the consumer is unlikely to qualify for such a loan.)

The Bureau is proposing two safe harbors for how a creditor may comply with the requirement to make available a comparable, alternative loan (unless the consumer is unlikely to qualify for the loan). In transactions that do not involve a mortgage broker, a creditor will be deemed to have made available a comparable, alternative loan to a consumer if, any time prior to application that the creditor provides to the consumer an individualized quote for a loan that includes discount points and origination points or fees, the creditor also provides a quote for the comparable, alternative loan. In transactions that involve mortgage brokers, a creditor will be deemed to have made a comparable, alternative loan available to consumers if it provides to mortgage brokers the pricing for all of its comparable, alternative loans that do not include discount points and origination points or fees. Mortgage brokers then will provide quotes to consumers for loans that do not include discount points and origination points or fees when presenting different loan options to consumers. The requirement would not apply where the consumer is unlikely to qualify for the comparable, alternative loan.

The Bureau is also seeking comment on a number of related issues, including whether the Bureau should adopt a “bona fide” requirement to ensure that consumers receive value in return for paying discount points and origination points or fees, and different options for structuring such a requirement; whether additional adjustments to the proposal concerning the treatment of affiliate fees would make it easier for consumers to compare offers between two or more creditors; whether to take a different approach concerning situations in which a consumer does not qualify for a comparable, alternative loan that does not include discount points and origination points or fees; and whether to require information about a comparable, alternative loan be provided not just in connection with informal quotes, but also in advertising and at the time that consumers are provided disclosures three days after application. These issues are described in more detail in the section-by-section analysis, above.

Benefits for Small Entities: The Bureau’s proposal with regard to points and fees has a number of potential benefits for small entities. First, relative to the Dodd-Frank Act ban on points and fees, allowing consumers to pay upfront discount points and origination points or fees in transactions in certain circumstances would increase the range

of mortgage transactions available to consumers. Thus, the increased range of payment options would allow small creditors and loan originator organizations to be more flexible in marketing different mortgage loan products to consumers. The availability of different payment options also would enhance the ability of small creditors and loan originator organizations to enter into certain mortgage loan transactions with consumers. Furthermore, a consumer’s ability to refinance is costly to the creditor. Preserving consumers’ ability to choose to pay interest upfront in the form of discount points would reduce the ultimate cost to creditors from both loan default and prepayment.

Moreover, the ability of small creditors to charge discount points in exchange for lower interest rates would accommodate those consumers who prefer to pay more at settlement in exchange for lower monthly interest charges and could produce a greater volume of available credit in residential mortgage markets. Preserving this ability would potentially allow a wider access to homeownership, which would benefit consumers, creditors, loan originator organizations, and individual loan originators. The ability to charge origination fees up front also would allow small creditors to recover fixed costs at the time they are incurred rather than over time through increased interest payments or through the secondary market prices. And, similarly, preserving the flexibility for affiliates of creditors and loan originator organizations to charge fees upfront should allow for these firms to charge directly for their services. This means that creditors and loan originator organizations may be less likely to divest such entities than if the Dodd-Frank Act mandate takes effect as written.

Costs for Small Entities: As described, in the absence of the proposed rule in which the Bureau exercises its exemption authority, generally the only mortgage transactions permitted pursuant to the Dodd-Frank Act would be loans that do not include any discount points and origination points or fees. Under the proposed rule, creditors would be required in most instances to make available these loans. (Making available the comparable, alternative loan is not necessary if the consumer is unlikely to qualify for such a loan.) To ease compliance burdens, the Bureau is proposing two safe harbors for how a creditor may comply with the requirement to make available a comparable, alternative loan available.

The requirement that creditors must generally make available loans that do not include discount points and origination points or fees (unless the consumer is unlikely to qualify for such a loan) would impose some restrictions on small creditors and loan originator organizations. As discussed in part VII, this requirement may impose costs on smaller entities with more limited access to the secondary market or to affordable hedging opportunities. There may be instances where a consumer’s choice of the comparable, alternative loan from a small creditor increases that firm’s financial risk; however for the reasons discussed, the Bureau believes such instances would be rare. The Bureau seeks comment on the costs to small entities from this requirement.

The proposed rule also solicits comment on whether the Bureau should adopt a “bona fide” requirement to ensure that consumers receive value in return for paying discount points and origination points or fees, and different options for structuring such a requirements. To the extent the final rule imposes a bona fide requirement that departs from current market pricing practices, this condition may restrict small entities’ flexibility in pricing. Implementing a requirement that the payment of discount points and origination points or fees be bona fide may also impose additional compliance and monitoring costs. Small creditors may already need to determine and monitor when discount points are bona fide for the purposes of the Bureau’s forthcoming ATR rulemaking; and to the extent that the definitions of bona fide discount points in the ATR context and bona fide discount points and origination points or fees are similar, the additional costs would be reduced. Regarding compliance, the proposal seeks comments on market based approaches or approaches based on firms’ own pricing policies; in either case, compliance would likely entail increased records retention.

Moreover, the Bureau is soliciting comment on whether to require information about the comparable, alternative loan to be provided not just in connection with informal quotes, but also in advertising and after application by providing a Loan Estimate, or the first page of the Loan Estimate, which is the integrated disclosures under TILA and RESPA proposed by the Bureau in the TILA-RESPA Integration Proposal.

Changes to the advertising rules under Regulation Z are unlikely to raise specific costs of compliance for small entities, apart from those costs associated with learning about and adjusting to any new regulations. The

requirement to provide the Loan Estimate for the comparable, alternative loan would marginally increase cost for some small entity originators. The Bureau seeks comments on the specific impacts these alternatives may have for small entities.

(b) Compensation Based on Transaction Terms

The proposed rule clarifies and revises restrictions on pooled compensation, profit-sharing, and bonus plans for loan originators, depending on the potential incentives to steer consumers to different transaction terms. As discussed in the section-by-section analysis to proposed 1026.36(d)(1)(iii), the proposal regarding bonus plans would permit employers to make contributions from general profits derived from mortgage activity to 401(k) plans, employee stock option plans, and other “qualified plans” under section 401(a) of the IRC and ERISA, as applicable, and also would permit employers to pay bonuses or make contributions to non-qualified profit-sharing or retirement plans from general profits derived from mortgage activity if: (1) The loan originator affected has originated five or fewer mortgage transactions during the last 12 months; or (2) the company’s mortgage business revenues are limited (the Bureau is seeking comment on whether 50 percent or 25 percent of total revenues would be an appropriate test for such limitation, and on other related issues). The Bureau is also proposing, to permit compensation funded by general profits derived from mortgage activity in the form of bonuses and other payments under profit-sharing plans and contributions to non-qualified defined benefit or contribution plans where an individual loan originator is the loan originator for five or fewer transactions within the 12-month period preceding the payment of the compensation. Even though contributions and bonuses could be funded from general mortgage profits, the amounts paid to individual loan originators could not be based on the terms of the transactions that the individual had originated.

With respect to the proposal to permit bonuses under profit-sharing plans and contributions to non-qualified retirement plans where the revenues of the mortgage business do not exceed a certain percentage of the total revenues of the organization (or, as applicable, the business until to which the profit-sharing plan applies), for small depository institutions and credit unions (defined as those institutions with assets under \$175 million), regulatory data from 2010 indicate that

at the higher threshold of 50 percent of total revenue, roughly 2 percent of small commercial banks (about 75 banks) and 3 percent of small credit unions (about 200 credit unions) would remain subject to the proposed restrictions. Using a lower threshold of 25 percent of revenue, roughly 28 percent of small commercial banks and 22 percent of small credit unions would be subject to the proposed restrictions. The numbers are larger and more significant for small savings institutions whose primary business focus is on residential mortgages. At the higher threshold, 59 percent of these firms would be restricted from paying bonuses based on mortgage-related profits to their individual loan originators.¹¹⁸ The Bureau lacks comprehensive data on nonbank lenders and, in particular, does not have information regarding the precise range of business activities that such companies engage in. As a result, it is unclear at this time the extent to which such nonbank lenders will face restrictions on their compensation practices.

Firms that did not change their compensation practices in response to the current rule and the Dodd-Frank Act and, thus, currently offer compensation arrangements that would be prohibited under the proposed rule, will incur costs. These include costs from changing internal accounting practices, renegotiating the remuneration terms in the contracts of existing employees, and any other industry practice related to these methods of compensation. For these firms, the prohibition on compensation based on transaction terms may contribute to adverse selection among individual loan originators, a possible lower average quality of individual loan originators in such a firm, and higher retention costs. The discrete nature of the threshold also implies that some loan originators may now suffer the disadvantage of facing competitors with fewer restrictions on compensation. These potential differential effects may be greater for small entities. The Bureau seeks comments and data on the current compensation practices of those firms at or above the thresholds.

During the Small Business Review Panel process, a SER stated that there should be no threshold limit because

¹¹⁸ Estimates are based on 2010 Call Report data. Revenue from loan originations is assumed to equal fee and interest income from 1–4 family residences as reported. To the extent that other revenue on the Call Reports is tied to loan originations, these numbers may be underestimated. Revenue estimates for credit unions are not available; instead, the percentage of assets held in 1–4 family residential real estate is used instead.

any limit would disadvantage small businesses that originate only mortgages. In response to this and other SERs feedback, the Small Business Review Panel recommended that the Bureau seek public comment on the ramifications for small businesses and other businesses of setting the revenue limit at 50 percent of company revenue or at other levels. The Small Business Review Panel also recommended that the Bureau solicit comment on the treatment of qualified and non-qualified plans and whether treating qualified plans differently than non-qualified plans would adversely affect small lenders and brokerages relative to large lenders and brokerage. While the Bureau expects that for some small entities, the de minimis exception should address some of the concerns expressed by the SERs through the Small Business Review Panel process, the Bureau is seeking comment on these issues.

(c) Loan Originator Qualification Requirements

The proposal would implement a Dodd-Frank Act provision requiring both individual loan originators and their employers to be “qualified” and to include their license or registration numbers on loan documents. Where an individual loan originator is not already required to be licensed under the SAFE Act, the proposal would require his or her employer to ensure that the individual loan originator meets character, fitness, and criminal background check standards that are equivalent to SAFE Act requirements and receives training commensurate with the individual loan originator’s duties. Employers would be required to ensure that their individual loan originator employees are licensed or registered under the SAFE Act where applicable. Employers and the individual loan originators that are primarily responsible for a particular transaction would be required to list their license or registration numbers on key loan documents along with their names.

Costs to Small Entities: Employees of depositories and bona fide non-profit organizations do not have to meet the SAFE Act standards that apply only to licensing, such as taking pre-licensure classes, passing a test, meeting character and fitness standards, having no felony convictions within the previous seven years, or taking annual continuing education classes. The proposed rule would require these institutions to adopt character and criminal record screening and ongoing training requirements. However, the Bureau

believes that many of these entities already have adopted screening and training requirements, either to satisfy safety-and-soundness requirements or as a matter of good business practice.

For any entity that adopted screening and training requirements in the first instance, the Bureau estimates the costs to include the cost of a criminal background check and the time involved in checking employment and character references of an applicant. The time and cost required to provide occasional, appropriate training to individual loan originators will vary greatly depending on the lending activities of the entity and the skill and experience level of the individual loan originators; however, the Bureau anticipates that the training that many non-profit and depository individual loan originator employees already receive will be adequate to meet the proposed requirement. The Bureau expects that in no case would the training needed to satisfy the proposed requirement be more comprehensive, time-consuming, or costly than the online training approved by the NMLSR to satisfy the continuing education requirement imposed under the SAFE Act on those individuals who are subject to state licensing.

The requirement to include the NMLSR unique identifiers and names of loan originators on loan documents may impose some additional costs relative to current practice. However, this may be mitigated by the fact that the Federal Housing Finance Agency already requires the NMLSR numerical identifier of individual loan originators and loan originator organizations to be included on all loan applications for Fannie Mae and Freddie Mac loans.

(d) Other Provisions

(i) *Mandatory Arbitration and Credit Insurance*: The proposal would implement the Dodd-Frank Act requirements that prohibit agreements requiring consumers to submit any disputes that may arise to mandatory arbitration rather than filing suit in court and that ban the financing of premiums for credit insurance. Firms may incur some compliance cost such as amending standard contract form to reflect these changes.

(ii) *Dual Compensation, Pricing Concessions, and Proxies*: The proposed rule contains provisions that would adjust existing rules governing compensation to individual loan originations in connection with closed-end mortgage transactions to account for Dodd-Frank Act amendments to TILA and provide greater clarity and flexibility.

These proposed provisions would preserve the current prohibition on the payment or receipt of commissions or other loan originator compensation based on the terms of the transaction (other than loan amount) and on loan originators being compensated simultaneously by both consumers and other parties in the same transaction. The proposal would, however, revise the Loan Originator Final Rule to provide that if a loan originator organization receives compensation directly from a consumer in connection with a transaction, the loan originator organization may pay compensation in connection with the transaction (e.g., a commission) to individual loan originators and the individual loan originators may receive compensation from the loan originator organization. The proposed rule also would clarify that payments to a loan originator paid on the consumer's behalf by a person other than a creditor or its affiliates, such as a non-creditor seller, home builder, home improvement contractor, or realtor, are considered compensation received directly from the consumer if they are made pursuant to an agreement between the consumer and the person other than the creditor or its affiliates.

In addition, the proposed rule would allow reductions in loan originator compensation in a limited set of circumstances where there are unanticipated increases in closing costs from non-affiliated third parties in a violation of applicable law (such as a tolerance violation under Regulation X). The proposed rule would also provide additional guidance on determining whether a factor used as a basis for compensation is prohibited as a "proxy" for a transaction term.

These provisions will provide greater flexibility, relative to the statutory provisions of the Dodd-Frank Act, for firms needing to comply with the regulations. This greater clarity and flexibility should lower any costs of compliance for small entities by, for example, reducing costs for attorneys and compliance officers as well as potential costs of over-compliance and unnecessary litigation. These provisions of the proposed rule would therefore reduce the compliance burdens on small entities. The Bureau seeks comments on the specific impacts these provisions may have for small entities.

(4) Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and the Type of Professional Skills Necessary for the Preparation of the Report or Record

Section 603(b)(4) of the RFA requires an estimate of the classes of small

entities that will be subject to the requirements. The classes of small entities that will be subject to the reporting, recordkeeping, and compliance requirements of the proposed rule are the same classes of small entities that are identified above in part VIII.

Section 603(b)(4) of the RFA also requires an estimate of the type of professional skills necessary for the preparation of the reports or records. The Bureau anticipates that the professional skills required for compliance with the proposed rule are the same or similar to those required in the ordinary course of business of the small entities affected by the proposed rule. Compliance by the small entities that will be affected by the proposed rule will require continued performance of the basic functions that they perform today.

5. Identification, to the Extent Practicable, of All Relevant Federal Rules Which May Duplicate, Overlap, or Conflict With the Proposed Rule

The proposal contains restrictions on loan originator compensation practices, prerequisites to the making of a mortgage transaction with discount points and origination points or fees under most circumstances, requirements for loan originators to be qualified and licensed or registered, and restrictions on mandatory arbitration and the financing of certain credit insurance premiums. The Bureau has identified certain other Federal rules that relate in some fashion to these areas and has considered to what extent they may duplicate, overlap, or conflict with this proposal. Each of these is discussed below.

The Bureau's Regulation X, 12 CFR part 1024, implements RESPA. The regulation requires, among other things, the disclosure to consumers pursuant to RESPA of real estate settlement costs. The settlement costs required to be disclosed under Regulation X include discount points and origination charges. See 12 CFR part 1024, app. C. Thus, Regulation X governs the disclosure of certain charges that this proposal would regulate substantively. The Bureau believes, however, that substantive restrictions on the charging of discount points and origination points or fees, as well as substantive restrictions on loan originator compensation, are distinct and independent from rules governing how such charges must be disclosed. Accordingly, the Bureau does not believe this proposal duplicates, overlaps, or conflicts with Regulation X.

The Bureau's Regulations G, 12 CFR part 1007, and H, 12 CFR part 1008,

implement the SAFE Act. Those regulations include the requirements pursuant to the SAFE Act that individual loan originators be qualified and licensed or registered, as applicable. As noted, this proposal also contains certain qualification, registration, and licensing requirements. This proposal, however, supplements the existing requirements of Regulations G and H, to the extent they apply to persons subject to this proposal's requirements. Where a person is already subject to the same kind of requirement that this proposal imposes pursuant to Regulation G or H, this proposal cross-references the existing requirement to avoid duplication. The Bureau believes this proposal therefore does not duplicate, overlap, or conflict with Regulations G and H. If the Bureau implements TILA section 129B(b)(2) in the final rule, the Bureau will endeavor to minimize any potential overlap with the procedures currently required by Regulation G.

In the section-by-section analysis to § 1026.36(d)(1)(i), above, the Bureau notes the Interagency Guidance on incentive compensation. 75 FR 36395 (Jun. 17, 2010). As discussed there, the Interagency Guidance was issued to help ensure that incentive compensation policies at large depository institutions do not encourage imprudent risk-taking and are consistent with the safety and soundness of the institutions. As also noted above, however, the Bureau's proposed rule does not affect the Interagency Guidance on loan origination compensation. While certain compensation practices may violate either the Interagency Guidance or this proposal but not the other, no practice is mandated by one and also prohibited by the other. Accordingly, the Bureau believes that this proposal does not conflict with the Interagency Guidance. The Bureau also believes that there is no duplication or overlap between the two.

In addition to existing Federal rules, the Bureau is also in the process of several other rulemakings relating to mortgage credit to implement requirements of the Dodd-Frank Act. These other rulemakings are discussed in part II.E, above. As noted there, the Bureau is coordinating carefully the development of those proposals and final rules. Among those that include provisions potentially intersecting with this proposal are the TILA-RESPA Integration, HOEPA, and ATR rulemakings.

- Under the TILA-RESPA Integration Proposal, the integrated disclosures must include an NMLSR ID, which parallels proposed § 1026.36(g)(1)(ii) in this notice. The Bureau has sought to

avoid duplication, overlap, or conflict in this regard through proposed comment 36(g)(1)(ii)-1, which states that an individual loan originator may comply with the requirement in § 1026.36(g)(1)(ii) by complying with the applicable provision governing disclosure of NMLSR IDs in rules issued by the Bureau under the TILA-RESPA Integration rulemaking.

The ATR and HOEPA rulemakings both involve the concept of bona fide discount points. As discussed in the section-by-section analysis to proposed § 1026.36(d)(2)(ii)(C), this proposal includes an analogous concept in providing that no discount points and origination points or fees may be imposed on the consumer in certain transactions unless there is a bona fide reduction in the interest rate. The same discussion refers to the 2011 ATR Proposal and notes the parallel, while also recognizing that the two contexts may not necessarily call for an identical definition of "bona fide" given the differences between the purposes and scope of the requirements. The Bureau intends to coordinate carefully between this rulemaking and the ATR and HOEPA rulemakings with respect to any definitions of bona fide for their respective purposes, to ensure that they create no duplication, overlap, or conflict.

6. Description of Any Significant Alternatives to the Proposed Rule Which Accomplish the Stated Objectives of Applicable Statutes and Minimize Any Significant Economic Impact of the Proposed Rule on Small Entities

a. Payments of Upfront Points and Fees

The Dodd-Frank Act prohibits consumers from making an "upfront payment of discount points, origination points, or fees" to a loan originator, creditor, or their affiliates in all retail and wholesale loan originations where the loan originator is compensated by creditors or brokerage firms. During the Small Business Review Panel process, one proposal the Bureau presented to the SERs for consideration concerned the nature of permissible origination fees. Specifically the Bureau asked the SERs to provide feedback on the proposal that consumers could, at the time of origination, remit to the loan originator, creditor, or their affiliates payment for bona fide or third-party charges connected with this origination, if these fees were independent of the size of the loan as well as its terms.

This condition reflected the Bureau's belief that the actual costs incurred in originating a loan, whether in the

wholesale or retail market, did not vary materially with the size of the initial loan balance. Under such constant costs, the requirement that fees not vary with the balance would benefit consumers in two distinct ways. First, it would likely improve market efficiency by requiring fees to consumers to mirror the actual costs of loan origination, precisely as they would in a competitive market, and consequently lower consumer costs. Second, it would eliminate a potential source of misinterpretation by consumers by essentially precluding originators from using the term "points" when referring to both origination points (charges to the borrower for originating the loan) and discount points (charges to the borrower that are exchanged for future interest payments).

Industry, through both the Small Business Review Panel process and outreach, and consumer groups raised concerns with this proposal. SERs, in particular, raised objections focusing on the potential that the requirement would disadvantage smaller creditors. SERs and others also raised objections to the validity of the assumption of constant origination costs.

Several SERs participating in Small Business Review Panel and participants in outreach calls asserted that, contrary to the Bureau's supposition, the economic costs of origination do vary with the loan balance and related loan characteristics. Two robust examples were cited in support of this assertion. The first involved GSE-imposed loan level pricing adjustments based on loan balance, which are incurred in the sale of mortgages to the secondary market. The second involved loans subsidized through the provision of an FHA or VA-funded financial guarantee against default by the primary borrower. More extensive services are required to originate such a loan, including efforts expended on consumer qualification and on certification of the terms of the guarantee per dollar of initial loan balance, than are required on a conventional loan.

In addition, certain costs of hedging risk, incurred by creditors during and after origination vary with loan size. The most common example of this is the cost to the creditor of buying various forms of derivative securities to hedge the financial risks of newly-originated mortgage loans, the costs of which do vary with loan size and are incurred by creditors merely warehousing such loans for resale and those intending to hold these mortgages in portfolio.

In response to the feedback it obtained from the SERs during the Small Business Review Panel process, as well as feedback obtained through

other outreach efforts, the Bureau has not proposed to restrict origination fees from varying with the size of the loan. Instead, an alternative provision, developed with the benefit of the SERs that met with the Small Business Review Panel as well as additional outreach to industry and consumer groups, would require a creditor to make available to a consumer a comparable, alternative loan that does not include discount points and origination points or fees as a prerequisite to the creditor or loan originator organization imposing discount points and origination points or fees on the consumer in the transaction (unless the consumer is unlikely to qualify for the comparable, alternative loan). Further, no discount points and origination points or fees could be imposed on the consumer unless there was a bona fide reduction in the interest rate. These provisions within the Bureau's current proposal are designed to accomplish a similar purpose as the flat fee requirement, namely to ensure that consumers are in the position to shop and receive value for origination points and fees, but do so in a way to minimize adverse consequences for industry and consumers that the flat fee requirement might entail.

7. Discussion of Impact on Cost of Credit for Small Entities

Section 603(d) of the RFA requires the Bureau to consult with small entities regarding the potential impact of the proposed rule on the cost of credit for small entities and related matters. 5 U.S.C. 603(d). To satisfy this statutory requirement, the Bureau notified the Chief Counsel on May 9, 2012, that the Bureau would collect the advice and recommendations of the same SERs identified in consultation with the Chief Counsel during the Small Business Review Panel process concerning any projected impact of the proposed rule on the cost of credit for small entities.¹¹⁹ The Bureau sought and collected the advice and recommendations of the SERs during the Small Business Review Panel Outreach Meeting regarding the potential impact on the cost of business credit, since the SERs, as small providers of financial services, could also provide valuable input on any such impact related to the proposed rule.¹²⁰

¹¹⁹ See 5 U.S.C. 603(d)(2)(A). The Bureau provided this notification as part of the notification and other information provided to the Chief Counsel with respect to the Small Business Review Panel process pursuant to section 609(b)(1) of the RFA.

¹²⁰ See 5 U.S.C. 603(d)(2)(B).

The Bureau had no evidence at the time of the Small Business Review Panel Outreach Meeting that the proposals then under consideration would result in an increase in the cost of business credit for small entities under any plausible economic conditions. The proposals under consideration at the time applied to consumer credit transactions secured by a mortgage, deed of trust, or other security interest on a residential dwelling or a residential real property that includes a dwelling, and the proposals would not apply to loans obtained primarily for business purposes.¹²¹

At the Small Business Review Panel Outreach Meeting, the Bureau specifically asked the SERs a series of questions regarding any potential increase in the cost of business credit. Specifically, the SERs were asked if they believed any of the proposals under consideration would impact the cost of credit for small entities and, if so, in what ways and whether there were any alternatives to the proposals being considered that could minimize such costs while accomplishing the statutory objectives addressed by the proposal.¹²² Although some SERs expressed the concern that any additional federal regulations, in general, had the potential to increase credit and other costs, all SERs responding to these questions stated that the proposals under consideration in this rulemaking would have little to no impact on the cost of credit to small businesses.

Based on the feedback obtained from SERs at the Small Business Review Panel Outreach Meeting, the Bureau currently has no evidence that the proposed rule would result in an increase in the cost of credit for small business entities. In order to further evaluate this question, the Bureau solicits comment on whether the proposed rule would have any impact on the cost of credit for small entities.

IX. Paperwork Reduction Act

A. Overview

The Bureau's collection of information requirements contained in this proposal, and identified as such, will be submitted to the Office of Management and Budget (OMB) for review under section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) (Paperwork Reduction Act or PRA) on or before

¹²¹ See Outline of Proposals at appendix A.

¹²² See the SBREFA Final Report, at app., appendix D, slide 38 (*PowerPoint slides from the Panel Outreach Meeting, "Topic 7: Impact on the Cost of Business Credit"*).

publication of this proposal in the **Federal Register**. Under the Paperwork Reduction Act, the Bureau may not conduct or sponsor, and a person is not required to respond to, an information collection unless the information collection displays a valid OMB control number.

This proposed rule would amend 12 CFR part 1026 (Regulation Z). Regulation Z currently contains collections of information approved by OMB, and the Bureau's OMB control number is 3170-0015 (Truth in Lending Act (Regulation Z) 12 CFR part 1026). As described below, the proposed rule would amend the collections of information currently in Regulation Z.

The title of this information collection is: Loan Originator Compensation. The frequency of response is on-occasion. The information collection requirements in this proposed rule are required to provide benefits for consumers and would be mandatory. See 15 U.S.C. 1601 *et seq.* Because the Bureau would not collect any information under the proposed rule, no issue of confidentiality arises. The likely respondents would be commercial banks, savings institutions, credit unions, mortgage companies (non-bank creditors), mortgage brokers, and non-profit organizations that make or broker closed-end mortgage loans for consumers.

Under the proposal, the Bureau would account for the paperwork burden associated with Regulation Z for the following respondents pursuant to its administrative enforcement authority: insured depository institutions with more than \$10 billion in total assets, their depository institution affiliates, and certain non-depository loan originator organizations. The Bureau and the FTC generally both have enforcement authority over non-depository institutions for Regulation Z. Accordingly, the Bureau has allocated to itself half of its estimated burden to non-depository institutions. Other Federal agencies, including the FTC, are responsible for estimating and reporting to OMB the total paperwork burden for the institutions for which they have administrative enforcement authority. They may, but are not required, to use the Bureau's burden estimation methodology.

Using the Bureau's burden estimation methodology, the total estimated burden for the approximately 22,400 institutions subject to the proposal, including Bureau respondents,¹²³ would

¹²³ For purposes of this PRA analysis, the Bureau's respondents include 128 depository institutions and their depository institution

be approximately 64,700 hours annually and 169,600 one-time hours. For the 10,984 Bureau respondents subject to this proposal, the estimates for the ongoing burden hours are roughly 32,400 annually, and the total one-time burden hours are roughly 84,500.

The aggregate estimates of total burdens presented in this part IX are based on estimated costs that are averages across respondents. The Bureau expects that the amount of time required to implement each of the proposed changes for a given institution may vary based on the size, complexity, and practices of the respondent.

B. Information Collection Requirements

1. Record Retention Requirements

Regulation Z currently requires creditors to create and maintain records to demonstrate their compliance with Regulation Z provisions regarding compensation paid to or received by a loan originator. As discussed above in part V, the proposed rule would require creditors to retain these records for a three-year period, rather than for a two-year period as currently required. The proposed rule would apply the same requirement to organizations when they act as a loan originator in a transaction, even if they do not act as a creditor in the transaction. In addition, creditors would be required to make and maintain records for three years to show that they made available to a consumer a comparable, alternative mortgage loan when required by this proposed rule and complied with the requirement that where discount points and origination points or fees are charged, there be bona fide reduction in the interest rate compared to the interest rate for the comparable, alternative loan.

For the requirement extending the record retention requirement for creditors from two years, as currently provided in Regulation Z, to three years, the Bureau assumes that there is not additional marginal cost. For most, if not all firms, the required records are in electronic form. The Bureau believes that, as a consequence, all creditors should be able to use their existing recordkeeping systems to maintain the required documentation for mortgage origination records for one additional year at a negligible cost of investing in new storage facilities.

Loan originator organizations, but not creditors, will incur costs from the new requirement to retain records related to

compensation. For the requirement that organizations retain records related to compensation on loan transactions, these firms will need to build the requisite reporting regimes. At some firms this may require the integration of information technology systems; for others simple reports can be generated from existing core systems.

For the 8,051 Bureau respondents that are non-depository loan originator organizations but not creditors, the one-time burden is estimated to be roughly 162,800 hours to review the regulation and establish the requisite systems to retain compensation information. The Bureau estimates the requirement for these Bureau respondents to retain documentation of compensation arrangements is assumed to require 64,400 ongoing burden hours annually. The Bureau has allocated to itself one-half of this burden.

The proposal would require a creditor to retain records that it made available to a consumer, when required, a comparable, alternative loan that does not include discount points and origination points or fees, or that it made a good-faith determination that a consumer is unlikely to qualify for it. The Bureau believes that there is no additional cost or burden associated with this requirement because it believes that most, if not all creditors, already keep records of quotes of loan terms that they make to individual consumers as a matter of usual and customary practice. The Bureau believes that, as a consequence, all creditors should be able to use their existing recordkeeping systems to maintain the required documentation. The Bureau seeks public comment on how creditors currently keep track of quotes they have made to particular consumers and any additional costs from the requirement to track compliance with the requirements regarding the comparable, alternative loan.

2. Requirement To Obtain Criminal Background Checks, Credit Reports, and Other Information for Certain Individual Loan Originators

To the extent loan originator organizations employ or retain the services of individual loan originators who are not required to be licensed under the SAFE Act, and who are not so licensed, the loan originator organizations would be required to obtain a criminal background check and credit report for the individual loan originators. Loan originator organizations would also be required to obtain from the NMLSR or individual loan originator information about any findings against such individual loan

originator by a government jurisdiction. In general, the loan originator organizations that would be subject to this requirement are depository institutions (including credit unions) and non-profit organizations whose loan originators are not subject to State licensing because the State has determined the organization to be a bona fide non-profit organization. The burden of obtaining this information may be different for a depository institution than it is for a non-profit organization because depository institutions already obtain criminal background checks for their loan originators to comply with Regulation G and have access to information about findings against such individual loan originator by a government jurisdiction through the NMLSR.

a. Credit Check

Both depository institutions and non-profit organizations will incur one-time costs related to obtaining credit reports for all existing loan originators and ongoing costs for all future loan originators that are hired or transfer into this function. For the estimated 2,843 Bureau respondents, which include depository institutions over \$10 billion, their depository affiliates, and one-half the estimated burdens for the non-profit non-depository organizations, this one time estimated burden would be 2,950 hours and the estimated on going burden would be 150 hours.

b. Criminal Background Check

Depository institutions already obtain criminal background checks for each of their individual loan originators through the NMLSR for purposes of complying with Regulation G. A criminal background check provided by the NMLSR to the depository institution is sufficient to meet the requirement to obtain a criminal background check in this proposed rule. Accordingly, the Bureau believes they will not incur any additional burden.

Non-depository loan originator organizations that do not have access to information about criminal history in the NMLSR, including bona fide non-profit organizations, could satisfy the latter requirements by obtaining a national criminal background check.¹²⁴ For the assumed 200 non-profit originators and their 1000 loan

affiliates. The Bureau's respondents include an estimated 2,515 non-depository creditors, an assumed 200 not-for profit originators (which may overlap with the other non-depository creditors), and 8,051 loan originator organizations.

¹²⁴ This check, more formally known as an individual's FBI Identification Record, uses the individual's fingerprint submission to collect information about prior arrests and, in some instances, federal employment, naturalization, or military service.

originators,¹²⁵ the one-time burden is estimated to be roughly 265 hours.¹²⁶ The ongoing cost to perform the check for new hires is estimated to be 15 hours annually. The Bureau has allocated to itself one-half of these burdens.

c. Information About Findings Against the Individual by Government Jurisdictions

Depository institutions already obtain and have access to information about government jurisdiction findings against their individual loan originators through the NMLSR. Such information is sufficient to meet the requirement to obtain a criminal background check in this proposed rule. Accordingly, the Bureau does not believe they will incur significant additional burden.

The information for employees of non-profit organizations is generally not in the NMLSR. Accordingly, under the proposed rule a non-profit organization would have to obtain this information using individual statements concerning any prior administrative, civil, or criminal findings. For the assumed 1,000 loan originators who are employees of bona-fide non-profit organizations, the Bureau estimates that no more than 10 percent have any such findings by a governmental jurisdiction to describe. The one-time burden is estimated to be 20 hours, and the annual burden to obtain the information from new hires is estimated to be one hour.

C. Comments

Comments are specifically requested concerning: (1) Whether the proposed collections of information are necessary for the proper performance of the functions of the Bureau, including whether the information will have practical utility; (2) the accuracy of the estimated burden associated with the proposed collections of information; (3) how to enhance the quality, utility, and clarity of the information to be collected; and (4) how to minimize the burden of complying with the proposed collections of information, including the

¹²⁵ The Bureau has not been able to determine how many loan originators organizations qualify as bona fide non-profit organizations or how many of their employee loan originators are not subject to SAFE Act licensing. Accordingly, the Bureau has estimated these numbers.

¹²⁶ The organizations are also assumed to pay \$50 to get a national criminal background check. Several commercial services offer an inclusive fee, ranging between \$48.00 and \$50.00, for fingerprinting, transmission, and FBI processing. Based on a sample of three FBI-approved services, accessed on 2012-08-02: Accurate Biometrics, available at: <http://www.accuratebiometrics.com/index.asp>; Daon Trusted Identity Servs., available at: <http://daon.com/prints>; and Fieldprint, available at: http://www.fieldprintfbi.com/FBISubPage_FullWidth.aspx?ChannelID=272.

application of automated collection techniques or other forms of information technology. All comments will become a matter of public record. Comments on the collection of information requirements should be sent to the Office of Management and Budget (OMB), Attention: Desk Officer for the Consumer Financial Protection Bureau, Office of Information and Regulatory Affairs, Washington, DC, 20503, or by the Internet to http://oira_submission@omb.eop.gov, with copies to the Bureau at the Consumer Financial Protection Bureau (Attention: PRA Office), 1700 G Street NW., Washington, DC 20552, or by the Internet to CFPB_Public_PRA@cfpb.gov.

List of Subjects in 12 CFR Part 1026

Advertising, Consumer protection, Credit, Credit unions, Mortgages, National banks, Reporting and recordkeeping requirements, Savings associations, Truth in lending.

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed revisions. New language is shown inside bold arrows, and language that would be removed is shown inside bold brackets.

Authority and Issuance

For the reasons set forth in the preamble, the Bureau proposes to amend Regulation Z, 12 CFR part 1026, as set forth below:

PART 1026—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 1026 continues to read as follows:

Authority: 12 U.S.C. 5512, 5581; 15 U.S.C. 1601 *et seq.*

2. Section 1026.25 is amended by adding paragraph (c) to read as follows:

Subpart D—Miscellaneous

§ 1026.25 Record Retention.

* * * * *

▶(c) *Records related to certain requirements for mortgage loans.*

(1) [Reserved]

(2) *Records related to requirements for loan originator compensation.*

Notwithstanding the two-year record retention requirement in paragraph (a) of this section, for transactions subject to § 1026.36 of this part:

(i) A creditor must maintain records sufficient to evidence all compensation it pays to a loan originator organization (as defined in § 1026.36(a)(1)(iii)) or the creditor's individual loan originator (as defined in § 1026.36(a)(1)(ii)) and the compensation agreement that governs

those payments for three years after the date of payment.

(ii) A loan originator organization must maintain records sufficient to evidence all compensation it receives from a creditor, a consumer, or another person, all compensation it pays to the loan originator organization's individual loan originators, and the compensation agreement that governs those receipts or payments for three years after the date of each receipt or payment.

(3) *Records related to requirements for discount points and origination points or fees.* For each transaction subject to § 1026.36(d)(2)(ii), the creditor must maintain for three years after the date of consummation records sufficient to evidence:

(i) The creditor has made available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees as required by § 1026.36(d)(2)(ii)(A) or, if such a loan was not made available to the consumer, a good-faith determination that the consumer was unlikely to qualify for such a loan; and

(ii) Compliance with the "bona fide" requirements under § 1026.36(d)(2)(ii)(C). ◀

Subpart E—Special Rules for Certain Home Mortgage Transactions

3. Section 1026.36 is amended by:

- a. Revising the section heading;
- b. Revising paragraphs (a), (d)(1), (d)(2), and (e)(3)(i)(C);
- c. Re-designating paragraph (f) as paragraph (j);
- d. Adding new paragraph (f) and paragraphs (g), (h), and (i); and
- e. Revising newly re-designated paragraph (j).

The revisions and additions read as follows:

§ 1026.36 Prohibited acts or practices ▶ and certain requirements for ◀ [in connection with] credit secured by a dwelling.

(a) *Loan originator* ▶, ◀ [and] *mortgage broker* ▶, and *compensation* ◀ defined— (1) *Loan originator*. ▶(i) ◀ For purposes of this section, the term "loan originator" means, with respect to a particular transaction, a person who [for compensation or other monetary gain, or in expectation of compensation or other monetary gain,] ▶ takes an application, ◀ arranges, ▶ offers, ◀ negotiates, or otherwise obtains an extension of consumer credit for another person ▶ in expectation of compensation or other monetary gain or for compensation or other monetary gain. ◀ The term "loan originator" includes an employee of the creditor if

the employee meets this definition. The term “loan originator” includes [the] ▶ a ◀ creditor ▶ for the transaction ◀ [only] if the creditor does not [provide the funds for] ▶ finance ◀ the transaction at consummation out of the creditor’s own resources, including drawing on a *bona fide* warehouse line of credit, or out of deposits held by the creditor ▶. The term “loan originator” includes all creditors for purposes of § 1026.36(f) and (g). The term does not include an employee of a manufactured home retailer who assists a consumer in obtaining or applying to obtain consumer credit, provided such employee does not take a consumer credit application, offer or negotiate terms of a consumer credit transaction, or advise a consumer on credit terms (including rates, fees, and other costs).

(ii) An “individual loan originator” is a natural person who meets the definition of “loan originator” in paragraph (a)(1)(i) of this section.

(iii) A “loan originator organization” is any loan originator, as defined in paragraph (a)(1)(i) of this section, that is not an individual loan originator ◀.

(2) *Mortgage broker.* For purposes of this section, a mortgage broker with respect to a particular transaction is any loan originator that is not ▶ a creditor or the creditor’s ◀ [an] employee [of the creditor].

▶ (3) *Compensation.* The term “compensation” includes salaries, commissions, and any financial or similar incentive provided to a loan originator for originating loans. ◀

* * * * *

(d) *Prohibited payments to loan originators—(1) Payments based on transaction terms [or conditions].* (i) ▶ Except as provided in paragraph (d)(1)(iii) of this section, in ◀ [In] connection with a consumer credit transaction secured by a dwelling, no loan originator shall receive and no person shall pay to a loan originator, directly or indirectly, compensation in an amount that is based on any of the transaction’s terms [or conditions]. ▶ If a loan originator’s compensation is based in whole or in part on a factor that is a proxy for a transaction’s terms, the loan originator’s compensation is based on the transaction’s terms. A factor (that is not itself a term of a transaction originated by the loan originator) is a proxy for the transaction’s terms if the factor substantially correlates with a term or terms of the transaction and the loan originator can, directly or indirectly, add, drop, or change the factor when originating the transaction. ◀

(ii) For purposes of this paragraph (d)(1), the amount of credit extended is

not deemed to be a transaction term [or condition], provided compensation received by or paid to a loan originator, directly or indirectly, is based on a fixed percentage of the amount of credit extended; however, such compensation may be subject to a minimum or maximum dollar amount.

[(iii) This paragraph (d)(1) shall not apply to any transaction in which paragraph (d)(2) of this section applies.]

▶ (iii) Notwithstanding paragraph (d)(1)(i) of this section, an individual loan originator may receive, and a person may pay to an individual loan originator, compensation in the form of a contribution to a defined contribution plan or defined benefit plan that is a qualified plan and in which the individual loan originator participates, provided that the contribution is not directly or indirectly based on the terms of that individual loan originator’s transactions subject to paragraph (d) of this section. In addition, notwithstanding paragraph (d)(1)(i) of this section, an individual loan originator may receive, and a person may pay, compensation in the form of a bonus or other payment under a profit-sharing plan sponsored by the person or a contribution to a defined benefit plan or defined contribution plan in which the individual loan originator participates that is not a qualified plan, even if the compensation directly or indirectly is based on the terms of the transactions subject to paragraph (d) of this section of multiple individual loan originators employed by the person during the time period for which the compensation is paid to the individual loan originator, provided that:

(A) The compensation paid to an individual loan originator is not directly or indirectly based on the terms of that individual loan originator’s transactions subject to paragraph (d) of this section; and

(B) At least one of the following conditions is satisfied:

ALTERNATIVE 1—PARAGRAPH (d)(1)(iii)(B)(1):

(1) Not more than 50 percent of the total revenues of the person (or, if applicable, the business unit to which the profit-sharing plans applies) are derived from the person’s mortgage business during the tax year immediately preceding the tax year in which the payment or contribution is made. The total revenues are determined through a methodology that is consistent with generally accepted accounting principles and, as applicable, the reporting of the person’s income for purposes of Federal tax filings or, if none, any industry call

reports filed regularly by the person. As applicable, the methodology also shall reflect an accurate allocation of revenues among the person’s business units. Notwithstanding the provisions of subparagraph (d)(3) of this section, the revenues of the person’s affiliates are not taken into account for purposes of this paragraph, provided that, if the profit-sharing plan applies to the affiliate, then the person’s total revenues for purposes of this paragraph also include the total revenues of the affiliate. The total revenues that are derived from the mortgage business is that portion of the total revenues that are generated through a person’s transactions subject to paragraph (d) of this section; or

ALTERNATIVE 2—PARAGRAPH (d)(1)(iii)(B)(1):

(1) Not more than 25 percent of the revenues of the person (or, if applicable, the business unit to which the profit-sharing plan applies) are derived from the person’s mortgage business during the tax year immediately preceding the tax year in which the payment or contribution is made. The total revenues are determined through a methodology that is consistent with generally accepted accounting principles and, as applicable, the reporting of the person’s income for purposes of Federal tax filings or, if none, any industry call reports filed regularly by the person. As applicable, the methodology also shall reflect an accurate allocation of revenues among the person’s business units. Notwithstanding the provisions of subparagraph (d)(3) of this section, the revenues of the person’s affiliates are not taken into account for purposes of this paragraph, provided that, if the profit-sharing plan applies to the affiliate, then the person’s total revenues for purposes of this paragraph also include the total revenues of the affiliate. The total revenues that are derived from the mortgage business is that portion of the total revenues that are generated through a person’s transactions subject to paragraph (d) of this section; or

(2) The individual loan originator was the loan originator for five or fewer transactions subject to paragraph (d) of this section during the 12-month period preceding the date of the decision to make the payment or contribution. ◀

(2) *Payments by persons other than consumer—* ▶ (i) *Dual compensation.* (A) Except as provided in paragraph (d)(2)(i)(C) of this section, if ◀ [If] any loan originator receives compensation directly from a consumer [in a consumer credit transaction secured by a dwelling]:

►1◀(i) No loan originator shall receive compensation, directly or indirectly, from any person other than the consumer in connection with the transaction; and

►2◀(ii) No person who knows or has reason to know of the consumer-paid compensation to the loan originator (other than the consumer) shall pay any compensation to a loan originator, directly or indirectly, in connection with the transaction.

►(B) Compensation directly from a consumer includes payments to a loan originator made pursuant to an agreement between the consumer and a person other than the creditor or its affiliates.

(C) *Exception.* If a loan originator organization receives compensation directly from a consumer in connection with a transaction, the loan originator organization may pay compensation to an individual loan originator, and the individual loan originator may receive compensation from the loan originator organization.

(ii) *Restrictions on discount points and origination points or fees.* (A) If any loan originator receives compensation from any person other than the consumer in connection with a transaction, a creditor or a loan originator organization may not impose on the consumer any discount points and origination points or fees, as defined in paragraph (d)(2)(ii)(B) of this section, in connection with the transaction unless the creditor makes available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan.

(B) The term “discount points and origination points or fees” for purposes of this paragraph (d) and paragraph (e) of this section means all items that would be included in the finance charge under § 1026.4(a) and (b), and any fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2), that are payable at or before consummation by the consumer in connection with the transaction to a creditor or a loan originator organization, other than:

(1) Interest, including per-diem interest, or the time-price differential;

(2) Any bona fide and reasonable third-party charges not retained by the creditor or loan originator organization; and

(3) Items that are excluded from the finance charge under § 1026.4(c)(5), (c)(7)(v) and (d)(2).

(C) No discount points and origination points or fees may be

imposed on the consumer in connection with a transaction subject to paragraph (d)(2)(ii)(A) of this section unless there is a bona fide reduction in the interest rate compared to the interest rate for the comparable, alternative loan that does not include discount points and origination points or fees required to be made available to the consumer under paragraph (d)(2)(ii)(A) of this section. For any rebate paid by the creditor that will be applied to reduce the consumer's settlement charges, the creditor must provide a bona fide rebate in return for an increase in the interest rate compared to the interest rate for the comparable, alternative loan that does not include discount points and origination points or fees required to be made available to the consumer under paragraph (d)(2)(ii)(A) of this section. ◀

* * * * *

(e) * * *

(3) * * *

(i) * * *

(C) The loan with the lowest total dollar amount ►of discount points and origination points or fees. If two or more loans have the same total dollar amount of discount points and origination points or fees, the loan originator must present the loan with the lowest interest rate that has the lowest total dollar amount of discount points and origination points or fees. ◀[for origination points or fees and discount points.]

* * * * *

►(f) *Loan originator qualification requirements.* A loan originator for a consumer credit transaction secured by a dwelling must comply with this paragraph (f) and be registered and licensed in accordance with applicable State and Federal law, including the Secure and Fair Enforcement of Mortgage Licensing Act of 2008 (SAFE Act, 12 U.S.C. 5102 *et seq.*), its implementing regulations (12 CFR part 1007 or part 1008), and State SAFE Act implementing law. To comply with this paragraph (f), a loan originator organization that is not a government agency or State housing finance agency must:

(1) Comply with all applicable State law requirements for legal existence and foreign qualification;

(2) Ensure that its individual loan originators are licensed or registered to the extent the individual is required to be licensed or registered under the SAFE Act, its implementing regulations, and State SAFE Act implementing law; and

(3) For each of its individuals who is not required to be licensed and is not licensed as a loan originator pursuant to

§ 1008.103 of this chapter or State SAFE Act implementing law:

(i) Obtain:

(A) A State and national criminal background check through the Nationwide Mortgage Licensing System and Registry (NMLSR) or, in the case of an individual loan originator who is not a registered loan originator under the NMLSR, a State and national criminal background check from a law enforcement agency or commercial service;

(B) A credit report from a consumer reporting agency described in section 603(p) of the Fair Credit Reporting Act (15 U.S.C. 1681a(p)) secured, where applicable, in compliance with the requirements of section 604(b) of the Fair Credit Reporting Act (15 U.S.C. 1681b(b)); and

(C) Information from the NMLSR about any administrative, civil, or criminal findings by any government jurisdiction or, in the case of an individual loan originator who is not a registered loan originator under the NMLSR, such information from the individual loan originator;

(ii) Determine, on the basis of the information obtained pursuant to paragraph (f)(3)(i) of this section and any other information reasonably available to the loan originator organization, that the individual loan originator:

(A) Has not been convicted of, or pleaded guilty or *nolo contendere* to, a felony in a domestic, foreign, or military court during the preceding seven-year period or, in the case of a felony involving an act of fraud, dishonesty, a breach of trust, or money laundering, at any time; and

(B) Has demonstrated financial responsibility, character, and general fitness such as to command the confidence of the community and to warrant a determination that the individual loan originator will operate honestly, fairly, and efficiently; and

(iii) Provide periodic training covering Federal and State law requirements that apply to the individual loan originator's loan origination activities.

(g) *NMLSR ID on loan documents.* (1) For a transaction secured by a dwelling, a loan originator organization must include on the loan documents described in paragraph (g)(2) of this section, whenever each such loan document is provided to a consumer or presented to a consumer for signature, as applicable:

(i) Its name and NMLSR identification number (NMLSR ID), if the NMLSR has provided it an NMLSR ID; and

(ii) The name of the individual loan originator with primary responsibility for the origination and, if the NMLSR has provided such person an NMLSR ID, that NMLSR ID.

(2) The loan documents that must include the names and NMLSR IDs pursuant to paragraph (g)(1) of this section are:

(i) The credit application;

(ii) The disclosure provided under section 5(c) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2604(c));

(iii) The disclosure provided under section 128 of the Truth in Lending Act (15 U.S.C. 1638);

(iv) The note or loan contract;

(v) The security instrument; and

(vi) The disclosure provided to comply with section 4 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2603).

(3) For purposes of this § 1026.36, NMLSR identification number means a number assigned by the Nationwide Mortgage Licensing System and Registry to facilitate electronic tracking of loan originators and uniform identification of, and public access to, the employment history of, and the publicly adjudicated disciplinary and enforcement actions against, loan originators.

(h) *Prohibition on mandatory arbitration clauses and waivers of certain consumer rights-* (1) *Arbitration.* A contract or other agreement in connection with a consumer credit transaction secured by a dwelling may not require arbitration or any other non-judicial procedure to resolve disputes arising out of the transaction. This prohibition does not limit a consumer and creditor or any assignee from agreeing, after a dispute arises between them, to use arbitration or other non-judicial procedure to resolve a dispute.

(2) *No waivers of Federal statutory causes of action.* A contract or other agreement in connection with a consumer credit transaction secured by a dwelling may not limit a consumer from bringing a claim in court, an arbitration, or other non-judicial procedure, pursuant to any provision of law, for damages or any other relief, in connection with any alleged violation of any Federal law. This prohibition applies to a post-dispute agreement to use arbitration or other non-judicial procedure to resolve a dispute, thus such an agreement may not limit the ability of a consumer to bring a covered claim through the agreed-upon non-judicial procedure.

(i) *Prohibition on financing single-premium credit insurance.* (1) A creditor may not finance any premiums or fees

for credit insurance in connection with a consumer credit transaction secured by a dwelling. This prohibition does not apply to credit insurance for which premiums or fees are calculated and paid in full on a monthly basis.

(2) In this paragraph (i), “credit insurance”:

(i) Includes insurance described in § 1026.4(d)(1) and (3) of this part, whether or not such insurance is voluntary; but

(ii) Excludes credit unemployment insurance for which the unemployment insurance premiums are reasonable, the creditor receives no direct or indirect compensation in connection with the unemployment insurance premiums, and the unemployment insurance premiums are paid pursuant to another insurance contract and not paid to an affiliate of the creditor. ◀

▶ ◀ [f] This section does not apply to a home-equity line of credit subject to § 1026.40 ▶, except that § 1026.36(h) and (i) applies to such credit when secured by the consumer’s principal dwelling ◀. Section 1026.36(d) ▶, ◀ [and] (e) ▶, (f), (g), (h), and (i) ◀ does not apply to a loan that is secured by a consumer’s interest in a timeshare plan described in 11 U.S.C. 101(53D).

4. Supplement I to part 1026 is amended as follows:

a. Under Section 1026.25—*Record Retention*:

i. 25(a) *General rule*, paragraph 5 is removed;

ii. New heading 25(c)(2) *Records related to requirements for loan originator compensation* and paragraphs 1 and 2 are added.

b. Under Section 1026.36—*Prohibited Acts or Practices in Connection with Credit Secured by a Dwelling*:

i. The heading is revised to read Section 1026.36—*Prohibited Acts or Practices and Certain Requirements for Credit Secured by a Dwelling*;

ii. Paragraph 1 is revised;

iii. 36(a) *Loan originator and mortgage broker defined*, the heading is revised to read 36(a) *Loan originator, mortgage broker, and compensation defined*, paragraphs 1 and 4 are revised, and new paragraph 5 is added;

iv. 36(d) *Prohibited payments to loan originators*, paragraph 1 is revised;

v. 36(d)(1) *Payments based on transaction terms and conditions*, the heading is revised to read 36(d)(1) *Payments based on transaction terms*, paragraphs 1 through 8 are revised, and new paragraph 10 is added;

vi. 36(d)(2) *Payments by persons other than consumer*, new heading 36(d)(2)(i) *Dual compensation* is added and paragraphs 1 and 2 are revised, new

heading 36(d)(2)(ii) *Restrictions on discount points and origination points or fees* and new paragraphs 1 through 3 are added, new heading Paragraph 36(d)(2)(ii)(A) and new paragraphs 1 through 4 are added, new heading Paragraph 36(d)(2)(ii)(B) and new paragraphs 1 through 4 are added;

vii. 36(e) *Prohibition on steering*, 36(e)(3) *Loan options presented*, paragraph 3 is revised;

viii. New heading 36(f) *Loan originator qualification requirements* and new paragraphs 1 and 2 are added;

ix. New heading Paragraph 36(f)(1) and new paragraph 1 are added;

x. New heading Paragraph 36(f)(2) and new paragraph 1 are added;

xi. New heading Paragraph 36(f)(3), and new paragraph 1 are added;

xii. New heading Paragraph 36(f)(3)(i) and new paragraph 1 are added;

xiii. New heading Paragraph 36(f)(3)(ii) and new paragraph 1 are added;

xiv. New heading Paragraph 36(f)(3)(ii)(B) and new paragraph 1 are added;

xv. New heading Paragraph 36(f)(3)(iii) and new paragraph 1 are added;

xvi. New headings 36(g) *NMLSR ID on loan documents*, Paragraph 36(g)(1) and new paragraphs 1 and 2 are added;

xvii. New heading Paragraph 36(g)(1)(ii) and new paragraph 1 are added;

xviii. New heading Paragraph 36(g)(2) and new paragraph 1 are added.

Supplement I to Part 1026—Official Interpretations

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Subpart D—Miscellaneous

Section 1026.25—Record Retention

25(a) General rule.

* * * * *

◻ 5. *Prohibited payments to loan originators.* For each transaction subject to the loan originator compensation provisions in § 1026.36(d)(1), a creditor should maintain records of the compensation it provided to the loan originator for the transaction as well as the compensation agreement in effect on the date the interest rate was set for the transaction. See § 1026.35(a) and comment 35(a)(2)(iii)–3 for additional guidance on when a transaction’s rate is set. For example, where a loan originator is a mortgage broker, a disclosure of compensation or other broker agreement required by applicable State law that complies with § 1026.25 would be presumed to be a record of the amount actually paid to the loan

originator in connection with the transaction.]

* * * * *

▶ 25(c)(2) Records related to requirements for loan originator compensation.

1. *Scope of records of loan originator compensation.* Section 1026.25(c)(2)(i) requires a creditor to maintain records sufficient to evidence all compensation it pays to a loan originator organization or the creditor's individual loan originators, as well as the compensation agreements that govern those payments for three years after the date of the payments. Section 1026.25(c)(2)(ii) requires that a loan originator organization maintain records sufficient to evidence all compensation it receives from a creditor, a consumer, or another person and all compensation it pays to the loan originator organization's individual loan originators, as well as the compensation agreements that govern those payments or receipts for three years after the date of the receipts or payments.

i. *Records sufficient to evidence payment and receipt of compensation.* Records are sufficient to evidence payment and receipt of compensation if they demonstrate the following facts: The nature and amount of the compensation; that the compensation was paid, and by whom; that the compensation was received, and by whom; and when the payment and receipt of compensation occurred. The records that are sufficient necessarily will vary on a case-by-case basis depending on the facts and circumstances, particularly with regard to the nature of the compensation. In addition to the compensation agreements themselves, which are to be retained in all circumstances, records of the payment and receipt of compensation to be maintained under § 1026.25(c)(2) might include, for example, and depending on the facts and circumstances, copies of required filings under applicable provisions of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001, *et seq.*, and the Internal Revenue Code (IRC) relating to qualified defined benefit and defined contribution plans; copies of qualified or non-qualified bonus and profit-sharing plans in which individual loan originator employees participate; the names of any loan originators covered by such plans; a settlement agent "flow of funds" worksheet or other written record; a creditor closing instructions letter directing disbursement of fees at consummation; records of any payments, distributions, awards, or

other compensation made under any such agreements or plans. Where a loan originator is a mortgage broker, a disclosure of compensation or broker agreement required by applicable State law that recites the broker's total compensation for a transaction would be presumed to be a record of the amount actually paid to the loan originator in connection with the transaction.

ii. *Compensation agreement.* For purposes of § 1026.25(c)(2), a compensation agreement includes any agreement, whether oral, written, or based on a course of conduct that establishes a compensation arrangement between the parties (*e.g.*, a brokerage agreement between a creditor and a loan originator organization, provisions of employment contracts addressing payment of compensation between a creditor and an individual loan originator employee). Creditors and loan originators are free to specify what transactions are governed by a particular compensation agreement as they see fit. For example, they may provide, by the terms of the agreement, that the agreement governs compensation payable on transactions consummated on or after some future effective date (in which case, a prior agreement governs transactions consummated in the meantime). For purposes of applying the record retention requirement, the relevant compensation agreement for a given transaction is the agreement pursuant to which compensation for that transaction is determined, pursuant to the agreement's terms.

iii. *Three-year retention period.* The requirements in § 1026.25(c)(2)(i) and (ii) that the records be retained for three years after the date of receipt or payment, as applicable, means that the records are retained for three years after each receipt or payment, as applicable, even if multiple compensation payments relate to a single transaction. For example, if a loan originator organization pays an individual loan originator a commission consisting of two separate payments of \$1,000 each on June 5 and July 7, 2012, then the organization loan originator is required to retain records sufficient to evidence the two payments through June 4, 2015, and July 6, 2015, respectively.

2. An example of § 1026.25(c)(2) as applied to a loan originator organization is as follows: Assume a loan originator organization originates only loans where the loan originator organization derives revenues exclusively from fees paid by creditors that fund its originations (*i.e.*, "creditor-paid" compensation) and pays its individual loan originators commissions and annual bonuses. The

loan originator organization must retain a copy of the agreement with any creditor that pays the loan originator organization compensation for originating loans and documentation evidencing the specific payment it receives from the creditor for each loan originated. In addition, the loan originator organization must retain copies of the agreements with its individual loan originators governing their commissions and their annual bonuses and records of any specific commissions and bonuses.◀

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Subpart E—Special Rules for Certain Home Mortgage Transactions

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Section 1026.36—Prohibited Acts or Practices ▶ and Certain Requirements for◀ [in Connection with] Credit Secured by a Dwelling

1. *Scope of coverage.* Section 1026.36(b) ▶, ◀ [and] (c) ▶, (h), and (i) ◀ applies to closed-end consumer credit transactions secured by a consumer's principal dwelling.▶ Section 1026.36(h) and (i) also applies to home-equity lines of credit under § 1026.40 secured by a consumer's principal dwelling.◀ Section 1026.36(d) ▶, ◀ [and] (e) ▶, (f), and (g) ◀ applies to closed-end consumer credit transactions secured by a dwelling. [Section 1026.36(d) and (e) applies to closed]▶ Closed◀-end [loans]▶ consumer credit transactions include transactions ◀ secured by first or subordinate liens, and reverse mortgages that are not home-equity lines of credit under § 1026.40. See § 1026.36([f]▶j◀) for additional restrictions on the scope of this section, and §§ 1026.1(c) and 1026.3(a) and corresponding commentary for further discussion of extensions of credit subject to Regulation Z.

* * * * *

36(a) Loan originator ▶, ◀ [and] mortgage broker ▶, and compensation ◀ defined.

1. *Meaning of loan originator.* i. *General.* ▶ A. ◀ Section 1026.36(a) provides that a loan originator is any person who for compensation or other monetary gain ▶ takes an application, ◀ arranges, ▶ offers, ◀ negotiates, or otherwise obtains an extension of consumer credit for another person. [Thus,]▶ The term includes a person who assists a consumer in obtaining or applying for consumer credit by advising on credit terms (including rates, fees, and other costs), preparing application packages (such as a credit or pre-approval application or supporting

documentation), or collecting application and supporting information on behalf of the consumer to submit to a loan originator or creditor. A loan originator includes a person who in expectation of compensation or other monetary gain advertises or communicates to the public that such person can or will provide any of these services or activities.

B. The [the] term “loan originator” also includes employees of a creditor as well as employees of a mortgage broker that satisfy this definition. In addition, the definition of loan originator expressly includes any creditor that satisfies the definition of loan originator but makes use of “table funding” by a third party. See comment 36(a)–1.ii [below] discussing table funding. Although consumers may sometimes arrange, negotiate, or otherwise obtain extensions of consumer credit on their own behalf, in such cases they do not do so for another person or for compensation or other monetary gain, and therefore are not loan originators [under this section]. A “loan originator organization” is a loan originator that is an organization such as a trust, sole proprietorship, partnership, limited liability partnership, limited liability company, corporation, bank, thrift, finance company, or a credit union. An “individual loan originator” is limited to a natural person. (Under § 1026.2(a)(22), the term “person” means a natural person or an organization.)

ii. *Table funding.* Table funding occurs when the creditor does not provide the funds for the transaction at consummation out of the creditor’s own resources, including, for example, drawing on a *bona fide* warehouse line of credit, or out of deposits held by the creditor. Accordingly, a table-funded transaction is consummated with the debt obligation initially payable by its terms to one person, but another person provides the funds for the transaction at consummation and receives an immediate assignment of the note, loan contract, or other evidence of the debt obligation. Although § 1026.2(a)(17)(i)(B) provides that a person to whom a debt obligation is initially payable on its face generally is a creditor, § 1026.36(a)(1) provides that, solely for the purposes of § 1026.36, such a person is also considered a loan originator. [The creditor generally is not considered a loan originator unless table funding occurs.] For example, if a person closes a loan in its own name but does not fund the loan from its own resources or deposits held by it because it immediately assigns the loan

[at] after consummation, it is considered a creditor for purposes of Regulation Z and also a loan originator for purposes of § 1026.36. However, if a person closes a loan in its own name and finances a consumer credit transaction from the person’s own resources, including drawing on a *bona fide* warehouse line of credit or out of deposits held by the person, but does not immediately assign the loan at closing the person is not a table-funded creditor but is included in the definition of loan originator for the purposes of § 1026.36(f) and (g). Such a person [draws on a *bona fide* warehouse line of credit to make the loan at consummation, it is considered] is a creditor, not a loan originator, for purposes of Regulation Z, including the other provisions of § 1026.36.

iii. *Servicing.* [The definition of] A “loan originator” does not [apply to] include a loan servicer when the servicer modifies an existing loan on behalf of the current owner of the loan. Other than § 1026.36(b) and (c), § 1026.36 [The rule] applies to extensions of consumer credit that constitute a refinancing under § 1026.20(a). Thus, other than § 1026.36(b) and (c), § 1026.36 [and] does not apply if a person renegotiates, modifies, replaces, or subordinates [of] an existing obligation’s terms [does not constitute], unless the transaction is a refinancing under § 1026.20(a).

iv. *Real estate brokerage.* A “loan originator” does not include a person that performs only real estate brokerage activities (e.g., does not perform mortgage broker activities or extend consumer credit) if the person is licensed or registered under applicable State law governing real estate brokerage, unless such person is paid by a creditor or a loan originator for a particular consumer credit transaction subject to § 1026.36. A person is not paid by a creditor or a loan originator if the person is paid by a creditor or a loan originator on behalf of a consumer solely for performing real estate brokerage activities.

v. *Seller financing by natural persons.* The definition of “loan originator” does not include a natural person, estate, or trust that finances the sale of three or fewer properties in any 12-month period owned by such natural person, estate, or trust where each property serves as a security for the credit transaction. The natural person, estate, or trust also must not have constructed or acted as a contractor for the construction of the dwelling in its ordinary course of business. The natural person, estate, or trust must additionally determine in

good faith and document that the buyer has a reasonable ability to repay the credit transaction. The natural person, estate, or trust makes such a good faith determination by complying with the requirements of § 1026.43. The credit transaction also must be fully amortizing, have a fixed rate or an adjustable rate that adjusts only after five or more years, and be subject to reasonable annual and lifetime limitations on interest rate increases.

* * * * *

4. *Managers and administrative staff.* For purposes of § 1026.36, managers, administrative and clerical staff, and similar individuals who are employed by a creditor or loan originator but do not arrange, negotiate, or otherwise obtain an extension of credit for a consumer, or whose compensation is not based on whether any particular loan is originated, are not loan originators. A “producing manager” who also arranges, negotiates, or otherwise obtains an extension of consumer credit for another person, is a loan originator. Thus, a producing manager’s compensation is subject to the restrictions of § 1026.36.

5. *Compensation— i. General.* For purposes of § 1026.36, compensation is defined in § 1026.36(a)(3) as salaries, commissions, and any financial or similar incentive provided to a person for engaging in loan originator activities. See comment 36(d)(1)–2 for examples of types of compensation that are covered by § 1026.36(d) and (e), and comment 36(d)(1)–3 for examples of types of compensation that are not covered by § 1026.36(d) and (e). For example, the term “compensation” includes:

A. An annual or other periodic bonus; or

B. Awards of merchandise, services, trips, or similar prizes.

ii. *Name of fee.* Compensation includes amounts the loan originator retains and is not dependent on the label or name of any fee imposed in connection with the transaction. For example, if a loan originator imposes a “processing fee” in connection with the transaction and retains such fee, it is deemed compensation for purposes of § 1026.36(d) and (e), whether the originator expends the time to process the consumer’s application or uses the fee for other expenses, such as overhead.

iii. *Amounts for third-party charges.* Compensation includes amounts the loan originator retains, but does not include amounts the originator receives as payment for bona fide and reasonable charges, such as credit reports, where those amounts are passed on to a third

party that is not the creditor, its affiliate, or the affiliate of the loan originator. In some cases, amounts received for payment for such third-party charges may exceed the actual charge because, for example, the originator cannot determine with accuracy what the actual charge will be before consummation. In such a case, the difference retained by the originator is not deemed compensation if the third-party charge imposed on the consumer or collected from a person other than the consumer was bona fide and reasonable, and also complies with State and other applicable law. On the other hand, if the originator marks up a third-party charge (a practice known as “upchargin”), and the originator retains the difference between the actual charge and the marked-up charge, the amount retained is compensation for purposes of § 1026.36(d) and (e). For example:

A. Assume a loan originator receives compensation directly from either a consumer or a creditor. Further assume the loan originator uses average charge pricing under Regulation X to charge the consumer \$25 for a credit report provided by a third party that is not the creditor, its affiliate or the affiliate of the loan originator. At the time the loan originator imposes the credit report fee on the consumer, the loan originator is uncertain of the cost of the credit report because the cost of a credit report from the consumer reporting agency is paid in a monthly bill and varies from between \$15 and \$35 depending on how many credit reports the originator obtains that month. Assume the \$25 for the credit report is paid by the consumer or is paid by the creditor with proceeds from a rebate. Later, at the end of the month, the cost for the credit report is determined to be \$15 for this consumer’s transaction. In this case, the \$10 difference between the \$25 credit report fee imposed on the consumer and the actual \$15 cost for the credit report is not deemed compensation for purposes of § 1026.36(d) and (e), even though the \$10 is retained by the loan originator.

B. Using the same example in comment 36(a)–5.iii.A above, the \$10 difference would be compensation for purposes of § 1026.36(d) and (e) if the price for a credit report varies between \$10 and \$15.

iv. *Returns on equity interests and dividends on equity holdings.* The term “compensation” for purposes of § 1026.36(d) and (e) also includes, for example, stocks and stock options, and equity interests that are awarded to individual loan originators. Thus, the awarding of stocks or stock options, or

equity interests to individual loan originators is subject to the restrictions in § 1026.36(d) and (e). For example, a person may not award additional stock or a preferable type of equity interest to an individual loan originator based on the terms of a consumer credit transaction subject to § 1026.36(d) and (e) originated by that individual loan originator. However, bona fide returns or dividends paid on stocks or other equity holdings, including those paid to owners or shareholders of an loan originator organization who own such stock or equity interests, are not considered compensation for purposes of § 1026.36(d) and (e). Bona fide returns or dividends are those returns and dividends that are paid pursuant to documented ownership or equity interests and are not functionally equivalent to compensation. Ownership and equity interests must be bona fide. Bona fide ownership and equity interests are allocated according to a loan originator’s respective capital contribution and the allocation is not a mere subterfuge for the payment of compensation based on terms of a transaction. For example, assume that three individual loan originators form a loan originator organization that is a limited liability company (LLC). The three individual loan originators are members of the LLC, and the LLC agreement governing the loan originator organization’s structure calls for regular distributions based on the members’ respective equity interests. If the members’ respective equity interests are allocated based on the members’ transaction terms, rather than according to their respective capital contributions, then distributions based on such equity interests are not bona fide and, thus, are considered compensation for purposes of § 1026.36(d) and (e). ◀

* * * * *
36(d) *Prohibited payments to loan originators.*

1. *Persons covered.* Section 1026.36(d) prohibits any person (including the creditor) from paying compensation to a loan originator in connection with a covered credit transaction, if the amount of the payment is based on any of the transaction’s terms [or conditions]. For example, a person that purchases a loan from the creditor may not compensate the loan originator in a manner that violates § 1026.36(d).

* * * * *
36(d)(1) *Payments based on transaction terms [and conditions].*

1. ▶ *Compensation that is “based on” transaction terms.* i. Whether compensation is “based on” transaction terms does not require a determination

that any person subjectively intended that there be a relationship between the amount of the compensation paid and a transaction term. Instead, the determination is based on the objective facts and circumstances indicating that compensation would have been different if a transaction term had been different. In general, this determination is based on a comparison of transactions originated, but a violation does not require a comparison of multiple transactions.

ii. The prohibition on payment and receipt of compensation based on transaction “terms” under § 1026.36(d)(1)(i) encompasses compensation that directly or indirectly is based on the terms of a single transaction of a single individual loan originator or the terms of multiple transactions of the individual loan originator within the time period for which the compensation is paid, where such transactions are subject to § 1026.36(d). The prohibition also covers compensation in the form of a bonus or other payment under a profit-sharing plan sponsored by the person or a contribution to a qualified or non-qualified defined contribution or benefit plan in which the individual loan originator participates, if the compensation directly or indirectly is based on the terms of the transactions of multiple individual loan originators employed by the person within the time period for which the compensation is paid, although such compensation may be permissible under § 1026.36(d)(1)(iii). For further clarity on the definitions of qualified plans, profit-sharing plans, the time period in which compensation is paid, and the other terms used in this comment 36(d)(1)–1.ii, see comment 36(d)(1)–2.iii.

A. For example, assume that a creditor employs six individual loan originators and offers loans at a minimum interest rate of 6.0 percent and a maximum rate of 8.0 percent (unrelated to risk-based pricing). Assuming relatively constant loan volume and amounts of credit extended and relatively static market rates, if the individual loan originators’ aggregate transactions in a given calendar year average 7.5 percent rather than 7.0 percent, creating a higher interest rate spread over the creditor’s minimum acceptable rate of 6.0 percent, the creditor will generate higher amounts of interest revenue if the loans are held in portfolio and increased proceeds from secondary market purchasers if the loans are sold. Assume that the increased revenues lead to higher profits for the creditor (*i.e.*, expenses do not

increase so as to negate the effect of the higher revenues). If the creditor pays a bonus to an individual loan originator out of a bonus pool established with reference to the creditor's profitability that, all other factors being equal, is higher than the bonus would have been if the average rate of the six individual loan originators' transactions was 7.0 percent, then the bonus is indirectly related to the terms of multiple transactions of multiple loan originators. Therefore, the bonus is compensation based on the transactions' terms and is prohibited under § 1026.36(d)(1)(i), unless the conditions under § 1026.36(d)(1)(iii) are satisfied such that the compensation is permitted under that provision.

B. Assume that an individual loan originator's employment contract with a creditor guarantees a quarterly bonus in a specified amount conditioned upon the individual loan originator meeting certain performance benchmarks (e.g., volume of loans monthly). A bonus paid following the satisfaction of those contractual conditions is not directly or indirectly based on the terms of multiple individual loan originators' transactions, because the creditor is obligated to pay the bonus, in the specified amount, regardless of the terms of multiple loan originators' transactions and the effect of those multiple transaction terms on the creditor's revenues and profits. ◀

◀ **Compensation.** i. *General.* For purposes of § 1026.36(d) and (e), the term "compensation" includes salaries, commissions, and any financial or similar incentive provided to a loan originator that is based on any of the terms or conditions of the loan originator's transactions. See comment 36(d)(1)–3 for examples of types of compensation that are not covered by § 1026.36(d) and (e). For example, the term "compensation" includes:

A. An annual or other periodic bonus; or

B. Awards of merchandise, services, trips, or similar prizes.

ii. *Name of fee.* Compensation includes amounts the loan originator retains and is not dependent on the label or name of any fee imposed in connection with the transaction. For example, if a loan originator imposes a "processing fee" in connection with the transaction and retains such fee, it is deemed compensation for purposes of § 1026.36(d) and (e), whether the originator expends the time to process the consumer's application or uses the fee for other expenses, such as overhead.

iii. *Amounts for third-party charges.* Compensation includes amounts the

loan originator retains, but does not include amounts the originator receives as payment for *bona fide* and reasonable third-party charges, such as title insurance or appraisals. In some cases, amounts received for payment for third-party charges may exceed the actual charge because, for example, the originator cannot determine with accuracy what the actual charge will be before consummation. In such a case, the difference retained by the originator is not deemed compensation if the third-party charge imposed on the consumer was *bona fide* and reasonable, and also complies with State and other applicable law. On the other hand, if the originator marks up a third-party charge (a practice known as "upcharging"), and the originator retains the difference between the actual charge and the marked-up charge, the amount retained is compensation for purposes of § 1026.36(d) and (e). For example:

A. Assume a loan originator charges the consumer a \$400 application fee that includes \$50 for a credit report and \$350 for an appraisal. Assume that \$50 is the amount the creditor pays for the credit report. At the time the loan originator imposes the application fee on the consumer, the loan originator is uncertain of the cost of the appraisal because the originator may choose from appraisers that charge between \$300 and \$350 for appraisals. Later, the cost for the appraisal is determined to be \$300 for this consumer's transaction. In this case, the \$50 difference between the \$400 application fee imposed on the consumer and the actual \$350 cost for the credit report and appraisal is not deemed compensation for purposes of § 1026.36(d) and (e), even though the \$50 is retained by the loan originator.

B. Using the same example in comment 36(d)(1)–1.iii.A above, the \$50 difference would be compensation for purposes of § 1026.36(d) and (e) if the appraisers from whom the originator chooses charge fees between \$250 and \$300.]

2. *Examples of compensation that is based on transaction terms [or conditions].* Section 1026.36(d)(1) ▶ does not prohibit compensating a loan originator differently on different transactions, provided the difference is not based on a transaction's terms or a proxy for the transaction's terms. The section ◀ prohibits loan originator compensation that is based on the terms [or conditions] of the loan originator's transactions.

▶ i. ◀ For example, the rule prohibits compensation to a loan originator for a transaction based on that transaction's interest rate, annual percentage rate, [loan-to-value ratio,] or the existence of

a prepayment penalty. The rule also prohibits compensation ▶ to a loan originator that is ◀ based on a factor that is a proxy for a transaction's terms [or conditions]. ▶ If the loan originator's compensation is based in whole or in part on a factor that is a proxy for a transaction's terms, then the loan originator's compensation is based on a transaction's terms. A factor (that is not itself a term of a transaction originated by the loan originator) is a proxy for the transaction's terms if the factor substantially correlates with a term or terms of the transaction and the loan originator can, directly or indirectly, add, drop, or change the factor when originating the transaction. ◀ For example,] ▶ :

A. No proxy exists if compensation is not substantially correlated with a difference in a transaction's terms. Assume a creditor pays loan originator employees with less than three years of employment with the creditor a commission of 0.75 percent of the total loan amount, loan originator employees with three through five years of employment 1.25 percent of the loan amount, and loan originator employees with more than five years of employment 1.5 percent of the total loan amount. For this creditor, there is no substantial correlation between whether loans are originated by a loan originator with less than three years of employment, three through five years of employment, or more than five years of employment with any term of the creditor's transactions. Thus, payment of compensation in this circumstance based on tenure is not a proxy for a transaction's terms.

B. ◀ [A consumer's credit score or similar representation of credit risk, such as the consumer's debt-to-income ratio, is not one of the transaction's terms conditions. To illustrate, assume that consumer A and consumer B receive loans from the same loan originator and the same creditor. Consumer A has a credit score of 650, and consumer B has a credit score of 800. Consumer A's loan has a 7 percent interest rate, and consumer B's loan has a 6½ percent interest rate, because of the consumers' different credit scores. If the creditor pays the loan originator \$1,500 in compensation for consumer A's loan and \$1,000 in compensation for consumer B's loan, because the creditor varies compensation payments in whole or in part with the consumer's credit score, the originator's compensation would be based on the transactions' terms.]

▶ Assume a creditor pays a loan originator differently based on whether a loan the person originates will be held

by the creditor in portfolio or sold by the creditor into the secondary market. The creditor holds in portfolio only loans that have a fixed interest rate and a five-year term with a final balloon payment. The creditor sells into the secondary market all other loans, which typically have a higher fixed interest rate and a thirty-year term. The creditor pays a loan originator a 1.5 percent commission for originating loans to be held in portfolio, and pays the same loan originator a 1 percent commission for originating loans that will be sold into the secondary market. Thus, whether a loan is held in portfolio or sold into the secondary market for this creditor correlates highly with whether the loan has a five-year term or a thirty-year term, which are terms of the transaction. Also, the loan originator can indirectly change the factor by steering the consumer to choose a loan destined for portfolio or for sale into the secondary market. Whether or not the loan will be held in portfolio is a factor that is a proxy for the transaction's terms.

C. Assume a loan originator organization pays its individual loan originators different commissions for loans based on the location of the home. The loan originator organization pays its individual loan originators 1 percent of the loan amount for originating refinancings in State A and 2 percent of the loan amount for originating refinancings in State B. For this organization loan originator, on average, loans for refinancings in State A have substantially lower interest rates than loans for refinancings in State B even if a loan originator, however, cannot influence whether the refinancing of a particular loan is for a home located in State A or State B. In this instance, whether a refinancing is originated in State A or State B is not a proxy for the transaction's terms.

ii. *Pooled compensation.* Where loan originators are compensated differently and they each originate loans with different terms, § 1026.36(d)(1) does not permit the pooling of compensation so that the loan originators share in that pooled compensation. For example, assume that Loan Originator A receives a commission of two percent of the amount of credit extended on each loan he or she originates and originates loans that generally have higher interest rates than the loans that Loan Originator B originates. In addition, assume Loan Originator B receives a commission of one percent of the amount of credit extended on each loan he or she originates and originates loans that generally have lower interest rates than the loans originated by Loan Originator

A. The compensation to these loan originators may not be pooled so that the loan originators each share in that pooled compensation. This type of pooling is prohibited by § 1026.36(d)(1) because each loan originator is being paid based on loan terms, with each loan originator receiving compensation based on the terms of the transactions the loan originators collectively make.

iii. *Payment and distribution of compensation to loan originators.* Section 1026.36(d)(1)(i) prohibits a person from paying and a loan originator from receiving compensation that is based on any transaction terms, except as provided in § 1026.36(d)(1)(iii). Comment 36(d)(1)–1.ii clarifies that this prohibition covers the payment of compensation that directly or indirectly is based on the terms of a single transaction of that individual loan originator, the terms of multiple transactions of that individual loan originator, or the terms of multiple transactions of multiple individual loan originators employed by the person. Comment 36(d)(1)–1.ii also provides examples of when a bonus paid to an individual loan originator is and is not based on the terms of transactions of multiple individual loan originators. Section 1026.36(d)(1)(iii) provides that, notwithstanding § 1026.36(d)(1)(i), a person may make a contribution to a qualified defined contribution or benefit plan in which the individual loan originator participates, provided that the contribution is not directly or indirectly based on the terms of that individual loan originator's transactions subject to § 1026.36(d). The section also provides that, notwithstanding § 1026.36(d)(1)(i), an individual loan originator may receive, and a person may pay to an individual loan originator, compensation in the form of a bonus or other payment under a profit-sharing plan or a contribution to a non-qualified defined benefit or contribution plan even if the compensation directly or indirectly is based on the terms of the transactions subject to § 1026.36(d) of multiple individual loan originators, but only if the conditions set forth in § 1026.36(d)(1)(iii)(A) and (B) are satisfied, as applicable. Pursuant to § 1026.36(j) and comment 36–1, § 1026.36(d) applies to closed-end consumer credit transactions secured by dwellings and reverse mortgages that are not home-equity lines of credit under § 1026.40.

A. *Profit-sharing plan.* Under § 1026.36(d)(1)(iii), a profit-sharing plan is a plan sponsored and funded by a person under which the person pays an individual loan originator directly in cash, stock, or other non-deferred

compensation or through deferred compensation to be distributed at retirement or another future date. The person's funding of the profit-sharing plan, and the distributions to the individual loan originators, may be determined by a fixed formula or may be at the discretion of the person (e.g., the person may elect not to contribute to the profit-sharing plan in a given year). For purposes of § 1026.36(d)(1)(iii), profit-sharing plans include "bonus plans," "bonus pools," or "profit pools" from which a person pays individual loan originators employed by the person (as well as other employees, if it so elects) additional compensation based in whole or in part on the profitability of the person or the business unit within the person's organizational structure whose profitability is referenced for the compensation payment, as applicable (i.e., depending on the level within the company at which the profit-sharing plan is established). For example, a creditor that pays its individual loan originators bonuses at the end of a calendar year based on the creditor's average net return on assets for the calendar year is considered a profit-sharing plan under § 1026.36(d)(1)(iii). A bonus that is paid to an individual loan originator without reference to the profitability of the person or business unit, as applicable, such as a retention payment budgeted for in advance, does not violate the prohibition on payment of compensation based on transaction terms under § 1026.36(d)(1)(i), as clarified by comment 36(d)(1)–1.ii; therefore, the provisions of § 1026.36(d)(1)(iii) do not apply (see comment 36(d)(1)–1.ii for further guidance).

B. *Contributions to defined benefit and contribution plans.* A defined benefit plan is a retirement plan in which the sponsoring person agrees to provide a certain benefit to participants based on a pre-determined formula. A defined contribution plan is an employer-sponsored retirement plan in which contributions are made to individual accounts of employees participating in the plan, and the final distribution consists solely of assets (including investment returns) that have accumulated in these individual accounts. Depending on the type of defined contribution plan, contributions may be made either by the sponsoring employer, the participating employee, or both. Defined contribution plans and defined benefit plans are either qualified or non-qualified. For guidance on the distinction between qualified and non-qualified plans and the relevance of

such distinction to the provisions of § 1026.36(d)(1)(iii), see comments 36(d)(1)–2.iii.E and –2.iii.G.

C. *Directly or indirectly based on the terms of multiple individual loan originators.* The compensation arrangements addressed in § 1026.36(d)(1)(iii) are directly or indirectly based on the terms of transactions of multiple individual loan originators when the compensation, or its amount, results from or is otherwise related to the terms of those multiple individual loan originators' transactions subject to § 1026.36(d). See comment 36(d)(1)–1.i for further guidance on when compensation is “based on” loan terms. See comment 36(d)(1)–1.ii for examples of when an individual loan originator's compensation is and is not based on multiple transactions of multiple individual loan originators. If a creditor does not permit its individual loan originator employees to deviate from the transaction terms established by the creditor for each consumer, such as the interest rate offered or existence of a prepayment penalty, then the creditor's payment of a bonus at the end of a calendar year to an individual loan originator under a profit-sharing plan is not directly or indirectly based on the transaction terms during that calendar year. If a loan originator organization's revenues are derived exclusively from fees paid by the creditors that fund its originations pays a bonus under a profit-sharing plan, the bonus is not directly or indirectly based on multiple individual loan originators' transaction terms because § 1026.36(d)(1)(i) precludes any person (including the creditor) from paying to a loan originator (in this case, the loan originator organization) compensation based on the terms of the loans it is purchasing.

D. *Time period for which the compensation is paid.* Under § 1026.36(d)(1)(iii), the time period for which the compensation is paid is the time period for which the individual loan originator's performance was evaluated for purposes of the compensation decision (e.g., calendar year, quarter, month), whether or not the compensation is actually paid during or after the time period. For example, assume a creditor assesses the financial performance of its mortgage business on a quarterly and calendar year basis (which annual review is the basis for the creditor's income tax filings). Among the factors taken into account in assessing the financial performance of the creditor's mortgage business are the interest rate spreads over the creditor's minimum acceptable rates of the loans subject to § 1026.36(d)

originated for the creditor by individual loan originators employed by the creditor during the calendar year (i.e., because the rate spreads will affect the amount of interest income and secondary market sale proceeds of the mortgage business line). Following its third quarter review, the creditor decides to pay a “pre-holiday bonus” in early November to every individual loan originator employee in an amount equal to two percent of each employee's salary. For purposes of § 1026.36(d)(1)(iii), the compensation decision is directly or indirectly based on the terms of multiple transactions of multiple individual loan originators during the full calendar year because it took into account the terms of transactions during the first three quarters as well as projected similar transaction terms for the remainder of the calendar year.

E. *Employer contributions to qualified plans.* Section 1026.36(d)(1)(iii) permits a person to compensate an individual loan originator through making a contribution to a qualified defined contribution or defined benefit plan in which an individual loan originator employee participates, even if the compensation is directly or indirectly based on the terms of transactions subject to § 1026.36(d) of multiple individual loan originators. For purposes of § 1026.36(d)(1)(iii), qualified defined contribution and defined benefit plans (collectively, qualified plans) include 401(k) plans, employee stock ownership plans (ESOPs), profit-sharing plans, savings incentive match plans for employees (SIMPLE plans), simplified employee pensions (SEPs), and any other plans that satisfy the qualification requirements under section 401(a) of the Internal Revenue Code (IRC) and applicable terms of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001, *et seq.* For purposes of § 1026.36(d)(1)(iii), qualified plans also include tax-sheltered annuity plans under IRC section 403(b) and eligible governmental deferred compensation plans under IRC section 457(b). For example, a loan originator organization may make discretionary contributions to a qualified profit-sharing plan (i.e., the loan originator organization's annual contribution is not fixed and may even be zero in a given year) in accordance with a definite formula for allocating and distributing the contribution among the plan participants, even if the discretionary contribution is directly or indirectly based on the terms of

multiple individual loan originators' transactions.

F. *Compensation based on terms of an individual loan originator's transactions.* Under both § 1026.36(d)(1)(iii), with regard to contributions made to qualified plans, and § 1026.36(d)(1)(iii)(A), with regard to compensation in the form of a bonus or other payment under a profit-sharing plan or a contribution to a non-qualified defined contribution or benefit plan, the payment of compensation to an individual loan originator may not be directly or indirectly based on the terms of that individual loan originator's transaction or transactions. Consequently, the compensation payment may not take into account, for example, that the individual loan originator's transactions subject to § 1026.36(d) during the preceding calendar year had higher interest rate spreads over the creditor's minimum acceptable rate on average than similar transactions for other individual loan originators employed by the creditor. See comment 36(d)(1)–1 for further guidance on determining whether compensation is “based on” transaction terms.

ALTERNATIVE 1—PARAGRAPH 2.iii.G

G. *Bonuses under profit-sharing plans; employer contributions to defined contribution and defined benefit plans other than qualified plans.* Section 1026.36(d)(1)(iii)(B)(1) permits compensation to an individual loan originator in the form of a bonus or other payment under a profit-sharing plan or a contribution to a defined contribution or benefit plan other than a qualified plan even if the payment or contribution is directly or indirectly based on the terms of multiple individual loan originators' transactions subject to § 1026.36(d), if certain conditions are met. Specifically, the compensation is permitted if no more than 50 percent of the total revenues of the person (or, if applicable, the business unit within the person at which level the payment or contribution is made) are derived from the person's mortgage business during the tax year immediately preceding the tax year in which the compensation is paid.

1. *Total revenues.* The total revenues for purposes of the revenue test under § 1026.36(d)(1)(iii)(B)(1) are the revenues of the person or the business unit to which the profit-sharing plan applies, as applicable, during the tax year immediately preceding the tax year in which the compensation is paid. Under this provision, whether the revenues of the person or the business

unit are used depends on the level within the person's organizational structure at which the profit-sharing plan is established and whose profitability is referenced for purposes of payment of the compensation under the profit-sharing plan. If the profitability of a business unit is referenced for purposes of establishing the profit-sharing plan rather than the overall profits of the person, then the revenues of the business unit are used. If the profitability of the person is referenced for purposes of establishing the profit-sharing plan, however, then the total revenues of the person are used. For example, if a creditor has two separate business units, one for commercial credit transactions and one for consumer credit transactions, and the profits of the consumer credit business unit are referenced for purposes of establishing a bonus pool to pay bonuses to individual loan originators then the profit-sharing plan applies to the consumer credit business unit, and thus the total revenues of the consumer credit business unit are the total revenues used for purposes of § 1026.36(d)(1)(i)(B)(1). If the creditor has a single profit-sharing plan for all of its employees, however, the creditor's total revenues across all business lines are used. The total revenues for the person or the applicable business unit or division, as applicable, are those revenues during the tax year immediately preceding the tax year in which the compensation is paid. A tax year is the person's annual accounting period for keeping records and reporting income and expenses (*i.e.*, it may be a calendar year or a fiscal year depending on the person's annual accounting period). Thus, for example, if a loan originator organization at the level of the organization (rather than a lower-tier business unit) pays multiple individual loan originator employees a bonus under a profit-sharing plan in February 2013, and the loan originator organization uses a calendar year accounting period, then the total revenues used for purposes of § 1026.36(d)(1)(i)(B)(1) are the organization's revenues generated during 2012. Pursuant to § 1026.36(d)(1)(i)(B)(1), the total revenues are determined through a methodology that is consistent with generally accepted accounting principles (GAAP) and, as applicable, the reporting of the person's income for purposes of Federal tax filings or, if none, any industry call reports filed regularly by the person. Depending on the person, the industry call report to be used may be, for example, the NMLSR

Mortgage Call Report or the NCUA Call Report. For example, to determine its total revenues on a calendar year basis, a Federal credit union that is exempt from paying Federal income tax uses a methodology to determine total annual revenues that reflects the income reported in the NCUA Call Reports. If the credit union does not file NCUA Call Reports, however, the credit union uses a methodology that, pursuant to § 1026.36(d)(1)(i)(B)(1), otherwise is consistent with GAAP and, as applicable, reflects an accurate allocation of revenues among the credit union's business units. Pursuant to § 1026.36(d)(1)(i)(B)(1), the revenues of the person's affiliates generally are not taken into account for purposes of the revenue test unless the profit-sharing plan applies to the affiliate, in which case the person's total revenues also include the total revenues of the affiliate. The profit-sharing plan applies to the affiliate when, for example, the funds used to pay a bonus to an individual loan originator are the same funds used to pay a bonus to employees of the affiliate.

2. *Revenues derived from mortgage business.* Section 1026.36(d)(1)(iii)(B)(1) provides that revenues derived from mortgage business are the portion of the total revenues (*see* comment 36(d)(1)–2.iii.G.1) that are generated through a person's transactions subject to § 1026.36(d). Pursuant to § 1026.36(j) and comment 36–1, § 1026.36(d) applies to closed-end consumer credit transactions secured by dwellings and reverse mortgages that are not home-equity lines of credit under § 1026.40. Thus, a person's revenues from its mortgage business include, for example: origination fees and interest associated with loans for purchase money or refinance purposes originated by individual loan originators employed by the person, income from servicing of loans for purchase money or refinance purposes originated by individual loan originators employed by the person, and proceeds of secondary market sales of loans for purchase money or refinance purposes originated by individual loan originators employed by the person. Revenues derived from mortgage business do not include, for example, servicing income where the loans being serviced were purchased by the person after the loans' origination by another person, or origination fees, interest, and secondary market sale proceeds associated with home-equity lines of credit, loans secured by consumers' interests in timeshare plans, or loans made primarily for business, commercial or agricultural purposes.

ALTERNATIVE 2—PARAGRAPH 2.iii.G

G. *Bonuses under profit-sharing plans; employer contributions to defined contribution and defined benefit plans other than qualified plans.* Section 1026.36(d)(1)(iii)(B)(1) permits compensation to an individual loan originator in the form of a bonus or other payment under a profit-sharing plan or a contribution to a defined contribution or benefit plan other than a qualified plan even if the payment or contribution is directly or indirectly based on the terms of multiple individual loan originators' transactions subject to § 1026.36(d), if certain conditions are met. Specifically, the compensation is permitted if no more than 25 percent of the total revenues of the person (or, if applicable, the business unit within the person at which level the payment or contribution is made) are derived from the person's mortgage business during the tax year immediately preceding the tax year in which the compensation is paid.

1. *Total revenues.* The total revenues for purposes of the revenue test under § 1026.36(d)(1)(iii)(B)(1) are the revenues of the person or the business unit to which the profit-sharing plan applies, as applicable, during the tax year immediately preceding the tax year in which the compensation is paid. Under this provision, whether the revenues of the person or the business unit are used depends on the level within the person's organizational structure at which the profit-sharing plan is established and whose profitability is referenced for purposes of payment of the compensation under the profit-sharing plan. If the profitability of a business unit is referenced for purposes of establishing the profit-sharing plan rather than the overall profits of the person, then the revenues of the business unit are used. If the profitability of the person is referenced for purposes of establishing the profit-sharing plan, however, then the total revenues of the person are used. For example, if a creditor has two separate business units, one for commercial credit transactions and one for consumer credit transactions, and the profits of the consumer credit business unit are referenced for purposes of establishing a bonus pool to pay bonuses to individual loan originators then the profit-sharing plan applies to the consumer credit business unit, and thus the total revenues of the consumer credit business unit are the total revenues used for purposes of § 1026.36(d)(1)(i)(B)(1). If the creditor has a single profit-sharing plan for all of

its employees, however, the creditor's total revenues across all business lines are used. The total revenues for the person or the applicable business unit or division, as applicable, are those revenues during the tax year immediately preceding the tax year in which the compensation is paid. A tax year is the person's annual accounting period for keeping records and reporting income and expenses (*i.e.*, it may be a calendar year or a fiscal year depending on the person's annual accounting period). Thus, for example, if a loan originator organization at the level of the organization (rather than a lower-tier business unit) pays multiple individual loan originator employees a bonus under a profit-sharing plan in February 2013, and the loan originator organization uses a calendar year accounting period, then the total revenues used for purposes of § 1026.36(d)(1)(i)(B)(1) are the organization's revenues generated during 2012. Pursuant to § 1026.36(d)(1)(i)(B)(1), the total revenues are determined through a methodology that is consistent with generally accepted accounting principles (GAAP) and, as applicable, the reporting of the person's income for purposes of Federal tax filings or, if none, any industry call reports filed regularly by the person. Depending on the person, the industry call report to be used may be, for example, the NMLSR Mortgage Call Report or the NCUA Call Report. For example, to determine its total revenues on a calendar year basis, a Federal credit union that is exempt from paying Federal income tax uses a methodology to determine total annual revenues that reflects the income reported in the NCUA Call Reports. If the credit union does not file NCUA Call Reports, however, the credit union uses a methodology that, pursuant to § 1026.36(d)(1)(i)(B)(1), otherwise is consistent with GAAP and, as applicable, reflects an accurate allocation of revenues among the credit union's business units. Pursuant to § 1026.36(d)(1)(i)(B)(1), the revenues of the person's affiliates generally are not taken into account for purposes of the revenue test unless the profit-sharing plan applies to the affiliate, in which case the person's total revenues for purposes also include the total revenues of the affiliate. The profit-sharing plan applies to the affiliate when, for example, the funds used to pay a bonus to an individual loan originator are the same funds used to pay a bonus to employees of the affiliate.

2. *Revenues derived from mortgage business.* Section 1026.36(d)(1)(iii)(B)(1)

provides that revenues derived from mortgage business are the portion of the total revenues (*see* comment 36(d)(1)–2.iii.G.1) that are generated through a person's transactions subject to § 1026.36(d). Pursuant to § 1026.36(j) and comment 36–1, § 1026.36(d) applies to closed-end consumer credit transactions secured by dwellings and reverse mortgages that are not home-equity lines of credit under § 1026.40. Thus, a person's revenues from its mortgage business include, for example: origination fees and interest associated with loans for purchase money or refinance purposes originated by individual loan originators employed by the person, income from servicing of loans for purchase money or refinance purposes originated by individual loan originators employed by the person, and proceeds of secondary market sales of loans for purchase money or refinance purposes originated by individual loan originators employed by the person. Revenues derived from mortgage business do not include, for example, servicing income where the loans being serviced were purchased by the person after the loans' origination by another person, or origination fees, interest, and secondary market sale proceeds associated with home-equity lines of credit, loans secured by consumers' interests in timeshare plans, or loans made primarily for business, commercial or agricultural purposes.

H. *Individual loan originators who originate five or fewer mortgage loans.* Section 1026.36(d)(1)(iii)(B)(2) permits compensation to an individual loan originator in the form of a bonus or other payment under a profit-sharing plan or a contribution to a defined contribution or benefit plan other than a qualified plan even if the payment or contribution is directly or indirectly based on the terms of multiple individual loan originators' transactions subject to § 1026.36(d), if certain conditions are met. Specifically, the compensation is permitted if the individual is a loan originator (as defined in § 1026.36(a)(1)(i)) for five or fewer transactions subject to § 1026.36(d) during the 12-month period preceding the date of the decision to make the payment or contribution.

ALTERNATIVE 1—PARAGRAPHS 2.iii.H.1 and 2.iii.I

1. For example, assume a loan originator organization employs six individual loan originators during a given calendar year. In January of the following calendar year, the loan originator organization formally determines the financial performance of its mortgage business for the prior

calendar year, which takes into account the terms of all transactions subject to § 1026.36(d) of the individual loan originators employed by the person during that calendar year. Based on that determination, the loan originator organization on February 1 decides to pay bonuses to the individual loan originators out of a "bonus pool." Assume that between February 1 of the prior calendar year and January 31 of the current calendar year, individual loan originators A, B, and C each were the loan originators for between three and five transactions subject to § 1026.36(d), and individual loan originators D, E, and F each were the loan originators for between 10 and 15 transactions subject to § 1026.36(d). Therefore, the loan originator organization may award the bonuses to individual loan originators A, B, and C, but the loan originator organization may not award the bonuses to individual loan originators D, E, and F unless the loan originator organization can demonstrate that its mortgage business revenues are 50 percent or less of the total revenues of the loan originator organization or the business unit to which the profit-sharing plan applies, as applicable (thereby satisfying the conditions of § 1026.36(d)(1)(iii)(B)(1)).

I. *Additional examples.* 1. Assume that Company A is solely engaged in the mortgage and credit card businesses. Company A generates \$1 million in revenue in a given calendar year and files its income taxes on a calendar-year basis. Company A's mortgage business accounts for \$150,000 in revenue (or 15 percent of the company's total revenues), while its credit card business accounts for \$850,000 in revenue (or 85 percent). A bonus pool is set aside at the level of the company, rather than the individual business units. Because Company A's mortgage business accounts for less than 50 percent of its total revenues, Company A may take into account the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators when paying a bonus or other compensation to an individual loan originator under a profit-sharing plan or making a contribution to a defined benefit or contribution plan (whether or not a qualified plan). However, the compensation cannot reflect the terms of that individual loan originator's transaction or transactions.

2. Assume that Company B is solely engaged in the mortgage and credit card businesses. Company B earns \$1 million in revenue in a given calendar year, and it files its income taxes on a calendar-year basis. Company B's mortgage business accounts for \$510,000 in

revenue (51 percent), and its credit card business accounts for \$490,000 in revenue (49 percent). A bonus pool is set aside at the level of the company, rather than the individual business units. Because Company B's mortgage business accounts for more than the 50 percent of its total revenues, Company B may not take into account the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators when paying a bonus or other compensation under a profit-sharing plan or making a contribution to a non-qualified defined benefit or contribution plan. The compensation may be based on the financial performance of the credit card business alone. In addition, the compensation may be based on the terms of multiple individual loan originators' transactions with regard to a contribution to a qualified plan. Further, where an individual loan originator has been the loan originator for five or fewer transactions subject to § 1026.36(d) during the 12 month period immediately preceding the decision to make the compensation payment, Company B make take into account the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators when paying a bonus or other compensation under a profit-sharing plan or making a contribution to a defined benefit or contribution plan (whether or not a qualified plan). In all instances, however, the compensation cannot reflect the terms of that individual loan originator's transaction or transactions. ◀

ALTERNATIVE 2—PARAGRAPHS 2.iii.H.1 and 2.iii.I

1. For example, assume a loan originator organization employs six individual loan originators during a given calendar year. In January of the following calendar year, the loan originator organization formally determines the financial performance of its mortgage business for the prior calendar year, which takes into account the terms of all transactions subject to § 1026.36(d) of the individual loan originators employed by the person during that calendar year. Based on that determination, the loan originator organization on February 1 decides to pay bonuses to the individual loan originators out of a "bonus pool." Assume that between February 1 of the prior calendar year and January 31 of the current calendar year, individual loan originators A, B, and C each were the loan originators for between three and five transactions subject to § 1026.36(d), and individual loan originators D, E, and F each were the

loan originators for between 10 and 15 transactions subject to § 1026.36(d). Therefore, the loan originator organization may award the bonuses to individual loan originators A, B, and C, but the loan originator organization may not award the bonuses to individual loan originators D, E, and F unless the loan originator organization can demonstrate that its mortgage business revenues are 25 percent or less of the total revenues of the loan originator organization or the business unit to which the profit-sharing plan applies, as applicable (thereby satisfying the conditions of § 1026.36(d)(1)(iii)(B)(1)).

I. *Additional examples.* 1. Assume that Company A is solely engaged in the mortgage and credit card businesses. Company A generates \$1 million in revenue in a given calendar year and files its income taxes on a calendar-year basis. Company A's mortgage business accounts for \$150,000 in revenue (or 15 percent of the company's total revenues), while its credit card business accounts for \$850,000 in revenue (or 85 percent). A bonus pool is set aside at the level of the company, rather than the individual business units. Because Company A's mortgage business accounts for less than 25 percent of its total revenues, Company A may take into account the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators when paying a bonus or other compensation to an individual loan originator under a profit-sharing plan or making a contribution to a defined benefit or contribution plan (whether or not a qualified plan). However, the compensation cannot reflect the terms of that individual loan originator's transaction or transactions.

2. Assume that Company B is solely engaged in the mortgage and credit card businesses. Company B earns \$1 million in revenue in a given calendar year, and it files its income taxes on a calendar-year basis. Company B's mortgage business accounts for \$300,000 in revenue (30 percent), and its credit card business accounts for \$700,000 in revenue (70 percent). A bonus pool is set aside at the level of the company, rather than the individual business units. Because Company B's mortgage business accounts for more than the 25 percent of its total revenues, Company B may not take into account the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators when paying a bonus or other compensation under a profit-sharing plan or making a contribution to a non-qualified defined benefit or contribution plan. The compensation may be based on the financial

performance of the credit card business alone. In addition, the compensation may be based on the terms of multiple individual loan originators' transactions with regard to a contribution to a qualified plan. Further, where an individual loan originator has been the loan originator for five or fewer transactions subject to § 1026.36(d) during the 12 month period immediately preceding the decision to make the compensation payment, Company B make take into account the terms of multiple transactions subject to § 1026.36(d) of multiple individual loan originators when paying a bonus or other compensation under a profit-sharing plan or making a contribution to a defined benefit or contribution plan (whether or not a qualified plan). In all instances, however, the compensation cannot reflect the terms of that individual loan originator's transaction or transactions. ◀

3. *Examples of compensation not based on transaction terms [or conditions].* The following are only illustrative examples of compensation methods that are permissible (unless otherwise prohibited by applicable law), and not an exhaustive list. Compensation is not based on the transaction's terms [or conditions] if it is based on, for example:

- i. The loan originator's overall loan volume (*i.e.*, total dollar amount of credit extended or total number of loans originated), delivered to the creditor.
- ii. The long-term performance of the originator's loans.
- iii. An hourly rate of pay to compensate the originator for the actual number of hours worked.
- iv. Whether the consumer is an existing customer of the creditor or a new customer.
- v. A payment that is fixed in advance for every loan the originator arranges for the creditor (*e.g.*, \$600 for every loan arranged for the creditor, or \$1,000 for the first 1,000 loans arranged and \$500 for each additional loan arranged).
- vi. The percentage of applications submitted by the loan originator to the creditor that results in consummated transactions.
- vii. The quality of the loan originator's loan files (*e.g.*, accuracy and completeness of the loan documentation) submitted to the creditor.
- viii. A legitimate business expense, such as fixed overhead costs.
- ix. Compensation that is based on the amount of credit extended, as permitted by § 1026.36(d)(1)(ii). *See* comment 36(d)(1)–9 discussing compensation based on the amount of credit extended.

4. *Creditor's flexibility in setting loan terms.* Section 1026.36(d)(1) does not limit a creditor's ability to offer a higher interest rate in a transaction as a means for the consumer to finance the payment of the loan originator's compensation or other costs that the consumer would otherwise be required to pay directly (either in cash or out of the loan proceeds). Thus, subject to § 1026.36(d)(2)(ii), a creditor may charge a higher interest rate to a consumer who will pay fewer of the costs of the transaction directly, or it may offer the consumer a lower rate if the consumer pays more of the costs directly. For example, if the consumer pays half of the transaction costs directly, a creditor may charge an interest rate of 6 percent but, if the consumer pays none of the transaction costs directly, the creditor may charge an interest rate of 6.5 percent. Section 1026.36(d)(1) also does not limit a creditor from offering or providing different loan terms to the consumer based on the creditor's assessment of the credit and other transactional risks involved. But see § 1026.36(d)(2)(ii). A creditor could also offer different consumers varying interest rates that include a constant interest rate premium to recoup the loan originator's compensation through increased interest paid by the consumer (such as by adding a constant 0.25 percent to the interest rate on each loan).

5. *Effect of modification of loan terms.* Under § 1026.36(d)(1), a loan originator's compensation may not be based on any of a credit transaction's terms. Thus, a creditor and loan originator may not agree to set the originator's compensation at a certain level and then subsequently lower it in selective cases (such as where the consumer is able to obtain a lower rate from another creditor). When the creditor offers to extend a loan with specified terms and conditions (such as the rate and points), the amount of the originator's compensation for that transaction is not subject to change (increase or decrease) based on whether different loan terms are negotiated. For example, if the creditor agrees to lower the rate that was initially offered, the new offer may not be accompanied by a reduction in the loan originator's compensation. Thus, while the creditor may change loan terms or pricing to match a competitor, to avoid triggering high-cost loan provisions, or for other reasons, the loan originator's compensation on that transaction may not be changed. A loan originator therefore may not agree to reduce its

compensation or provide a credit to the consumer to pay a portion of the consumer's closing costs, for example, to avoid high-cost loan provisions. See comment 36(d)(1)-7 for further guidance.

6. *Periodic changes in loan originator compensation and transactions' terms [and conditions].* This section does not limit a creditor or other person from periodically revising the compensation it agrees to pay a loan originator. However, the revised compensation arrangement must result in payments to the loan originator that are not based on the terms [or conditions] of a credit transaction. A creditor or other person might periodically review factors such as loan performance, transaction volume, as well as current market conditions for originator compensation, and prospectively revise the compensation it agrees to pay to a loan originator. For example, assume that during the first six months of the year, a creditor pays \$3,000 to a particular loan originator for each loan delivered, regardless of the loan terms [or conditions]. After considering the volume of business produced by that originator, the creditor could decide that as of July 1, it will pay \$3,250 for each loan delivered by that particular originator, regardless of the loan terms [or conditions]. No violation occurs even if the loans made by the creditor after July 1 generally carry a higher interest rate than loans made before that date, to reflect the higher compensation.

7. *Unanticipated increases in non-affiliated third-party closing costs.* Notwithstanding comment 36(d)(1)-5, § 1026.36(d)(1) does not prohibit loan originators from decreasing their compensation to cover unanticipated increases in non-affiliated third-party closing costs that result in the actual amounts of such closing costs exceeding limits imposed by applicable law, provided that the creditor or the loan originator does not know or should not reasonably be expected to know the amount of any third-party closing costs in advance. An example of where the loan originator is reasonably expected to know the amount of closing costs in advance is if the loan originator allows the consumer to choose from among only three pre-approved third-party service providers.

8. *Compensation received directly from the consumer.* The prohibition in § 1026.36(d)(1) does not apply to transactions in which any loan originator receives compensation directly from the consumer, in which case no other person may provide any compensation to a loan originator,

directly or indirectly, in connection with that particular transaction pursuant to § 1026.36(d)(2). Payments to a loan originator made out of loan proceeds are considered compensation received directly from the consumer, while payments derived from an increased interest rate are not considered compensation received directly from the consumer. However, points paid on the loan by the consumer to the creditor are not considered payments received directly from the consumer whether they are paid in cash or out of the loan proceeds. That is, if the consumer pays origination points to the creditor and the creditor compensates the loan originator, the loan originator may not also receive compensation directly from the consumer. Compensation includes amounts retained by the loan originator, but does not include amounts the loan originator receives as payment for *bona fide* and reasonable third-party charges, such as title insurance or appraisals. See comment 36(d)(1)-1.]

8. *Record retention.* Creditors and loan originator organizations are subject to certain record retention requirements under § 1026.25(a), (b), and (c)(2), as applicable, in order to comply with § 1026.36(d)(1). See comment 25(a)-5, 25(c)(2)-1 and -2 for guidance on complying with the record retention requirements of § 1026.25(a) as they apply to § 1026.36(d)(1).

10. *Amount of credit extended under a reverse mortgage.* For closed-end reverse mortgage loans, the "amount of credit extended" for purposes of § 1036.36(d)(1) means the maximum proceeds available to the consumer under the loan.

36(d)(2) *Payments by persons other than consumer.*

36(d)(2)(i) *Dual compensation.*
1. *Compensation in connection with a particular transaction.* Under § 1026.36(d)(2)(i)(A), if any loan originator receives compensation directly from a consumer in a transaction, no other person may provide any compensation to any loan originator, directly or indirectly, in connection with that particular credit transaction. See comment 36(d)(2)(i)-2 discussing compensation received directly from the consumer. The restrictions imposed under § 1026.36(d)(2) relate only to payments, such as commissions, that are specific to, and paid solely in connection with, the transaction in which the consumer has paid compensation directly to a loan originator. Section 1026.36(d)(2)(i)(C)

provides that, if a loan originator organization receives compensation directly from a consumer, the loan originator organization may provide compensation to individual loan originators and the individual loan originator may receive compensation from the loan originator organization. (See comment 36(a)(1)–1.i for an explanation of the use of the term “loan originator organization” and “individual loan originator” for purposes of § 1026.36(d)(2)(i)(C).) For example, payments by a mortgage broker organization to an employee as compensation for a specific credit transaction in the form of a salary or hourly wage, which is not tied to a specific transaction, do not violate § 1026.36(d)(2)(i)(A) even if the consumer directly pays the mortgage broker organization a fee in connection with that transaction. However, if any loan originator receives compensation directly from the consumer in connection with a specific credit transaction, neither the mortgage broker organization nor the employee of the mortgage broker company can receive compensation from the creditor in connection with that particular credit transaction.

2. *Compensation received directly from a consumer.* i. Payments to a loan originator from loan proceeds are considered compensation received directly from the consumer, while payments derived from an increased interest rate are not considered compensation received directly from the consumer. However, points paid on the loan by the consumer to the creditor are not considered payments to the loan originator that are received directly from the consumer whether they are paid directly by the consumer (for example, in cash or by check) or out of the loan proceeds. That is, if the consumer pays points to the creditor and the creditor compensates the loan originator, the loan originator may not also receive compensation directly from the consumer. Compensation includes amounts retained by the loan originator, but does not include amounts the loan originator receives as payment for bona fide and reasonable third-party charges, such as credit reports. See comment 36(a)–5.iii.

ii. Under Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA), A rebate that will be applied to reduce the consumer’s settlement charges, including origination fees a yield spread premium paid by a creditor to

the loan originator may be characterized on the RESPA disclosures made pursuant to the Real Estate Settlement Procedures Act as a “credit.” [that will be applied to reduce the consumer’s settlement charges, including origination fees.] A yield spread premium rebate disclosed in this manner is not considered to be received by the loan originator directly from the consumer for purposes of § 1026.36(d)(2).

iii. Section 1026.36(d)(2)(i)(B) provides that compensation directly from a consumer includes payments to a loan originator made pursuant to an agreement between the consumer and a person other than the creditor or its affiliates. Compensation to a loan originator is sometimes paid on the borrower’s behalf by a person other than a creditor or its affiliates, such as a non-creditor seller, home builder, home improvement contractor or real estate broker or agent. Such payments to a loan originator are considered compensation received directly from the consumer for purposes of § 1026.36(d)(2) if they are made pursuant to an agreement between the consumer and the person other than the creditor or its affiliates. State law will determine if there is an agreement between the parties. See § 1026.2(b)(3). The parties do not have to agree specifically that the payments will be used to pay for the loan originator’s compensation, but just that the person will make a payment toward the borrower’s closing costs. For example, assume that a non-creditor seller has an agreement with the borrower to pay \$1,000 of the borrower’s closing costs on a transaction. Any of the \$1,000 that is used to pay compensation to a loan originator is deemed to be compensation received directly from the consumer, even if the agreement does not specify that some or all of \$1,000 must be used to compensate the loan originator.

36(d)(2)(ii) Restrictions on Discount Points and Origination Points or Fees.

1. *Scope.* i. *Examples of transactions to which the restrictions on discount points and origination points or fees applies.* The prohibition in § 1026.36(d)(2)(ii) applies when:

A. For transactions that do not involve a loan originator organization, the creditor pays compensation in connection with the transaction (e.g., a commission) to individual loan originators that work for the creditor;

B. The creditor pays a loan originator organization compensation in connection with a transaction, regardless of how the loan originator organization pays compensation to

individual loan originators that work for the organization; and

C. The loan originator organization receives compensation directly from the consumer in a transaction and the loan originator organization pays individual loan originators that work for the organization compensation in connection with the transaction.

ii. *Examples of transactions to which the restrictions on discount points and origination points or fees does not apply.* The prohibition in § 1026.36(d)(2)(ii) does not apply when:

A. For transactions that do not involve a loan originator organization, the creditor pays individual loan originators that work for the creditor only in the form of a salary, hourly wage, or other compensation that is not tied to the particular transaction; and

B. For transactions that involve a loan originator organization, the loan originator organization receives compensation directly from the consumer and pays individual loan originators that work for the organization only in the form of a salary, hourly wage, or other compensation that is not tied to the particular transaction.

iii. *Relationship to provisions prohibiting dual compensation.* Section 1026.36(d)(2)(ii) does not override any of the prohibitions on dual compensation set forth in § 1026.36(d)(2)(i). For example, § 1026.36(d)(2)(ii) does not permit a loan originator organization to receive compensation in connection with a transaction both from a consumer and from a person other than the consumer.

2. *Record retention.* See § 1026.25(c)(3) for record retention requirements as they apply to § 1026.36(d)(2)(ii).

3. *Affiliates.* Section 1026.36(d)(3) provides that for purposes of § 1026.36(d), affiliates must be treated as a single person. Thus, under § 1026.36(d)(2)(ii)(A), neither a creditor’s affiliate nor an affiliate of the loan originator organization may impose on the consumer any discount points and origination points or fees in connection with the transaction unless the creditor makes available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan. In addition, for purposes of the definition of discount points and origination points or fees set forth in § 1026.36(d)(2)(ii)(B), charges that are payable by a consumer to a creditor’s affiliate or the affiliate of a loan originator organization are deemed to be payable to the creditor or loan originator organization, respectively.

Paragraph 36(d)(2)(ii)(A)

1. *Make available.* i. Unless a creditor determines that a consumer is unlikely to qualify for a comparable, alternative loan that does not include discount points and origination points or fees, the creditor must make such a loan available to the consumer. For transactions that do not involve a loan originator organization, a creditor will be deemed to have made available to the consumer such a loan if:

A. Any time the creditor provides any oral or written estimate of the interest rate, the regular periodic payments, the total amount of discount points and origination points or fees, or the total amount of closing costs specific to a consumer for a transaction that includes discount points and origination points or fees, the creditor also provides an estimate of those same types of information for a comparable, alternative loan that does not include discount points and origination points or fees, unless a creditor determines that a consumer is unlikely to qualify for such a loan. A creditor using this safe harbor is required to provide the estimate for the loan that does not include discount points and origination points or fees only if the estimate for the loan that includes discount points and origination points or fees is received by the consumer prior to the estimated disclosures required within three business days after application pursuant to the Bureau's regulations implementing the Real Estate Settlement Procedures Act (RESPA);

B. A creditor using the safe harbor described in comment 36(d)(1)(ii)–1.i.A is required to provide information about the loan that does not include discount points and origination points or fees only when the information about the loan that includes discount points or origination points or fees is specific to the consumer. Advertisements are not subject to this requirement. See comment 2(a)(2)–1.ii.A. If the information about the loan that includes discount points and origination points or fees is an advertisement under § 1026.24, the creditor using this safe harbor is not required to provide the quote for the loan that does not include discount points and origination points or fees. For example, if prior to the consumer submitting an application, the creditor provides a consumer an estimated interest rate and monthly payment for a loan that includes discount points and origination points or fees, and the estimates were based on the estimated loan amount and the consumer's estimated credit score, then the creditor must also disclose the

estimated interest rate and estimated monthly payment for the loan that does not include discount points and origination points or fees. In contrast, if the creditor provides the consumer with a preprinted list of available rates for different loan products that include discount points and origination points or fees, the creditor is not required to provide the information about the loans that do not include discount points and origination points or fees under this safe harbor.

C. For purposes of § 1026.36(d)(2)(ii)(A) and this comment, “comparable, alternative loan” means that the two loans for which estimates are provided as discussed in comment 36(d)(2)(ii)(A)–1.i.A have the same terms and conditions, other than the interest rate, any terms that change solely as a result of the change in the interest rate (such the amount of regular periodic payments), and the amount of any discount points and origination points or fees. If a creditor determines that the consumer is unlikely to qualify for such a loan that does not include discount points and origination points or fees, the creditor is not required to make the loan available to the consumer.

D. A creditor using this safe harbor must provide the estimate for the loan that does not include discount points and origination points or fees in the same manner (*i.e.*, either orally or in writing) as provided for the loan that does include discount points and origination points or fees. For both written and oral estimates, both of the written (or both of the oral) estimates must be given at the same time.

E. A creditor using this safe harbor must disclose estimates of the interest rate, regular periodic payments, the total amount of the discount points and origination points or fees, and the total amount of the closing costs for the loan that does not include discount points and origination points or fees only if the creditor disclosed estimates for those types of information for the loan that includes discount points and origination points or fees. For example, if a creditor provides estimates of the interest rate and monthly payments for a loan that includes discount points and origination points or fees, the creditor using the safe harbor must provide estimates of the interest rate and monthly payments for the loan that does not include discount points and origination points or fees, such as saying “your estimated interest rate and monthly payments on this loan product where you will not pay discount points and origination points or fees to the creditor or its affiliates is [x] percent,

and \$[x] per month.” On the other hand, if the creditor provides an estimate of only the interest rate for the loan that includes discount points and origination points or fees and does not provide an estimate of the regular periodic payments for that loan, the creditor using the safe harbor is required only to provide an estimate of the interest rate for the loan that does not include discount points and origination points or fees and is not required to provide an estimate of the regular periodic payments for the loan that does not include discount points and origination points or fees.

ii. For transactions that include a loan originator organization, a creditor will be deemed to have made available to the consumer a comparable, alternative loan that does not include discount points and origination points or fees if the creditor communicates to the loan originator organization the pricing for all loans that do not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan.

2. *Transactions for which the consumer is unlikely to qualify.* Under § 1026.36(d)(2)(ii)(A), a creditor or loan originator organization may not impose any discount points and origination points or fees on a consumer in a transaction unless the creditor makes available a comparable, alternative loan that does not include discount points and origination points or fees, unless the consumer is unlikely to qualify for such a loan. The creditor must have a good-faith belief that a consumer is unlikely to qualify for a loan that has the same terms and conditions as the loan that includes discount points and origination points or fees, other than the interest rate, any terms that change solely as a result of the change in the interest rate (such the amount of regular periodic payments), and the fact that the consumer will not pay discount points and origination points or fees. The creditor's belief that the consumer is unlikely to qualify for such a loan must be based on the creditor's current pricing and underwriting policy. In making this determination, the creditor may rely on information provided by the consumer, even if it subsequently is determined to be inaccurate.

3. *Loan with no discount points and origination points or fees.* In some cases, the creditor's pricing policy may not contain an interest rate for which the consumer will neither pay discount points and origination points or fees nor receive a rebate. For example, assume that a creditor's pricing policy provides interest rates only in 1/8 percent increments. Assume also that, under the

creditor's current pricing policy, the pricing available to a consumer for a particular loan product would be for the consumer to pay a 5.0 percent interest rate with .25 discount point, pay a 5.125 percent interest rate and receive .25 point in rebate, or pay a 5.250 percent interest rate and receive a 1.0 point in rebate. This creditor's pricing policy does not contain a rate for this particular loan product where the consumer would neither pay discount points and origination points or fees nor receive a rebate from the creditor. In such cases, the interest rate for a loan that does not include discount points and origination points or fees would be the interest rate for which the consumer does not pay discount points and origination points or fees and would receive the smallest possible amount of rebate from the creditor. Thus, in the example above, the interest rate for that particular loan product that does not include discount points and origination points or fees is the 5.125 percent rate with .25 point in rebate.

4. *Regular periodic payments.* For purposes of comments 36(d)(2)(ii)(A)–1 and –2, the regular periodic payments are the payments of principal and interest (or interest only, depending on the loan features) specified under the terms of the loan contract that are due from the consumer for two or more unit periods in succession.

Paragraph 36(d)(2)(ii)(B)

1. *Finance charge.* Under § 1026.36(d)(2)(ii)(B), the term discount points and origination points or fees generally includes all items that would be included in the finance charge under § 1026.4(a) and (b) as well as fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2). For purposes of § 1026.36(d)(2)(ii)(B), “items included in the finance charge under § 1026.4(a) and (b)” means those items included under § 1026.4(a) and (b), without reference to any other provisions of § 1026.4. Nonetheless, § 1026.36(d)(2)(ii)(B)(3) specifies that items that are excluded from the finance charge under § 1026.4(c)(5), (c)(7)(v), and (d)(2) are also excluded from the definition of discount points and origination points or fees. For example, property insurance premiums may be excluded from the finance charge if the conditions set forth in § 1026.4(d)(2) are met, and these premiums also may be excluded even though they are escrowed. See § 1026.4(c)(7)(v), (d)(2). Under § 1026.36(d)(2)(ii)(B)(3), these premiums also are excluded from the definition of discount points and

origination points or fees. In addition, charges in connection with transactions that are payable in a comparable cash transaction are not included in the finance charge. See comment 4(a)–1. For example, property taxes imposed to record the deed evidencing transfer from the seller to the buyer of title to the property are not included in the finance charge because they would be paid even if no credit were extended to finance the purchase. Thus, these charges are not included in the definition of discount points and origination points or fees.

2. *Amounts for third-party charges.* Section 1026.36(d)(2)(ii)(B) generally includes any fees described in § 1026.4(a)(2) notwithstanding that those fees may not be included in the finance charge under § 1026.4(a)(2). Section 1026.36(d)(2)(ii)(B)(2) excludes from the definition of discount points and origination points or fees any bona fide and reasonable third-party charges not retained by the creditor or loan originator organization. Section 1026.4(a)(2) discusses fees charged by a “third party” that conducts the loan closing. For purposes of § 1026.4(a)(2), the term “third party” includes affiliates of the creditor or the loan originator organization. Nonetheless, for purposes of the definition of discount points and origination points or fees, the term “third party” does not include affiliates of the creditor or the loan originator. Specifically, § 1026.36(d)(3) provides that for purposes of § 1026.36(d), affiliates must be treated as a single person. Thus, under § 1026.36(d), affiliates of the creditor or the loan originator are not considered third parties. As a result, fees described in § 1026.4(a)(2) would be included in the definition of discount points and origination points or fees if they are charged by affiliates of the creditor or the loan originator. Nonetheless, fees described in § 1026.4(a)(2) would not be included in such definition if they are charged by a third party that is not an affiliate of the creditor or any loan originator organization, pursuant to the exception in § 1026.36(d)(2)(ii)(B)(2). In some cases, amounts received by the creditor or loan originator organization for payment of independent third-party charges may exceed the actual charge because, for example, the creditor or loan originator organization cannot determine with accuracy what the actual charge will be before consummation. In such a case, the difference retained by the creditor or loan originator organization is not deemed to fall within the definition of discount points and origination points or fees if the third-party charge imposed

on the consumer was bona fide and reasonable, and also complies with State and other applicable law. On the other hand, if the creditor or loan originator organization marks up a third-party charge (a practice known as “upcharging”), and the creditor or loan originator organization retains the difference between the actual charge and the marked-up charge, the amount retained falls within the definition of discount points and origination points or fees. For example:

i. Assume a creditor charges the consumer a \$400 application fee that includes \$50 for a credit report and \$350 for an appraisal that will be conducted by a third party that is not the affiliate of the creditor or the loan originator organization. Assume that \$50 is the amount the creditor pays for the credit report to a third party that is not affiliated with the creditor or with the loan originator organization. At the time the creditor imposes the application fee on the consumer, the creditor is uncertain of the cost of the appraisal because the appraiser charges between \$300 and \$350 for appraisals. Later, the cost for the appraisal is determined to be \$300 for this consumer's transaction. Assume, however, that the creditor uses average charge pricing in accordance with Regulation X. In this case, the \$50 difference between the \$400 application fee imposed on the consumer and the actual \$350 cost for the credit report and appraisal is not deemed to fall within the definition of discount points and origination points or fees, even though the \$50 is retained by the creditor.

ii. Using the same example as in comment 36(d)(2)(ii)(B)–2.i above, the \$50 difference would fall within the definition of discount points and origination points or fees if the appraiser charge fees between \$250 and \$300.

3. *Information about whether point or fee will be paid to a creditor's affiliate or affiliate of the loan originator organization.* If at the time a creditor must comply with the requirements in § 1026.36(d)(2)(ii) the creditor does not know whether a particular origination point or fee will be paid to its affiliate or an affiliate of the loan originator organization or will be paid to a third-party that is not the creditor's affiliate or an affiliate of the loan originator organization, the creditor must assume that those origination points or fees will be paid to its affiliates or an affiliate of the loan originator organization, as applicable, for purposes of complying with the requirements in § 1026.36(d)(2)(ii). For example, assume that a creditor typically uses three title

insurance companies, one of which is an affiliate of the creditor and two are not affiliated with the creditor or the loan originator organization. If the creditor does not know at the time it must establish available credit terms for a particular consumer pursuant to § 1026.36(d)(2)(ii) whether the title insurance services will be performed by the affiliate of the creditor, the creditor must assume that the title insurance services will be conducted by the affiliate for purposes of complying with the requirements in § 1026.36(d)(2)(ii).

4. *Payable to a creditor or loan originator organization.* For purposes of § 1026.36(d)(2)(ii)(B), the phrase “payable at or before consummation by the consumer to a creditor or a loan originator organization” includes amounts paid by the consumer in cash at or before closing or financed as part of the transaction and paid out of the loan proceeds. ◀

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36(e) Prohibition on Steering.

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36(e)(3) Loan Options Presented.

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3. *Lowest interest rate.* To qualify under the safe harbor in § 1026.36(e)(2), for each type of transaction in which the consumer has expressed an interest, the loan originator must present the consumer with loan options that meet the criteria in § 1026.36(e)(3)(i). The criteria are: The loan with the lowest interest rate; the loan with the lowest total dollar amount ▶ of ◀ [for] discount points and origination points or fees; and a loan with the lowest interest rate without negative amortization, a prepayment penalty, a balloon payment in the first seven years of the loan term, shared equity, or shared appreciation, or, in the case of a reverse mortgage, a loan without a prepayment penalty, shared equity, or shared appreciation. ▶ The loan with the lowest interest rate for which the consumer likely qualifies is the loan with the lowest rate the consumer can likely obtain, regardless of how many discount points the consumer must pay to obtain it. ◀ To identify the loan with the lowest interest rate, for any loan that has an initial rate that is fixed for at least five years, the loan originator shall use the initial rate that would be in effect at consummation. For a loan with an initial rate that is not fixed for at least five years:

i. If the interest rate varies based on changes to an index, the originator shall use the fully-indexed rate that would be in effect at consummation without

regard to any initial discount or premium.

ii. For a step-rate loan, the originator shall use the highest rate that would apply during the first five years.

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▶ 36(f) Loan Originator Qualification Requirements.

1. *Scope.* Section 1026.36(f) sets forth qualification requirements that a loan originator must meet. As provided in § 1026.36(a)(1) and accompanying commentary, the term loan originator includes creditors for purposes of the qualification requirements in § 1026.36(f).

2. *Licensing and registration requirements.* Section 1026.36(f) requires loan originators to comply with State and Federal licensing and registration requirements, including any such requirements imposed by the SAFE Act and its implementing regulations and State laws. SAFE Act licensing and registration applies to individual loan originators, but many State licensing and registration requirements apply to organizations as well. Section 1026.36(f) does not affect who must comply with these licensing and registration requirements. For example, the fact that the definition of loan originator in § 1026.36(a)(1) differs somewhat from that in the SAFE Act does not affect who must comply with the SAFE Act.

Paragraph 36(f)(1).

1. *Legal existence and foreign qualification.* Section 1026.36(f)(1) requires a loan originator organization to comply with State law requirements governing the legal existence and foreign qualification of the loan originator organization. Covered State law requirements include those that must be complied with to bring the loan originator organization into legal existence, to maintain its legal existence, to be permitted to transact business in another State, or facilitate service of process. For example, covered State law requirements include those for incorporation or other type of legal formation and for designating and maintaining a registered agent for service of process. State law requirements to pay taxes and other requirements that do not relate to legal accountability of the loan originator organization to consumers are outside the scope of § 1026.36(f)(1).

Paragraph 36(f)(2).

1. *License or registration.* Section 1026.36(f)(2) requires the loan originator organization to ensure that its individual loan originators are licensed

or registered in compliance with the SAFE Act. A loan originator organization can meet this duty by confirming the registration or license status of an individual at www.nmlsconsumeraccess.org.

Paragraph 36(f)(3).

1. *Unlicensed individual loan originators.* Section 1026.36(f)(3) sets forth actions that a loan originator organization must take for any of its individual loan originators who are not required to be licensed, and are not licensed, pursuant to the SAFE Act. Individual loan originators who are not subject to SAFE Act licensing generally include employees of depository institutions and their Federally regulated subsidiaries and employees of bona fide non-profit organizations that a State has exempted from licensing under the criteria in 12 CFR 1008.103(e)(7).

Paragraph 36(f)(3)(i).

1. *Criminal and credit histories.* Section 1026.36(f)(3)(i) requires the loan originator organization to obtain, for each of its individual loan originators who is not licensed pursuant to the SAFE Act, a criminal background check, a credit report, and information related to any administrative, civil, or criminal determinations by any government jurisdiction. Loan originator organizations that do not have access to these items through the NMLSR may obtain them by other means. For example, a criminal background check may be obtained from a law enforcement agency or commercial service. A credit report may be obtained directly from a consumer reporting agency or through a commercial service. Information on any past administrative, civil, or criminal findings may be obtained from the individual loan originator.

Paragraph 36(f)(3)(ii).

1. *Scope of review.* Section 1026.36(f)(3)(ii) requires the loan originator organization to review the information that it obtains under § 1026.36(f)(3)(i) and other reasonably available information to determine whether the individual loan originator meets the standards in § 1026.36(f)(3)(ii). Other reasonably available information includes any information the loan originator organization has obtained or would obtain as part of its customary hiring and personnel management practices, including information obtained from application forms, candidate interviews, and reference checks.

Paragraph 36(f)(3)(ii)(B).

1. *Financial responsibility, character, and fitness.* The determination of financial responsibility, character, and general fitness required under § 1026.36(f)(3)(ii)(B) requires an assessment of reasonably available. A determination that an individual loan originator meets the standard complies with the requirement if it results from a reasonable assessment of information that is known to the loan originator organization or would become known to the loan originator organization as part of a reasonably prudent hiring process. Review and assessment of the individual loan originator's credit report does not require consideration of a credit score. A review and assessment of financial responsibility, character, and general fitness must consider whether the information indicates dishonesty or a pattern of irresponsible use of credit or of disregard of financial obligations. For example, conduct shown in a criminal background check may indicate dishonesty even if it did not result in a disqualifying felony conviction under § 1026.36(f)(3)(ii)(A). Irresponsible use of credit may be indicated by delinquent debts incurred as a result of extravagant spending on consumer goods but may not be shown by debts resulting from medical expenses.

Paragraph 36(f)(3)(iii).

1. *Training.* The periodic training required in § 1026.36(f)(3)(iii) must be adequate in frequency, timing, duration, and content to ensure the individual loan originator has the knowledge of State and Federal legal requirements that apply to the individual loan originator's loan origination activities. It must take into consideration the particular responsibilities of the individual loan originator and the nature and complexity of the mortgage loans with which the individual loan originator works. An individual loan originator is not required to receive training on requirements and standards that apply to types of mortgage loans the individual loan originator does not originate, or on subjects in which the individual loan originator already has the necessary knowledge and skill.

Training may be delivered by the loan originator organization or any other party and may utilize workstation, Internet, teleconferencing, or other interactive technologies and delivery methods. Training that a government agency or housing finance agency has established for an individual to originate mortgage loans under a program sponsored or regulated by that a Federal, State, or other government agency or housing finance agency satisfies the requirement in § 1026.36(f)(3)(iii), to the extent that the training covers the types of loans the individual loan originator originates and applicable Federal and State laws and regulations. Training that the NMLSR has approved to meet the licensed loan originator continuing education requirement at § 1008.107(a)(2) of this chapter satisfies the requirement of § 1026.36(f)(3)(iii), to the extent that the training covers the types of loans the individual loan originator originates and applicable Federal and State laws and regulations.

36(g) NMLSR ID on Loan Documents**Paragraph 36(g)(1)**

1. *NMLSR ID.* Section 1026.36(g)(1) requires a loan originator organization to include its name and NMLSR ID and the name and NMLSR ID of the individual loan originator on certain loan documents. As provided in § 1026.36(a)(1), the term loan originator does not exclude creditors for purposes this requirement. Thus, for example, if an individual loan originator employed by a bank originates a loan, the name and NMLSR ID of the individual and the bank must be included on covered loan documents. The NMLSR ID is a number generally assigned by the NMLSR to individuals registered or licensed through NMLSR to provide loan origination services. For more information, see the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) sections 1503(3) and (12) and 1504 (12 U.S.C. 5102(3) and (12) and 5103), and its implementing regulations (12 CFR 1007.103(a) and 1008.103(a)(2)). An organization may also have an NMLSR unique identifier.

2. *Loan originators without NMLSR IDs.* An NMLSR ID is not required by

§ 1026.36(g)(1) to be included on loan documents if the loan originator is not required to obtain and has not been issued an NMLSR ID. For example, certain loan originator organizations, and individual loan originators who are employees of bona fide non-profit organizations, may not be required to obtain a unique identifier under State law. However, some loan originators may have obtained NMLSR IDs, even if they are not required to have one for their current jobs. If a loan originator organization or an individual loan originator has been provided a unique identifier by the NMLSR, it must be included on the loan documents, regardless of whether the loan originator organization or individual loan originator is required to obtain an NMLSR unique identifier.

Paragraph 36(g)(1)(ii).

1. *Multiple individual loan originators.* If more than one individual meets the definition of a loan originator for a transaction, the NMLSR ID of the individual loan originator with primary responsibility for the transaction at the time the loan document is issued must be included. An individual loan originator may comply with the requirement in § 1026.36(g)(1)(ii), with respect to the TILA and RESPA disclosure documents, by complying with the applicable provision governing disclosure of NMLSR IDs in rules issued by the Bureau pursuant to section 1032(f) of the Dodd-Frank Act, 15 U.S.C. 5532(f).

Paragraph 36(g)(2).

1. *Amendments.* The requirements under § 1026.36(g)(2)(iv) and (v) to include the NMLSR ID on the note or other loan contract and the security instrument also apply to any amendment, rider, or addendum to the note or security instrument made at consummation. ◀

Dated: August 17, 2012.

Richard Cordray,

Director, Bureau of Consumer Financial Protection.

[FR Doc. 2012-20808 Filed 8-29-12; 11:15 am]

BILLING CODE 4810-AM-P