CHAPMAN AND CUTLER LLP

To the Point!

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Loan Originator Compensation Rule

The Consumer Financial Protection Bureau (the "CFPB") released its final loan originator compensation rule implementing certain provisions of the Dodd-Frank Wall Street Reform Act ("Dodd-Frank") (the "Rule"). This Rule amends the Regulation Z requirements by making certain clarifications and adding new requirements as set forth in Dodd-Frank. The majority of the Rule will become effective January 10, 2014; however, provisions barring mandatory arbitration and financing of credit insurance become effective June 1, 2013.

Loan Origination Compensation

The Rule prohibits a loan originator from receiving, and any person from paying a loan originator, direct or indirect compensation based on a term of the transaction or a proxy for a term of the transaction. A "proxy" for a term of the transaction is a factor that consistently varies with the term over a significant number of transactions, and the loan originator has the ability to add, drop or change that factor in originating the transaction. Compensation based on amount of credit extended is not prohibited if the compensation received or paid to the loan originator is based on a fixed percentage of the amount of credit extended.

The definition of "loan originator" under the Rule is broader than the definition in current Regulation Z. The Rule now defines "loan originator" as a person who performs any of the following activities for compensation or other monetary gain: takes an application; offers, arranges or assists a consumer in obtaining or applying to obtain, negotiates or makes an extension of credit for another person; or through advertising or other communication represents to the public that such person will perform these activities. The Rule contains exemptions from coverage as a loan originator for: (i) a person who performs purely administrative or clerical tasks and does not take an application or offer or negotiate credit terms; (ii) an employee of a manufactured home retailer who does not take an application, offer or negotiate credit terms or advise on credit terms; (iii) a person who performs only real estate brokerage activities unless the person is compensated by a creditor or loan originator or agent for consumer credit transactions; (iv) a seller-financer meeting certain requirements described below; and (v) a servicer or a servicer's employees, agents or contractors who negotiate, modify, replace or subordinate principal of existing loans where consumers are behind in payment or in default or have a reasonable likelihood of such.

A seller-financer is excluded as a loan originator if: (i) it finances less than three properties in any 12-month period; (ii) it has not constructed a residence on the property in the ordinary course of business; and (iii) the financings (a) are fully amortizing, (b) are ones that the financer determines in good faith the consumer has a reasonable ability to repay, and (c) have a fixed rate or an adjustable rate that is adjustable after five or more years. Seller-financers of one property are excluded as a loan originator if they meet substantially the same requirements as above, less the ability-to-repay determination.

Bonuses, Profit-Sharing, Pooled Compensation

The Rule generally prohibits loan originator compensation based on the profitability of a transaction or a pool of transactions. However, the Rule permits employers to make contributions to 401(k) plans, employee stock option plans and other defined contribution plans and designated tax-advantaged plans under the Internal Revenue Code. The Rule also permits non-deferred profits-based compensation plans that include profits from mortgage-related business if the loan originator originated 10 or fewer transactions during the last 12 months and the bonus does not exceed 10 percent of a loan originator's total compensation.

Pricing Concession
The Rule prohibits loan originator compensation from being reduced to offset the cost of a change in the terms of a transaction. An exception to this prohibition exists for an unforeseen increase in actual settlement cost over the estimate disclosed to the consumer under RESPA.

Dual Compensation

Consistent with existing regulations, the Rule provides that when a loan originator receives compensation directly from a consumer, the loan originator is prohibited from receiving compensation directly or indirectly from another person. The Rule also prohibits any person who knows or has reason to know of the consumer-paid compensation to the loan originator from paying any compensation to the loan originator in connection with the transaction. A new exception was added to allow mortgage brokers to pay their employees or contractors commissions, provided that the compensation is not based on the terms of the loans they generate.

Payment of Upfront Points and Fees by Consumer

The Rule allows a creditor to impose points and fees on a consumer when the creditor pays the loan originator, provided that the consumer does not also pay the loan originator.

The CFPB decided not to implement the proposed exception to the prohibition on imposition of points and fees by the creditor on the consumer if the creditor pays a loan originator, unless the creditor offers the consumer a loan without points and fees (the "Zero-Zero Alternative"). The CFPB will continue to review this issue and plans consumer testing to determine whether further regulation is appropriate.

Loan Originator Qualifications and Identifier Requirements

The Rule imposes duties on loan originator organizations to ensure their loan originators are "qualified" and, when required, properly licensed or registered, and comply with applicable law. The Rule also requires loan originator employees who are not required to be licensed under the SAFE Act to meet certain character, fitness and criminal background standards and be provided training appropriate for their job responsibilities and receive training regarding federal and state law requirements that apply to loan originator activities. This means all banks that employ loan originators must change policies, procedures, employee training and recordkeeping policies to establish compliance with these requirements. The Rule requires that the appropriate loan originator's name and NMLSR identification number appear on the credit application, note and mortgage. Loan originator organizations, including banks, should review the qualification requirements set forth under the Rule to determine whether their loan originator employees meet these specific requirements and whether the appropriate NMLSR identification numbers appear on required documents.

Prohibition of Mandatory Arbitration Clauses and Single Premium Credit Insurance

Effective June 1, 2013, clauses requiring consumers to submit to binding arbitration or barring a consumer from bringing a claim in court for residential mortgage loans or home equity lines of credit are prohibited. In addition, the Rule prohibits financing of any premiums or fees for credit insurance in connection with the consumer credit transaction secured by a dwelling, but the Rule allows credit insurance to be paid for on a monthly basis. Each creditor should review its loan documentation to ensure no mandatory arbitration clause is included and its procedures to ensure that it does not finance credit insurance premiums.

Record Retention

The Rule extends the existing recordkeeping requirements for loan originator compensation and the compensation agreements that govern those payments to apply to both creditors and mortgage brokers and increased the time period of retention from two years to three years.

Appraisal Rule for Higher-Priced Mortgage Loans under the Truth in Lending Act and Appraisals under the Equal Opportunity Act

On January 18, 2013, the banking regulators, including the Consumer Financial Protection Bureau (the "CFPB") and the Federal Housing Finance Agency, issued a joint final rule to implement certain provisions of the Dodd-Frank Wall Street Reform Act ("Dodd-Frank") on appraisal requirements for higher-priced mortgage loans ("HPMLs") under the Truth in Lending Act ("TILA") (the "TILA Rule"). On the same day, the CFPB issued a separate final rule implementing Dodd-Frank's provisions amending the Equal Credit Opportunity Act requirements on furnishing copies of appraisals and other written valuations to applicants (the "ECOA Rule" and, together with the TILA Rule, the "Rules"). The Rules require creditors to adopt both new disclosures and new practices related to appraisals. The Rules will become effective January 18, 2014.

TILA Rule

Under the TILA Rule, creditors are allowed to provide HPMLs only if: (i) the creditor obtains a written appraisal; (ii) the appraisal is performed by a certified or licensed appraiser; and (iii) the appraiser conducts a physical property visit of the interior of the property. The TILA Rule utilizes a modified definition of HPML as it is currently defined under Regulation Z.

In addition, the TILA Rule requires that the applicant must be provided with a statement regarding the purpose of the appraisal, that the creditor will provide the applicant a copy of any written appraisal and that the applicant may choose to have a separate appraisal conducted for the applicant's own use at his or her own expense at application. The applicant must be provided a free copy of any written appraisals at least three (3) business days before consummation of the loan.

The TILA Rule imposes additional requirements for HPML creditors to obtain a second written appraisal based on an interior inspection of the property at no cost to the borrower. This second appraisal is required: (i) if the seller acquired the home within 180 days prior to the date of the current sale; and (ii) if the price exceeds the seller's acquisition price by 10% (if acquired within past 90 days) or 20% (if acquired between 91 to 180 days earlier).

Qualified mortgages (under the Ability to Repay Rule) along with reverse mortgages, loans for initial construction of a property, temporary bridge loans, loans secured by a new manufactured home and transactions secured by a mobile home, boat or trailer are exempted from the TILA Rule.

ECOA Rule

The ECOA Rule applies to consumer and business first lien loans secured by a dwelling and sets forth similar disclosure requirements as the TILA Rule. The ECOA Rule requires creditors to notify applicants within three (3) business days of the right to receive a copy of the written appraisal or non-appraisal valuation. The ECOA Rule also requires creditors to provide applicants with a copy of the appraisal and other written valuations promptly at the earlier of: (i) completion of the appraisal or written valuation or (ii) three (3) business days before (x) consummation for closed-end credit or (y) account opening for open-end credit. The ECOA Rule permits applicants to waive the timing requirements, but applicants must receive the copies of all appraisals and other written non-appraised valuations at or prior to consummation or account opening. If the transaction is not consummated or the account is not opened, the applicants must receive a copy no later than 30 days after the creditor makes the adverse determination. Generally, creditors are not allowed to charge applicants for copies of the appraisal materials, but reasonable fees for cost of the appraisals or other written non-appraisal valuations are allowed under the ECOA Rule, unless prohibited by applicable law. The ECOA Rule and the TILA Rule overlap on the appraisal notice requirements and the same appraisal notice can be used to satisfy both Rules.

The Rules issued are an extension of existing requirements related to appraisals, and creditors should review their existing policies and procedures and make changes necessary to ensure the requirements of these Rules are met. Creditors should also utilize the safe harbor review checklist, the sample disclosure and the other resources available in the Rules' appendices to aid their review and revision of policies and procedures.

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