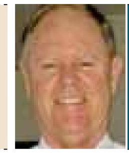

By Stanley M. Gordon
Managing member
Gordon & Associates

Are the Rule-Makers Getting Realistic?

A closer look reveals how the CFPB is adapting to the realities of the industry

Earlier this year, the Consumer Financial Protection Bureau (CFPB) issued several new regulations that began to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Although many in the industry have been critical of various aspects of the CFPB, taking a closer look at the bureau's approach to issues such as the ability-to-repay rule, the qualified mortgage (QM) definition and the issue of loan-originator compensation shows a reasonable effort by the CFPB to adapt these major structural changes to the realities of the mortgage business.

Admittedly, the mortgage market was correcting itself already before Dodd-Frank was enacted. Nevertheless, much of the industry's anxiety about the bureau has been alleviated by the willingness of the CFPB to adjust, based in large part to the diligent efforts of the Mortgage Bankers Association (MBA) and related groups.

This degree of industry participation illustrates exactly why it's important for mortgage professionals everywhere to stay informed about recent legislative activity and upcoming activity alike. With that in mind, here's a closer look at some of the CFPB's recent moves — and a closer look at what the future may hold, as well.

Background

Dodd-Frank delegated an immense task and broad authority to the CFPB to implement its policy determinations with respect to the mortgage industry. The extent of this delegation was unusual in allowing the CFPB to revise or waive via regulation certain aspects of the law, such as methods of compensation to loan originators.

These adjustments were to be based on its analysis of the impact of such laws on the consumer, as well as the ability of the industry to serve those consumers. This included a requirement for the CFPB to get input on some aspects of the law from small-business review panels in addition to the usual public-comment process for proposed regulations.

In addressing obvious abuses that occurred during the mortgage-finance bubble, it's apparent that the drafters of Dodd-Frank recognized that the mortgage business is complex and not easily understood by outsiders. In light of this, lawmaking bodies considered how such major legislative intervention could be implemented in a way that was the least disruptive. Hence, the CPFB was granted its broad authority to blend these changes into the marketplace, starting with extended effective dates for major aspects of the law to allow time for the bureau to learn more and adopt workable regulations.

Compensation

One of the realities of the marketplace is the fact that mortgage brokers and correspondents are — and should remain — a major source of loan originations. These small- to moderate-sized businesses perform a critical role in providing competition within the industry, as well as providing a highly efficient means of delivering mortgage services to consumers.

Mortgage brokers and correspondents also incur significant costs in marketing to consumers, not to mention the fact that they additionally incur a large part of the cost of origination on top of the ordinary costs of operating their businesses. These organizations often are best qualified to work directly with consumers, particularly

Illustration: Dennis Wunsch

as a result of today's increased competency requirements. It would be unhealthy to have a few major lenders dominating the marketplace, especially considering that history has shown that the major lenders have difficulty handling volume and providing timely service.

Notwithstanding these realities, Dodd-Frank — and until recently, the CFPB itself — exhibited a lack of understanding of the

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Stanley M. Gordon is the managing member of Gordon & Associates (sgordonlegal.com) in Costa Mesa, Calif., which provides counsel for the mortgage and real estate services industry. Gordon was general counsel for the Coldwell Banker Residential Group and was subsequently a chairman of a major mortgage banker and homebuilder. He's been involved with industry legislative issues at the federal level for more than 30 years. Reach Gordon at stan@sgordonlegal.com or (949) 338-3323.

Reprinted from *Scotsman Guide* Residential Edition and scotsmanguide.com, May 2013

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roles of the lender, the correspondent lender brokering a loan, the mortgage broker and their respective loan officers. Initially, for compensation purposes, Dodd-Frank regarded every person and entity as if they were a loan originator operating independently of each other. The CFPB now recognizes the appropriate roles of these parties, however, and has given itself some room for adjustment by adopting the definition of a "loan originator organization" as being distinct from an individual performing loan-originator functions.

As seen in the CFPB's commentary in the previous draft of loan-originator compensation rules, the ideal business structure implicit under Dodd-Frank was a no-cost loan — with no upfront fees — for the borrower. A no-cost loan was, under the law itself, the only case when other loan originators in the transaction — such as a mortgage brokerage and its loan officers — could be compensated, although early on the CFPB acknowledged that at least salaries could be paid by a lender to its loan officers. The only exception to this was if the borrower was not compensating the loan originator and was not paying any origination points, fees or even discount points to anyone in the transaction. This no-cost loan scenario has now been bypassed by the CFPB in its most recent regulations, however.

Lenders now may make payments to the mortgage broker when the borrower has made upfront payments to the lender, but this is still conditioned on the mortgage broker not being compensated by the borrower in the same transaction. This was a logical restoration of economic order by the CFPB and also was a necessary step to allow the broker's loan officers to be compensated.

QM

Related to all of this is the dual- compensation issue — that is, how to account for the loan officer's compensation in light of the 3 percent limitation of fees required for a QM. It's obvious that loan officers' commissions are being paid by the companies they represent and are a subpart of what their companies are paid in a given transaction. Certainly, loan officers' compensation should not be added to the commission or other compensation their companies are receiving for purposes of computing the 3 percent points and fees limitation for a QM. To do so would be double counting.

The CFPB is on the path to resolving this issue, as seen in its recent loan-officer compensation regulations. For instance, it has acknowledged the fact that double counting would disqualify large numbers of mortgages that would otherwise meet the QM requirements. Nevertheless, because many consumer advocates have continued to argue for this double counting, the CFPB has asked for further comment to some alternatives that it has proposed in recent QM regulations.

Since the issuing of these recent regulations, MBA has made it clear that it does not believe Congress ever intended for loan-officer compensation to be included in the 3 percent fee calculation. Of equal significance, however, is the MBA's position that the compensation mortgage brokers receive from lenders also should not be counted in this calculation, as it would be a part of the points and fees already being paid by the consumer to the lender. The MBA rightly has observed that these adjustments are necessary to preserve the role of the mortgage broker, which is an essential aspect of the origination marketplace. It would seem that the CFPB is on the way to reaching the same conclusion.

Additional issues

One aspect of loan-officer compensation that is overworked by the CFPB is the subject of proxy compensation and bonus plans for loan officers that may be indirect ways to compensate them based on the terms or type of loan. Arguably, it would be better if the CFPB gave guidance on this issue gradually and stopped assuming that everyone in the mortgage industry is trying to get around the law.

Dodd-Frank also sets forth the basic requirement that there be a good-faith determination of the borrower's ability to repay for all mortgage originations subject to this law. The question of whether such a determination was made can be raised by the borrower in litigation at the time of a foreclosure years after origination of the mortgage.

To give some sense of certainty to loan originators, Dodd-Frank details that if a mortgage meets the requirements of QM, there will be a presumption that there has been a good-faith determination of the borrower's ability to repay. What was left open for the CFPB to decide, however, was whether the presumption would be rebuttable or conclusive. With a conclusive presumption, the lender's litigation risks are minimized, making it less likely that borrowers will even want to litigate the ability-to-repay issue.

The CFPB has adopted the choice of a conclusive presumption for those mortgages where the lender meets its criteria for QM. This includes various underwriting requirements such as a debt-to-income ratio that's less than or equal to 43 percent. Even so, QM loans — which can be high-cost loans under the Truth in Lending Act — only will have a rebuttable presumption of compliance as to the lender's ability-to-repay determination. This illustrates the CFPB's responsiveness to the arguments of the mortgage industry that loan originations would be more limited and the scope of credit availability would be reduced if the conclusive presumption were not adopted for QM loans.

Another sign that the CFPB is willing to integrate its regulations in a manner that doesn't disrupt the marketplace is its overall approach to defining the actual requirements for a QM loan. For instance, although the CFPB's definition of what comprises a QM is set forth in the new regulations, it has adopted a major exception for mortgages that meet the underwriting criteria of the government-sponsored enterprises, the Federal Housing Administration or the U.S. Department of Veterans Affairs, giving these organizations the ability to establish their own QM standard for a period of as much as seven years if they choose to do so. It's also created some further exceptions for smaller lenders. Hopefully, over time, the CFPB will minimize its role of setting underwriting rules as it sees the marketplace operating in a responsible manner.

The CFPB has not, however, addressed jumbo loans, many of which will not meet the specific QM requirements but nonetheless

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should be considered qualified when the borrower has otherwise demonstrated an ability to repay the loan. This is a vital segment of the mortgage market that needs to be addressed with greater flexibility.

Further, the CFPB's treatment of compensation received by lender affiliates arguably remains discriminatory and inconsistent. For instance, compensation received by a lender's affiliates for loan-origination services is not included in determining whether the borrower has compensated the loan originator, which is relevant to whether the mortgage broker still can be compensated by the lender. All the same, such affiliate compensation is included in the computation of the 3 percent fee limitation for QM loans.

As to the QM fees' computation, the CFPB seems to believe that it cannot disregard affiliate compensation because of specific statutory language in Dodd-Frank. Nevertheless, there does not seem to be any factual or policy basis for discriminating against the use of lender affiliates, and therefore, the CFPB should do as much as it can to remedy this.

QRM

The other major determination forthcoming for the mortgage industry will be the adoption of the qualified residential mortgage (QRM) definition and related rules to be issued by the Federal Reserve, as well as other participating agencies. Under Dodd-Frank, lenders and investors will have to establish a 5 percent reserve for mortgages that they have originated or invested in that do not meet the QRM requirements.

It's generally expected that the QRM definition will include the loan-meeting requirements of QM. The most important issue beyond that for QRM, however, will be setting a loan-to-value ratio, or downpayment percentage for purchase mortgages. Proposals on this have ranged from 20 percent to less than 5 percent. The QRM definition also should conform to the requirements of Basel III, which is adopting revised international standards for the eligibility of mortgage-backed securities that are included in the net-worth calculation for banking institutions.

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All in all, it can be seen from the most recent regulations issued by the CFPB that the bureau is being responsive to educational efforts by the industry. It appears to be acting in a manner that's less disruptive to the mortgage business, while also implementing the policy determinations of Dodd-Frank in a manner that protects consumers. There's still much to be done, however, to integrate the major regulatory changes required under Dodd-Frank in a way that will encourage further availability of credit to the market.