

February 25, 2013

Monica Jackson  
Office of the Executive Secretary  
Consumer Financial Protection Bureau  
1700 G Street NW  
Washington, DC 20552

Re: Docket No. CFPB-2013-002, RIN 3170-AA34  
Recommendation for Alternative 1

Dear Ms. Jackson:

The [GROUP NAME]<sup>1</sup> submits the following comments on the Bureau's recent proposal for counting loan originator compensation in Regulation Z's definition of "points and fees." This proposal deals with the root source of predatory lending and the current foreclosure crisis--steering borrowers to more expensive, much riskier loans than the better loans for which borrowers qualified. Creditor incentive payments to retail loan officers and mortgage brokers drove this abusive practice and contributed directly to the unprecedented stripping of wealth from communities of color.

The definition of points and fees is critical to determining which mortgages will be considered qualified mortgages under the new ability-to-repay requirement and which will be categorized as high-cost under the Home Ownership and Equity Protection Act (HOEPA). High-cost mortgages have special, additional protections because, in part, the more expensive a loan is, the more likely it is to be abusive. If a loan has enough points and fees to trigger HOEPA coverage, the loan is subject to numerous important restrictions and consumers have heightened protection from dangerous lending practices. Under new rules that take effect in 2014, a loan that does not exceed a set maximum for points and fees (and also meets other requirements) will be considered a qualified mortgage for purposes of the Dodd-Frank ability to repay requirement. If a loan is a qualified mortgage, the creditor and any subsequent assignees get protection from the borrower--in the form of a rebuttable or un rebuttable<sup>2</sup> presumption that the lender has obeyed the law.

In passing the Dodd-Frank Act, Congress required creditors to include all loan originator compensation when calculating the points and fees in a loan, regardless of whether that compensation was paid by the consumer or the creditor, directly or indirectly. The CFPB included that requirement when adopting final regulations last month. But the Bureau also asked for comments on two proposed, alternative interpretations of that requirement. One interpretation ("Alternative 1"), would implement the rule as set forth by Congress. The other ("Alternative 2") would let creditors offset the amount of creditor-paid originator compensation against the amount of consumer-paid finance charges included in the points and fees. Under this approach, payments to brokers or loan officers from the creditor would not count toward the points and fees total so long as those payments were less than the total prepaid finance charges paid by the consumer.

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<sup>1</sup> [DESCRIPTION OF GROUP]

<sup>2</sup> Whether the presumption is rebuttable depends on the loan's interest rate. Prime-rate, qualified mortgages qualify for a "safe harbor" giving an un rebuttable presumption that the lender has complied with the law.

**We strongly encourage the Bureau to adopt Alternative 1 for all loans.** Adopting Alternative 2 would undermine legal protections for high cost loans and the loan-affordability rule for qualified mortgages enacted by Congress. Application of Alternative 2 would allow the mortgage industry to continue using loan originator compensation to steer borrowers into loans that industry players find more lucrative but that are riskier for homeowners and the economy in general.

Creditor-paid originator compensation led to most of the major abusive lending practices observed over the last decades. The compensation incentives were designed to encourage a loan originator to do something that is good for the lender without regard to its impact on the borrower. Creditors make payments to loan originators because they wanted borrowers to be steered into certain loans. Loan originators have, unsurprisingly, been responsive to these incentives, with the result that many homeowners have ended up with loans that did not reflect their ability to repay.

The problems with mortgage broker compensation have been well documented.<sup>3</sup> Loans originated by brokers, compared to loans originated directly by lenders, are more likely to default,<sup>4</sup> more likely to be adjustable rate mortgages, more likely to be stated-income loans,<sup>5</sup> and more likely to be based on fraud.<sup>6</sup> Broker-originated loans, at least in the subprime market, are usually more expensive for borrowers than lender originated loans.<sup>7</sup>

But this is not just a broker problem. Retail loan originator compensation has also been abused. The incentives available to in-house loan originators have also been designed to encourage the

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<sup>3</sup> See, e.g., Howell E. Jackson & Laurie Burlingame, Kickbacks or Compensation: The Case of Yield Spread Premiums, 12 Stan. J. L. Bus. & Fin. 289 (2007); Susan E. Woodward and Robert E. Hall, Diagnosing Consumer Confusion and Sub-Optimal Shopping Effort: Theory & Mortgage-Market Evidence, 102 American Econ. Rev. 3249 (Dec. 2012), *available at* [www.stanford.edu/~rehall/DiagnosingConsumerConfusionJune2012](http://www.stanford.edu/~rehall/DiagnosingConsumerConfusionJune2012).

<sup>4</sup> William P. Alexander, Scott D. Grimshaw, Grant R. McQueen, & Barrett A. Slade, Some Loans Are More Equal Than Others: Third-Party Originations and Defaults in the Subprime Mortgage Industry, 30 Real Est. Econ. 667 (2002).

<sup>5</sup> Edward Golding, Richard K. Green & Douglas A. McManus, Imperfect Information and the Housing Finance Crisis 10 (Feb. 1, 2008), *available at* [www.knowledgeplex.org/showdoc.html?id=1457741](http://www.knowledgeplex.org/showdoc.html?id=1457741).

<sup>6</sup> BasePoint Analytics, White Paper: Broker-Facilitated Fraud--The Impact on Mortgage Lenders 2 (2006-2007) (“[T]he most serious mortgage fraud risk is broker-facilitated fraud.”).

<sup>7</sup> See Office of Pol’y & Dev., Dep’t. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 2-24 - 2-43 (2008) (reviewing the literature); Keith Ernst, Debbie Bocian & Wei Li, Ctr. for Responsible Lending, *Steered Wrong: Brokers, Borrowers, and Subprime Loans* (2008), *available at* [www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.html](http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.html) (borrowers in the subprime market pay more when there is a broker); cf. Susan Woodward, *A Study of Closing Costs on FHA Mortgages*, U.S. Department of Housing and Urban Development, Office of Policy Development and Research. (2008), *available at* [www.urban.org/UploadedPDF/411682\\_fha\\_mortgages.pdf](http://www.urban.org/UploadedPDF/411682_fha_mortgages.pdf) (reporting data showing that borrowers on FHA loans pay more in interest, broker fees, and other closing costs when the broker is paid both by the borrower and the lender, as most brokers in the subprime market are).

origination of some loans over others--loans that were more profitable to the lender and worse for the borrower.<sup>8</sup> In-house originator compensation has also been implicated in flagrant racial discrimination in loan pricing. In a study of subprime lending in four cities in California, twenty-five percent of borrowers took out loans from a subsidiary or affiliate of a regulated financial institution, yet none were referred to the prime lender for lower-cost loans, even though most of the surveyed homeowners self-reported their credit as good or excellent.<sup>9</sup> Both upper-income Hispanics and upper-income African Americans are given less information about loan products and are steered to higher rate products, even by prime lenders.<sup>10</sup>

Dual compensation, which the Bureau has addressed in previous rulemaking, particularly contributed to the problems with loan originator compensation. Creditor-paid compensation is opaque. Mixed fees are confusing for borrowers and raise consumer costs.

As a result of these well-documented and pervasive problems, Congress adopted a multi-pronged approach in cracking down on abusive compensation practices. The Dodd-Frank Act bans dual compensation, bans tying compensation to any loan term (except the loan amount), and adds all loan originator compensation to the points-and-fees definition.

Proper calculation of the points and fees, as proposed in Alternative 1 and in line with the congressional mandate, is especially important because the Bureau has already watered down the ban on dual compensation by waiving the ban on mixed-fees (creditor-paid compensation to a loan originator in a transaction that also has consumer-paid upfront fees). Alternative 1 would discourage mixed fees.<sup>11</sup> But Alternative 2 would favor it by giving an offset to creditor-paid fees while fully counting compensation when all the fees are paid upfront by the borrower. A loan with fees paid through the opaque, back-end avenue of creditor payments could be deemed a qualified mortgage and fall below HOEPA's triggers while an equivalent loan with upfront, transparent pricing would not.

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<sup>8</sup> See Wall Street and the Financial Crisis: The Role of High Risk Home Loans: Hearing Before the Subcomm. on Investigations of S. Comm. on Homeland Security and Governmental Affairs, 111th Cong. 2d Sess. 5 (2010) (memorandum by Sen. Carl Levin, Chair, & Sen. Tom Coburn, Ranking Minority Member) (discussing Washington Mutual's compensation of in-house loan originators; noting compensation increased the more over-priced the loan was compared to the borrower's credit score.).

<sup>9</sup> Kevin Stein & Margaret Libby, California Reinvestment Committee, Stolen Wealth: Inequities in California's Subprime Mortgage Market 41, 47, 50 (Dec. 2001).

<sup>10</sup> Alan M. White, Borrowing While Black: Applying Fair Lending Laws to Riskbased Mortgage Pricing, 60 S.C. L. Rev. 677, 688 (2009) ("[L]enders and brokers . . . quote higher estimated interest rates, fees, and closing costs to blacks than to comparable whites."); Stella Adams, N.C. Fair Housing Center, Cash in Your Face (Sept. 2004). See Binyamin Applebaum & Ted Mellnik, The Hard Truth in Lending, The Charlotte Observer, Aug. 28, 2005, at 1A (finding pricing disparities in survey of twenty-five large lenders).

<sup>11</sup> Concerns about double-counting are easily cured by properly disclosing compensation in advance. If a creditor plans to pay the originator compensation from upfront fees paid by the consumer, the creditor could separately disclose the originator compensation--rather than concealing it in the upfront fee.

Alternative 1 is also important because Dodd-Frank did not eliminate all incentives for steering. Loan compensation may still be tied to the loan amount. Historically, many abusive lenders flipped unsecured debt into the home loan as a means of increasing the loan amount and thus the proceeds from fees. In addition, different creditors (including affiliates) may still offer different amounts of compensation to attract business. For these reasons, it is vital to fully and accurately count all loan originator compensation.

Alternative 2 would weaken HOEPA, the qualified mortgage and ability to repay rule, and the anti-steering provisions of Dodd-Frank. The offsetting allowed by Alternative 2 effectively doubles the points-and-fees thresholds. In contrast, the method of adding loan originator compensation under Alternative 1 would discourage excessive compensation and would implement the affected consumer protections as they were intended.

We call on the Bureau to properly implement Dodd-Frank by adopting Alternative 1 and to fully count all loan originator compensation.

Sincerely,