

CFPB Offers Regulation Z Guidance on Loan Originator Compensation

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Attorney Articles

The Consumer Financial Protection Bureau Issues Guidance Regarding Employer Contributions to Certain Employer-Sponsored Plans Under Regulation Z's (Truth in Lending Act) Restrictions Upon Payment of Compensation to Loan Originators.

On April 2, 2012, the Consumer Financial Protection Bureau (the "Bureau") released a Bulletin in response to several inquiries regarding the payment of compensation to loan originators who extend consumer credit secured by a dwelling under Regulation Z, 12 C.F.R. § 1026.36 ("Compensation Rules"), specifically (1) whether a financial institution may contribute to qualified profit sharing, 401(k), and employee stock ownership plans (collectively, "Qualified Plans") for employees, including those classified as loan originators, if employer contributions to such plans are derived from profits generated by loan originations in connection with a consumer credit transaction secured by a dwelling, and (2) guidance as to the permissibility of profit-sharing arrangements that are not in the nature of Qualified Plans.

Commentators have previously raised the concern that contributions made to retirement plans for mortgage originators violate Regulation Z because of the "profit sharing" aspect of these plans. The Bureau staff has previously expressed agreement with this concern. The April 2, 2012, guidance eliminates the concern for Qualified Plans, but confirms the concern for nonqualified plans.

Key Terms and Background

Loan Originator: 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. 12 C.F.R. § 1026.36(a).

Consumer Credit: Credit offered or extended to a consumer primarily for personal, family, or household purposes. 12 C.F.R. § 1026.2(a)(12).

Credit: The right to defer payment of debt or to incur debt and defer its payment. 12 C.F.R. § 1026.2(a)(14).

In connection with a consumer credit transaction secured by a dwelling (subject to certain narrow exceptions), 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. 12 C.F.R. § 1026.36(d).

Commentary to the Compensation Rules states that compensation includes salaries, commissions, and annual or periodic bonuses, or a proxy for a term or

Authors

Greg Pulles
William Hughes

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condition such as a credit score when the factor is based on a term or condition such as the interest rate on the loan. Terms or conditions of a transaction include the interest rate, annual percentage rate, loan-to-value ratio, or prepayment penalty.

Employer Contributions to Qualified Plans

In recognition of the fact that the Compensation Rules do not expressly address whether the loan origination provisions apply to contributions made to Qualified Plans, the Bureau provides written guidance on this subject in the April 2, 2012, Bulletin. Until final rules¹ are adopted by the Bureau, the Bureau's view is that the Compensation Rules permit employers to contribute to Qualified Plans out of a profit pool derived from loan originations. This means that, under the Compensation Rules, financial institutions may make contributions to Qualified Plans for loan originators out of a pool of profits derived from loans originated by employees.

Employer Contributions to Non-Qualified Plans

Although the Bureau has received questions about how the Compensation Rules apply to profit-sharing arrangements that are not in the nature of Qualified Plans, due to the fact-specific nature involved in addressing these arrangements, it finds it impractical to provide guidance with respect thereto. It anticipates providing greater guidance as to these arrangements in connection with a proposed rule on loan origination compensation, which would be finalized by January 21, 2013.

Discretionary non-qualified plans that are tied to profit targets should be revised and amended to exclude income from loan originations, pending the Bureau's additional guidance. Plans that establish the employer's contribution amount based on a loan originator's income are particularly at risk. The Bureau should be consulted about the specific provisions of an employer's plan.

¹ Pursuant to Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, rulemaking authority for Regulation Z transferred to the Bureau. As Section 1403 of the Dodd-Frank Act contains provisions that also address loan originator compensation, which will become self-effectuating on January 21, 2013 if the Bureau has not adopted final loan originator compensation rules by that date, the Bureau anticipates issuing a proposed rule for public comment in the near future on the loan origination provisions in the Dodd-Frank Act.