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April 8, 2019

LO Comp Flexibility to Increase Consumer Choice and Savings

Ms. Kathy Kraninger
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Dear Director Kraninger:

The Community Home Lenders Association (CHLA) is writing to offer recommendations on how to provide targeted flexibility on Loan Originator (LO) Compensation in an objective manner that would benefit consumers without opening up loopholes that would facilitate steering or other anti-consumer practices.

This letter builds on a September 26, 2018 letter sent to the Consumer Financial Protection Bureau (CFPB) by the major national groups representing mortgage lenders which advocated for flexibility under the CFPB's LO Comp rules in three specific circumstances which would *"help consumers and reduce regulatory burdens."*

The LO Comp statutory provision and the rule implementing it generally prohibit LO compensation from varying based on the terms of the loan (other than amount of the principal). The purpose is to protect consumers from steering and to eliminate financial incentives to push borrowers into higher rate loans. However, as the September 26 letter explains, the inflexibility of the rule in a few areas actually works to the detriment of consumers.

From the perspective of CHLA, there are four important criteria that need to be met in evaluating whether CFPB should make the types of changes outlined in this letter:

1. **CFPB has authority within the language of the statute to make the change.**

2. **Consumers would benefit from the change**

3. **The change would not open up loopholes to create new financial incentives to steer consumers to higher price loans**

4. **The change includes a bright line test for regulatory compliance purposes.**

This letter addresses the three proposals in the context of these criteria.

Authority to Reduce Compensation When a Loan Originator Makes an Error

The CFPB should permit the customary compensation a loan originator receives from its lender employer to be reduced by the costs associated with an error made by that same loan originator.

This is a simple bright line test that does not involve compensation varying based on the terms of the loan. Lenders should be given guidance to ensure accountability via documented policy and procedure. If a lender reduces compensation due to error, the lender should be required to document the incident and maintain a log of such incidents – and track all corrective action including but not limited to the originator entering training programs to ensure repeat offenses do not occur.

There is only a benefit, no downside, to the consumer. Moreover, it is only fair that the loan originator, not the lender, should absorb such costs. Allowing this change also facilitates financial accountability on the part of the loan originator, which should result in fewer loan errors, which in turn will reduce a lender's operational costs, which can be passed along to the consumer.

In order to exercise this flexibility, the lender should be required to document:

(1) the error made in every instance in which compensation is reduced,
(2) that the Loan Originator received training and guidance before the error was made, and
(3) that this is not just one transaction, but represents multiple mistakes.

Authority to Reduce Compensation on Housing Finance Authority (HFA) Loans

The arguments for this flexibility are also simple. In a June 19, 2018 letter to the CFPB, the National Council of State Housing Agencies (NCSHA), the trade group for state HFAs, noted that *"Because of robust underwriting, tax law-related paperwork, yield restrictions, and other program requirements, HFA loans are often more expensive to produce"* and further that covering such higher costs *"is particularly difficult given that many HFA programs include limits on the interest rates and fees that may be charged to borrowers."*

The letter further notes that before the LO Comp rule, it was common for the lender to absorb some of these additional costs by paying their loan originators a smaller fee for an HFA loan than for a non-HFA loan. However, the LO Comp rule has put an end to that.

The NCSHA letter concluded that "**The inability to reduce loan originator compensation** to offset HFA production costs under the current Loan Originator Compensation rule **harms consumer**s **by reducing the availability of these vital programs**." [Our bolding for emphasis].

The logical conclusion is that consumers would benefit from such flexibility. In addition, because HFA loans are generally more costly to underwrite and therefore less profitable, this does not create financial incentives to steer borrowers to higher priced loans.

Compensation would not vary based on the terms of a loan, but instead on whether a loan is or is not an HFA loan (and the prohibition against varying compensation among all of a lender's HFA loans could be retained). Creating flexibility for this category of HFA loans is a simple bright line test. By providing a singular exemption for HFA programs similar to the exemption granted to open end credit transactions such as HELOC's and HELOC HECM transactions, it should be easy to provide clear guidance and oversight to ensure steering is not occurring.

Authority to Reduce Compensation in Order to Match a Competitor's Offer for a Consumer that the Loan Originator Has Been Assisting

The CFPB has encouraged mortgage loan competition and consumer price shopping. However, an overly restrictive limitation that compensation may not vary can interfere with that objective.

Lenders are currently permitted to respond to a consumer conducting price shopping by lowering the rate on the loan being offered. However, the prohibition against reducing (varying) LO compensation discourages such actions, since a lenders' profit would be reduced or eliminated without the commensurate ability to reduce compensation being paid to LOs.

The impact is to reduce a lender's willingness to engage in such a competitive process. The September 26 letter argues for targeted flexibility for loan originators to lower their compensation voluntarily, in order to facilitate a more competitive offer and *"pass along the savings to the consumer."* On its face, this is clearly potentially beneficial to the consumer.

CHLA appreciates the need for an objective standard for what constitutes ***"demonstrable price competition."*** CHLA is sympathetic to this concern and appreciates that it cannot be a general standard that any lender can merely assert - e.g. a mere claim that the market is "competitive." Without an objective standard, flexibility could be used broadly to allow compensation to vary based on what the traffic might bear, with higher rates and fees for less sophisticated borrowers.

Following is a detailed proposal that addresses these concerns, by identifying objective and targeted circumstances necessary to meet a standard of demonstrable price competition and avoid a lender using this flexibility to adjust rates and terms based on different types of borrowers. Specifically, CHLA recommends the following conditions to meet this criteria:

1. *The lender has an agreed upon compensation schedule for the loan originator and has provided a loan estimate, with specific rates and terms, to a potential borrower.*

2. *After some period of time that the loan originator has worked with the borrower, the borrower requests that the lender improve upon the rate or terms of that loan estimate offer, citing a better offer from a different lender.*

3. *In response to this request, the lender improves the rate or loan terms of its original loan estimate.*

4. *The lender does not make regular use of this flexibility [here, the CFPB could set some general standard or percentage cap to prevent its indiscriminate use].*

5. *The lender must maintain a log or in some other way provide documentation that it has met all of the four preceding requirements.*

It is not uncommon for a lender that offers a loan estimate to a borrower to have its loan originator work closely with that borrower, potentially for an extended period of time - assisting the borrower with things like pre-qualifying the borrower, helping the borrower improve their credit standing, and helping to identify the best loan option that fits their needs.

CHLA is happy to provide representative examples of this, and for illustration purposes, cites an actual case from one of our members of a consumer that a loan originator assisted over the course of four months to pre-qualify and help the consumer make purchase offers on several homes. On the fourth such offer, the consumer entered into escrow on a home and completed a loan application and the lender provided a loan estimate.

Using the right to shop, the consumer then obtained a loan estimate from a different lender, with a lower rate. Without the loan originator's ability to reduce its compensation, the lender's profit would have been eliminated by matching the competing offer, so the lender did not do so. Therefore the loan originator lost the loan and the consumer as a client - even though the loan originator was willing to accept reduced compensation in order to close the loan and maintain a long term relationship with the consumer.

Thus, current CFPB rules often discourage a loan originator and the lender that employs that LO from matching loan offers and retaining clients that they have worked with for some time to assist. This fact pattern is not uncommon – and it can occur for various reasons, including having mortgage rates decline after the original loan estimate.

This outcome is manifestly unfair to the consumer who wants to consummate the loan with the original lender, but cannot justify the inferior terms. This outcome is manifestly unfair to the lender and its loan originator that spend time assisting the borrower with the loan process, but end up losing the loan. To make matters worse, the consumer may end up with a negative impression of the lender's failure to match the terms, as understandably a borrower may be skeptical about the explanation that CFPB rules make matching the offer more difficult.

In place of this, our proposal provides a more objective standard for *"demonstrable price competition"* and ensures that cost savings achieved by reducing compensation are passed along to the consumer. It does not result in variations in compensation based on loan terms, but instead on the targeted and limited circumstances that meet the criteria we are suggesting.

We appreciate the opportunity to present our views and recommendations on this subject, and would welcome the opportunity to discuss them with you and your staff.

Sincerely Yours,

Scott Olson, Executive Director
Community Home Lenders Association

Matthew VanFossen, Absolute Home Mortgage
Member, Community Home Lenders Association