REGULATORY ALERT

NATIONAL CREDIT UNION ADMINISTRATION
1775 DUKE STREET, ALEXANDRIA, VA 22314

DATE: **April 2012** **NO: 12-RA-03**

TO: **Federally Insured Credit Unions**

SUBJ: **New Flexibility in Loan Originator Compensation Rules and Pension Plan Payments**

Dear Board of Directors:

If your credit union makes closed-end residential mortgage loans, you will have new flexibility in loan originator Compensation Rules under the Truth in Lending regulation issued by the Consumer Financial Protection Bureau (CFPB).[1]

This letter explains what credit unions can and cannot do in terms of compensating loan originators.

How Is Loan Originators' Compensation Limited?

Essentially, your loan officers (loan originators) may not receive, directly or indirectly, compensation based on any term or condition of a closed-end mortgage transaction.[2] Compensation includes salaries, commissions, and annual or periodic bonuses. Terms or conditions of a transaction include the interest rate, loan-to-value ratio, or prepayment penalty.[3] Truth in Lending Regulation Z also includes examples of when compensation is not based on a transaction's term or condition.

The Compensation Rules are designed to eliminate incentives for loan originators who might steer borrowers to loan products less favorable to consumers. For example, if a loan originator personally earned more income for a loan with a higher interest rate or higher fees, the loan originator's self-interest could lead a borrower to obtain a loan that is more profitable to the loan originator.

If your credit union makes contributions to employee benefit / pension plans, you may be impacted by the Compensation Rules.

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[1] 12 C.F.R. § 1026.36. Originally adopted by the Federal Reserve Board in September 2010 (75 Fed. Reg. 58,509 (Sept. 24, 2010)). Covered institutions were required to comply with the provisions on April 6, 2011. Pursuant to Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, rulemaking authority for Regulation Z transferred to the Consumer Financial Protection Bureau. In December 2011, CFPB issued interim final rules recodifying provisions of Regulation Z (76 Fed. Reg. 79,768 (Dec. 22, 2011)).

[2] Employees and officials of a federal credit union are generally prohibited from receiving commissions, fees, or other compensation, directly or indirectly, in connection with *any* specific loan. 12 C.F.R. § 701.21(c)(8)(i).

[3] A federal credit union may not charge a prepayment penalty. 12 C.F.R. § 701.21(c)(6).

What is Changing?

Lately, the financial services industry has been asking about the funding of pensions for mortgage loan originators using earnings derived partly from mortgage lending activities. The Federal Reserve Board's (FRB's) original interpretation deemed it impermissible to fund mortgage loan originators' pension plans with earnings derived from closed-end mortgages. However:

- **On April 2, 2012, CFPB released informal guidance softening FRB's position.**

Until final rules are adopted, CFPB clarified how the Compensation Rules apply to qualified pension and profit sharing plans (Qualified Plans).[4] According to CFPB:

- **The Compensation Rules permit employers to contribute to Qualified Plans out of a profit pool derived from loan originations.**

What Should Credit Unions Do?

- **Credit unions may now make contributions to Qualified Plans for loan originators out of a pool of profits derived from loans originated by employees.**

By January 21, 2013, CFPB anticipates releasing more pointed guidance as to how the Compensation Rules apply to profit sharing arrangements *not* considered Qualified Plans.

- **If your credit union has a discretionary *non-qualified* pension plan tied to profit targets, you should amend the plan to exclude income from closed-end mortgage loan originations, pending additional guidance from CFPB.**

If your credit union has a pension plan that establishes the employer's contribution amount based on a loan originator's income, that plan is particularly at risk.

Should you have questions, please contact NCUA's Office of Consumer Protection, your regional office, or state supervisory authority.[5]

Sincerely,

/s/

Debbie Matz
Chairman

[4] As defined in the Internal Revenue Code. 26 U.S.C. § 401.

[5] You can reach NCUA's Office of Consumer Protection at 703-518-1140 or OCPMail@ncua.gov.