

REGULATORY ALERT

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

DATE: January 2014 **No.:** 14-RA-05

TO: Federally Insured Credit Unions

SUBJECT: Mortgage Loan Originator Compensation Requirements from the Consumer Financial Protection Bureau (CFPB)

ENCL: [2013 Loan Originator Rule Small Entity Compliance Guide](#)

ACTION: Compliance with all Provisions

Dear Board of Directors and Chief Executive Officer:

If your credit union receives compensation for originating closed-end mortgage loans or your credit union pays compensation to a loan originator for originating such loans, you must comply with CFPB's new Loan Originator Rule.

The rule generally regulates how compensation is paid to a loan originator in most closed-end mortgage transactions as described throughout this letter. Additionally, the rule contains provisions prohibiting mandatory arbitration, waiving certain federal claims, and financing credit insurance premiums in closed-end mortgage transactions and open-end credit, including home equity lines of credit (HELOCs) secured by a member's principal dwelling.

The rule instituted three separate mandatory compliance dates:

- **June 1, 2013:** Prohibitions on the waiver of certain federal rights and arbitration provisions in consumer-purpose, open- and closed-end loans secured by a member's principal dwelling became effective on June 1, 2013.
- **January 1, 2014:** Requirements defining compensation and the qualifications of a mortgage loan originator for consumer-purpose, closed-end loans secured by a dwelling became effective January 1, 2014.
- **January 10, 2014:** Finally, you are prohibited from financing credit insurance on loan applications received on or after January 10, 2014.

Background

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) generally prohibits an individual from engaging in the business of a mortgage loan originator without first obtaining and maintaining a unique identifier from the Nationwide Mortgage Licensing System & Registry (NMLSR) and either a registration

as a registered loan originator or a license and registration as a state-licensed loan originator.¹ Loan originators who are employees of federal credit unions are generally subject to the registration requirement, which is implemented by CFPB's Regulation G.² Loan originators who are employees of state-chartered credit unions are generally subject to the state licensing requirement, which is implemented by CFPB's Regulation H³ and applicable state law.

In 2009, the Board of Governors of the Federal Reserve System (Federal Reserve Board) proposed rules addressing loan originator compensation practices. The Federal Reserve Board's proposal prohibited certain payments to a mortgage broker or loan officer based on a transaction's terms or conditions, prohibited dual compensation, and prohibited a mortgage broker or loan officer from steering consumers to transactions that were not in the consumers' interest but increased mortgage broker or loan officer compensation.⁴

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended the Truth in Lending Act (TILA) to codify elements of the Federal Reserve Board's proposal.⁵ In 2010, the Federal Reserve Board finalized the proposed rules under its preexisting TILA powers and acknowledged that further rulemaking would be required to address certain issues and adjustments made by the Dodd-Frank Act.⁶

Effective April 2011, the Federal Reserve Board rule substantially restricted the payments to loan originators that had created incentives for them to steer consumers to more expensive loans. Under the rule, creditors could not base a loan originator's compensation on the transaction terms or conditions, other than the mortgage loan amount. In addition, the rule prohibited dual compensation arrangements in which a loan originator is paid compensation by both a consumer and a creditor (or any other person).⁷

After authority for Regulation Z transferred from the Federal Reserve Board, CFPB republished the rule at 12 CFR § 1026.36(d).⁸ CFPB subsequently adopted a rule to implement the Dodd-Frank Act loan originator provisions.

What Major Provisions are Addressed in CFPB's Loan Originator Rule?

The rule contains several provisions to better protect consumers and establish more uniform standards for loan originators:

- A clarified definition of "loan originator";

¹ 12 U.S.C. 5101-5116.

² 12 CFR Part 1007.

³ 12 CFR Part 1008.

⁴ 74 FR 43232 (August 26, 2009).

⁵ See, e.g., 15 U.S.C. 1639b.

⁶ 75 FR 58509 (September 24, 2010).

⁷ See generally 12 CFR § 226.36(d).

⁸ 76 FR 79768 (December 22, 2011).

- Prohibited compensation practices;
- Expanded recordkeeping requirements;
- Detailed qualification requirements for loan originators, including ongoing training;
- Mandatory identifying information on loan documents;
- Written policies and procedures to ensure compliance with the rule;
- Prohibited mandatory arbitration and waivers of federal claims available to consumers; and
- Restricted financing of credit insurance premiums.

Regulatory Tip: Only the provisions on mandatory arbitration, waivers of federal claims, and financing credit insurance premiums apply to HELOCs secured by a member's principal dwelling.

What Loans are Covered by the Rule?

The Loan Originator Rule applies to nearly all closed-end loans secured by a member's dwelling. The collateral may be real estate containing a dwelling or a mobile home, but it need not be a primary dwelling or a first lien. There are exemptions from certain provisions of the rule for HELOCs and loans secured by an interest in a timeshare plan. However, the provisions described above relating to the prohibition on mandatory arbitration, waiver of federal claims, and the financing of credit insurance apply to **any closed-end loan secured by a dwelling, as well as any open-end credit secured by the member's primary dwelling.**⁹

How is "Loan Originator" Defined?

The rule's provisions apply to loan originators, which can be **either a natural person¹⁰ or an organization – like a credit union.** Under the rule, a loan originator is defined as a person (individual loan originator) or entity (loan originator organization) who, in expectation of direct or indirect compensation or other monetary gain performs any of the following activities:

- Takes an application;
- Offers, arranges, or assists a consumer in obtaining or applying to obtain credit;
- Negotiates, or otherwise obtains or makes an extension of credit for another person; or
- Advertises, communicates, or represents to the public that they can or will perform any loan origination services.¹¹

Regulatory Tip: The rule's definition of "loan originator" is more expansive than the definition of "mortgage loan originator" under the SAFE Act. Unlike the SAFE Act, there is *no exception for employees who acted on fewer than five residential mortgage loans during a 12-month period.* Certain employees may be considered loan originators under this rule but not under the SAFE Act.

⁹ 12 CFR § 1026.36(b).

¹⁰ 12 CFR § 1026.36(a)(1)(ii).

The term “loan originator organization” can also include a credit union service organization (CUSO) that originates loans in a table-funding arrangement. Table-funding is a process where an originating entity does not fund a loan, but assigns the transaction to a creditor at settlement, and the loan is funded by a creditor.¹²

If you are a servicer, you become a loan originator if you perform loan origination activities on a covered transaction, such as handling a **refinancing** or assisting in **adding a different member on an existing debt**.¹³

This Regulatory Alert will focus primarily on your credit union’s role in receiving compensation as a loan originator organization and a creditor in certain circumstances, and any employee to whom you pay compensation for performing loan origination activities.

What Activities are *Not* Considered to be Performed by a Loan Originator?

Your credit union is *not* a loan originator if you are a *servicer*, unless you perform loan origination activities on replacing an existing obligation with a new debt.¹⁴

The rule identifies several other duties or tasks which are not considered to be performed by a loan originator:¹⁵

- A person who performs purely administrative or clerical tasks on behalf of a loan originator, including loan processing or credit underwriting activities;¹⁶
- A licensed real estate broker;¹⁷
- A loan servicer, its employees and agents who negotiate loan modification terms or other workout arrangements with delinquent borrowers.¹⁸

What Counts as Compensation under the Rule?

Under the rule, compensation generally includes **salaries, commissions, fees and any financial or similar incentive your credit union or your loan originator employees**

¹¹ 12 CFR § 1026.36(a)(1), Comments 36(a)-1, 36(a)-4 and 36(a)(1)(i)(B)-1.

¹² 12 CFR Part 1026, Supplement I, comment 36(a)-1.ii.

¹³ Renegotiating or modifying an existing mortgage does not constitute a loan origination activity. The rules for what determines whether a loan is a modification or a refinance are in 12 CFR § 1026.20(a) and accompanying commentary.

¹⁴ See 12 CFR § 1026.36(a)(1)(i)(E).

¹⁵ See section 3.II of CFPB’s Small Entity Compliance Guide for a more detailed discussion on exclusions.

¹⁶ A credit union employee who provides a credit application for the member to complete is *not* a loan originator. Additionally, a credit union employee who delivers a member’s credit application to you is *not* a loan originator, as long as the employee did not assist the consumer in completing the application, process or analyze information, or discuss credit terms that are or may be available based on the member’s financial characteristics. 12 CFR § 1026.36(a)(1)(i)(A), Comment 36(a)-4.

¹⁷ 12 CFR § 1026.36(a)(1)(C).

¹⁸ 12 CFR § 1026.36(a)(1)(E).

receive and retain. For example, compensation includes an annual or periodic bonus, as well as any awards of merchandise, services, tips, or similar prizes.¹⁹

If your credit union marks up a third-party charge – a process known as “up-charging” – **the difference between the actual charge and the marked-up charge is generally considered compensation.**

The rule *excludes* from the definition of compensation most payments your credit union may collect for *services other than loan origination* activities.²⁰

What New Limits Are Imposed on Compensation?

A primary purpose of the rule is to eliminate the most common incentives some loan originators historically used to steer consumers into loans less advantageous than those for which consumers otherwise qualified. **The rule prohibits compensating loan originators based on a term of a covered loan. It also prohibits compensation based on the collective terms of multiple transactions** (such as the average interest rate on 10 loans) or the terms of multiple transactions by multiple loan originators taken in the aggregate.

In general, a “transaction term” is any right or obligation of a party to the transaction.²¹ Under the rule, compensation may not be based on a term of the loan, such as the:

- **Interest rate;**
- Annual percentage rate (APR);
- **Collateral type;**
- Existence of a **prepayment penalty;**
- **Origination points or fees** paid to a creditor or loan originator;
- Fees for creditor-required **title insurance;** or
- **Proxy** for a transaction term.²² (CFPB provides several examples in its commentary.)²³

¹⁹ Compensation does *not* depend on the *label* given to a particular fee. The activity your credit union or your loan originator employee performs to generate the fee will determine if it is compensation. *Any payment made to your loan originator employees, including salary, commissions, and financial or similar incentive is compensation regardless of how it is labeled.*

²⁰ Particularly important to your credit union’s role as a loan originator organization, your credit union’s compensation does *not* include amounts you receive as payments for *bona fide and reasonable charges*, such as *credit reports*, you collect and pass on to a third party which is not a creditor, the creditor’s affiliate, or your credit union’s affiliate. For example, if your credit union, as a loan originator organization, provides *title insurance* to a consumer in a transaction, payment your credit union receives for the title insurance is *not compensation*, so long as your credit union’s insurance charge was bona fide and reasonable.

²¹ The amount of credit extended is *not* a term of a transaction. 12 CFR § 1026.36(d)(1)(ii).

²² 12 CFR § 1026.36(d)(1)(i). A factor (that is not itself a term of a transaction) is a proxy for a term of a transaction if (1) the factor consistently varies with a term of a transaction over a significant number of transactions, and (2) the loan originator has the ability, directly or indirectly, to add, drop or change the factor when originating the transaction.

²³ 12 CFR § 1026.36(d)(1), Comment 36(d)(1)-2(ii)(B).

Compensation to a loan originator based on profits of mortgage-related business activity is generally considered prohibited compensation based on the terms of multiple transactions by multiple individual loan originators. If your credit union is paying a loan originator, you generally may not pay this type of compensation.

Likewise, as loan originators, **your employees generally may not receive compensation that is based on the terms of multiple transactions conducted by multiple individual loan originators.**

If a loan originator receives compensation directly from a consumer, **the loan originator may not receive dual compensation** or any compensation from anyone else in connection with that loan.²⁴

Under the anti-steering provisions of the rule, **your credit union or your loan originator employees are not permitted to direct or “steer” a member to a loan product that will provide greater compensation to the originator,** unless that loan product is in the member’s interest.²⁵

Generally, the payment of a bonus from a bonus pool that takes into consideration profits received from consumer closed-end loans secured by a dwelling is also prohibited.

However, you can make some exceptions in limited circumstances for retirement plans and bonus plans as discussed below.²⁶

²⁴ The dual compensation prohibition does *not* apply to a loan originator organization (such as a credit union or CUSO) that receives compensation from a member and pays its mortgage loan originator employees.

²⁵ 12 CFR § 1026.36(e). The following elements are required to satisfy the anti-steering provision:

- Your member is presented with loan offers for each type of transaction in which they express an interest (that is, a fixed rate loan, adjustable rate loan, or a reverse mortgage); and
- The loan options presented to your member include the following:
 - The lowest interest rate for which the member qualifies;
 - The loan with the lowest total dollar amount of discount points, origination points or origination fees (or if two or more loans have the same total dollar amount of discount points, origination points or origination fees, the loan with the lowest interest rate that has the lowest total dollar amount of discount points, origination points or origination fees); and
 - The lowest rate for which the member qualifies for a loan with no risky features, such as a prepayment penalty, negative amortization, or a balloon payment in the first seven years.²⁵

²⁶ 12 CFR § 1026.36(d)(1)(iv), Comment 36(d)(1)-3. An employer may compensate an individual originator in the form of a contribution to a defined contribution plan that is a designated tax-advantaged plan under the Internal Revenue Service code. This includes 401(k) plans, employee annuity plans, simple retirement accounts, and simplified employee pensions. In addition to these retirement plan exceptions, a non-deferred, profit-based compensation plan or a bonus which takes into account the profits of the employer may be exempt. Such compensation cannot be directly or indirectly based on the terms of an individual loan originator’s transactions, and:

- The compensation cannot exceed 10 percent of an individual loan originator’s total compensation corresponding to the time period for which the compensation under the non-deferred profits-based compensation plan is paid; or
- An individual cannot have been a loan originator for more than 10 covered transactions consummated during the 12-month period preceding the date of the compensation determination.

What Compensation Methods Are Permitted?

The loan originator compensation rule establishes seven permissible methods of compensation for payment of salary, commissions, and other compensation. These “approved” compensation methods are essentially safe harbors under the rule:

1. The **loan originator’s overall dollar volume** (total dollar amount of credit extended or total number of transactions originated) delivered to the creditor;
2. The **long-term performance of the originator’s loans**;
3. An **hourly pay rate** based on the actual number of hours worked;
4. **Loans made to new members** versus loans to existing members;
5. A **payment that is fixed in advance for every loan** the originator arranges for the creditor (for example, \$600 for every credit transaction arranged for the creditor, or \$1,000 for the first 1,000 credit transactions arranged and \$500 for each additional credit transaction arranged);
6. A **percentage of the loan originator’s applications that close**;
7. The **quality of the loan originator’s loan files** (for example, accuracy and completeness of the loan documentation) submitted to the creditor.

What are the Qualification Requirements for Loan Originators?

The rule outlines certain qualification requirements for your credit union (if it is a loan originator organization) and your employees (if they serve as individual loan originators) to demonstrate **financial responsibility, character, and general fitness**. Likewise, this rule mandates additional qualification requirements for your employees serving as loan originators who, while employed by an institution subject to a federal regime of examination and supervision, only have to be registered under the SAFE Act.

If your credit union is a loan originator organization, **you must ensure your individual loan originators, which could include persons who operate under a brokerage agreement with your credit union, are licensed or registered in compliance with the SAFE Act and other applicable law.**²⁷

Employees *Not* Required to be Licensed under the SAFE Act

Your credit union may also need to comply with aspects of the rule pertaining to additional requirements for your loan originator employees who are only required to be registered with NMLSR – and not licensed – under the SAFE Act.²⁸ The rule outlines expectations to ensure individual loan originators who are not required to be licensed under the SAFE Act are **qualified, trustworthy, and properly trained**.

²⁷ Your credit union can meet this duty by confirming the registration or license status of an individual at www.nmlsconsumeraccess.org.

²⁸ For purposes of this Regulatory Alert, individual loan originators who are not subject to SAFE Act licensing requirements generally include employees of depository institutions and their federally regulated subsidiaries.

Information Collection: Your credit union will generally need to obtain a criminal background check, a credit report, and information from the NMLSR related to any administrative, civil, or criminal determinations by any government jurisdiction.²⁹

Determinations based on Information Collected: Additionally, with the information you are required to collect on your individual loan originators, you will also need to determine whether the individual loan originator has:

- Not been convicted of, or pleaded guilty or no contest to, a felony in a domestic or military court during the past seven years;
- Never been convicted of, or pleaded guilty or no contest to, a felony involving an act of fraud, dishonesty, breach of trust, or money laundering at any point; and
- Demonstrated financial responsibility, character, and general fitness that would lead you to determine the individual loan originator will operate honestly, fairly, and efficiently.

After the initial determination, your credit union only has to perform subsequent reviews and assessments if you know of reliable information indicating the individual loan originator likely does not meet the standards set by the rule. For example, if you know of criminal conduct by an individual loan originator through a newspaper article, a previously obtained criminal background report, or the NMLSR, you must determine whether any resulting conviction, or any other information, causes the individual to fail to meet the standards set by the rule, regardless of when your credit union hired or previously screened the loan originator.

Training Requirements: Your credit union is required to provide training to your loan originator employees. You must provide periodic training covering federal and state law requirements that apply to an individual's loan origination activities. This training requirement applies to individual loan originators regardless of when you hired them.³⁰

The periodic training must be sufficient in frequency, timing, duration, and content to ensure individual loan originators know the state and federal legal requirements that apply to their loan origination activities. The training must also consider the responsibilities of individual loan originators and the nature and complexity of the mortgage loans they originate.³¹

Your credit union can provide the necessary training in person or may use workstations, the Internet, teleconferencing, or other interactive technologies or delivery methods. You may also use a training program sponsored or regulated by a government agency or housing finance agency to satisfy these training requirements or an NMLSR-approved

²⁹ You must collect the above information for any individual: 1) hired on or after January 1, 2014; or 2) hired before that date but for whom no applicable statutory or regulatory background screening standards were in effect at the time of hire, or the applicable standards were not used to screen that individual.

³⁰ You are *not* required to provide training to loan originators who operate under a brokerage agreement with your credit union.

³¹ Individual loan originators are *not* required to receive training on requirements and standards that apply to types of mortgage loans they *do not originate* or on subjects on which they *already have knowledge and skill*.

licensed loan originator continuing-education training to satisfy the training requirement of this rule, as long as the training covers the types of loans the individual loan originator originates and the applicable federal and state laws and regulations.

What are the Recordkeeping Requirements?

The rule expands the scope and timeframe of previous recordkeeping requirements under TILA. **Creditors and loan originator organizations must keep records related to the requirements for loan originator compensation for three years after the date of payment or receipt of compensation.**³²

If you are a loan originator organization (including creditors that use table funding), you must maintain records sufficient to evidence:

- **All compensation you receive from creditors, consumers, and other individuals or entities;**
- **All compensation you pay to individual loan originators; and**
- **The compensation agreements** that govern those receipts or payments.

Records are sufficient to evidence payment and receipt of compensation if they demonstrate the following facts:

- The nature and amount of the compensation;
- Who paid the compensation;
- Who received the compensation; and
- When the payment and receipt of compensation occurred.³³

The additional records to document payment or receipt of compensation will vary on a case-by-case basis depending on facts and circumstances, particularly with regard to the nature of the compensation.

What Information Must be Included on Loan Documents?

Your credit union must include the applicable NMLSR identification number on all covered loan documents received after January 10, 2014. This ID number facilitates electronic tracking and uniform identification of loan originators and public access to the employment history of loan originators and any publicly adjudicated disciplinary and enforcement actions against them.

Regulatory Tip: If there is **more than one loan originator** for a transaction, your credit union must include identifying information of the individual loan originator with **primary responsibility** for the transaction at the time the loan document is issued.

³² 12 CFR § 1026.25. If your credit union meets the definition of a creditor that is *not* a loan originator organization for purposes of the compensation provisions (not a table-funded creditor), you must maintain records sufficient to evidence:

- All compensation you pay to loan originators; and
- The compensation agreements that govern those payments.

³³ 12 CFR § 1026.25(c)(2), Comment 25(c)(2)-1.i.

The loan documents that must contain the name and NMLSR ID are the credit application, note or loan contract, and the security instrument.³⁴

What Other Actions or Activities Does the Rule Prohibit?

In addition to the requirements discussed above, the final rule provides additional consumer protections. As a creditor under the rule, **your credit union is prohibited from requiring members to engage in mandatory arbitration or any other non-judicial procedure** to resolve any controversy or settle any claims arising out of a loan contract or other agreement.

If your credit union extends closed-end credit secured by a member's dwelling³⁵ or HELOCs secured by the member's principal dwelling, **your contract or other agreement may not bar a consumer from bringing a claim in court asserting a violation of any federal law.** It also prohibits anyone from applying or interpreting the contract to bar a federal claim.³⁶

The rule also restricts your credit union from financing, directly or indirectly, any premiums or fees for credit insurance in connection with a closed-end consumer credit transaction secured by a dwelling (except for certain time-share plans) or for a HELOC secured by the consumer's principal dwelling. The rule defines "credit insurance" as any credit life, credit disability, credit unemployment³⁷, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract.

Your credit union finances premiums or fees for credit insurance if it provides a member the right to defer payment of a credit insurance premium or fee owed by a member beyond the monthly period in which the premium or fee is due. For single-premium

³⁴ Your credit union does *not* need to include the information *more than once* on each of the specified loan documents. For example, you do *not* have to include the information *on each page* of a loan document. Additionally, if the individual loan originator with primary responsibility for a transaction *changes*, your credit union does *not* have to *reissue* previously completed documents merely to update a loan originator name and NMLSR ID. Going forward, your credit union would need to include on loan documents the information about the individual who now has primary responsibility, and would not include the information about the individual who formerly had primary responsibility.

³⁵ For certain time-share plans, a contract or other agreement could bar a consumer from bringing a claim in court asserting a violation of any federal law.

³⁶ As with the prohibitions against mandatory arbitration, after a dispute or claim under the transaction arises, a member, creditor, or any assignee may agree to settle or to use arbitration or another non-judicial procedure to resolve the dispute or claim.

³⁷ The rule *excludes credit unemployment insurance* from the definition of "credit insurance" *if*:

- The credit unemployment insurance premiums are *reasonable*;
- Your credit union receives *no direct or indirect compensation* in connection with the credit unemployment insurance premiums; and
- The credit unemployment insurance premiums are paid pursuant to a *separate insurance contract* and are not paid to any of your credit union's affiliates.

credit insurance, your credit union would violate the prohibition if you add the credit insurance premium or fee to the amount owed at closing.³⁸

How Should We Develop a Compliance Policy?

The rule requires credit unions that offer mortgages to **establish and maintain written policies and procedures** reasonably designed to ensure and monitor compliance, as well as the compliance of employees, with the provisions on compensation, steering, qualification, and identification. Written policies and procedures should be appropriate to the nature, size, complexity, and scope of the credit union's mortgage-lending activities and any subsidiaries.

What Other Resources are Available?

In addition to the referenced enclosure on the title page of this document, additional resources, including the full text of CFPB's final Loan Originator Rule, are available at <http://www.consumerfinance.gov/regulations/loan-originator-compensation-requirements-under-the-truth-in-lending-act-regulation-z/>.

If you have questions, contact NCUA's Office of Consumer Protection at (703) 518-1140 or at ComplianceMail@ncua.gov, or contact your regional office or state supervisory authority.

Sincerely,

/s/

Debbie Matz
Chairman

³⁸ This prohibition does not apply to credit insurance when the premiums or fees are calculated and paid in full on a monthly basis. Premiums are calculated on a monthly basis if they are determined mathematically by multiplying a rate by the actual monthly outstanding balance.