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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

Dear Ms. Jackson:

The Bureau issued a final rule in January that set out most of the provisions regarding Qualified Mortgages (QM). However, it also published for further comment a proposed rule addressing several issues, including treatment of mortgage originator compensation. This proposed rule deals with one of the core issues of the housing crisis and a major predatory lending practice -- the targeting of borrowers for loans that cost more and were much riskier than better loans for which they qualified. Creditor payments to mortgage brokers have been a major driver of this abusive practice.
This letter addresses the question of how the Bureau should apply the revised points-and-fees definition to creditor-paid broker compensation.

While the statute, and the CFPB's final QM rule and its mortgage loan originator rule, contain other provisions addressing this practice, the inclusion of creditor payments to brokers in the QM and HOEPA points and fees tests is the most important Dodd-Frank protection against this targeting. In order for this protection to work for borrowers, and to fulfill the purpose of the statute, it is critical that the CFPB fully count these creditor payments to brokers in the determination of points and fees. This means there should be no offsetting of borrower fees paid to creditors against these fees, since permitting offsetting would effectively exclude the counting of all or most of these creditor payments to brokers.

There has been a long history of mortgage brokers putting borrowers into more expensive and riskier loans in order to earn larger creditor payments. Such practices were particularly pronounced in the lead-up to the financial crisis, but remain a concern even after passage of Dodd Frank. First, many borrowers place a great deal of trust in brokers, relying on them to sort out the extremely confusing array of home loan options. Indeed that is a significant part of the service brokers sell. This puts brokers in the position of being able to direct which loan the borrower selects. That borrowers frequently perceive their relationship with a broker as one of trusted advisor is confirmed by numerous independent studies as well as consumer testing by the Federal Reserve Board.[1]

Second, brokers have a financial incentive to direct borrowers to loans that produce the highest payment to them (the broker). Third, and of particular relevance here, certain complex forms of creditor payments to brokers, known as yield spread premiums (or YSPs), are notoriously difficult for consumers to understand and, left unregulated, exacerbate existing financial incentives for brokers to offer loans according to which loan produces the highest payment to the broker. Creditors who want to make loans through the wholesale (broker) channel are competing with other creditors for those loans; those creditors willing to pay brokers the most are the ones who will get the loans. Rather than competition producing lower prices for borrowers, these forces - the complexity of the transaction, lack of transparency, borrower trust in brokers, brokers' incentives to generate the highest payment possible, and competition among creditors for brokered loans – combine instead to produce higher payments to brokers and higher costs to borrowers to cover these payments.[2] The resulting steering of borrowers to loans with higher prices than the borrower could or should have qualified for was widespread and well-documented.[3] The harmful impacts of this steering are widespread, and are particularly devastating in communities of color, where borrowers were steered to abusive subprime loans when they qualified for safe prime loans.

Dodd-Frank Approaches To Steering.

Dodd-Frank addressed this powerful perverse incentive in several ways. First, the law prohibits the direct tying of loan-originator compensation to the interest rate of the loan or other loan terms. Second, it generally prohibits the steering of borrowers to abusive loans, or to non-Qualified Mortgage loans. Third and most importantly, it amends the points-and-fees definition under HOEPA and creates a point-and-fee definition for Qualified Mortgages that both include creditor-paid loan originator compensation.

While the first two protections against loan targeting are helpful, they have important limitations. The prohibition against a lender varying the amount of loan-originator compensation based on the terms of loans it offers does not reduce the pressure on creditors to bid for a broker's loans by offering generous payments to brokers. It also does not eliminate the incentives for brokers to offer the products from more expensive lenders who pay them more. This "reverse competition", where the transaction is being directed by a party who is not paying the cost of the product -- in this case the broker directing the loan to a particular lender -- uniformly drives up

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[1] *See, e.g.,* Loan Originator Compensation & Steering, 75 Fed. Reg. 58509, 58511 (Sept. 24, 2010); Kellie K. Kim-Sung & Sharon Hermanson, *Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans*, Data Digest No. 83, 3 (AARP Public Policy Inst., Jan. 2003), *available at http://assets.aarp.org/rgcenter/post-import/dd83_loans.pdf*.

[2] *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 http://www.stanford.edu/~rehall/DiagnosingConsumerConfusionJune2012*.

[3] *See, e.g.,* Keith Ernst, Debbie Bocian & Wei Li, *Steered Wrong: Brokers, Borrowers, and Subprime Loans*, Center for Responsible Lending (2008).

the cost to consumers, particularly in a transaction as complex and non-transparent as the use of a YSP to compensate a broker.[4]

Lenders competing for broker business by paying higher YSPs is structurally similar to other well-known situations in the mortgage market. For example, forced placed insurance, title insurance, and mortgage insurance are all mortgage products where the provider of the product is selected or heavily influenced by someone other than the borrower who is actually paying the cost of the product. In all of these cases, the price of these products is out of line with similar products where reverse competition is not a factor in sales. Consumers pay more because business goes to those service providers who pay the arrangers the most, not those who charge customers the least. In short, other examples show that the prohibition on tying mortgage broker compensation directly to the terms of the loan reduces the incentives for the most blatant steering practice – pushing a borrower into a higher cost product sold by the same lender who also offers a lower cost product they qualify for -- but it does not address the basic incentive that brokers have to push borrowers into more costly loans.

The second Dodd-Frank provision addressing targeting - the prohibition against steering, is currently implemented through the Federal Reserve's steering restrictions. While these provisions are helpful in establishing the general principle that borrowers should not be steered to less favorable loans, there is strong evidence that their effect will be limited. The language of the provisions is narrow, and it explicitly recognizes that brokers are not required to establish business relations with any new, or lower cost, lender. And brokers can select among the group they do business with to provide quotes from three lenders who pay the highest YSPs. Extensive experience has shown that even more stringent and broader prohibitions against steering in state laws have not been enough – absent specific changes in compensation rules – to prevent steering. North Carolina implemented anti-steering provisions with the similar limitation of not requiring brokers to seek out lower cost lenders. It required brokers to provide a loan that was "reasonably advantageous to the borrower" from lenders "with whom the broker regularly does business."[5] This too had little impact, as many brokers chose only to do business with lenders that paid large broker payments, payments that were made possible by more expensive loans. Other states had still stronger provisions in the form of a fiduciary duty for mortgage brokers, which required them to act only in their clients' best interest.[6] In California and other states with this duty it nonetheless had little impact, as the dynamic of reverse competition forced creditors to offer large fees to attract broker loans, and again, these fees were made possible due to loans that were more expensive and riskier for borrowers.

The final, and crucial, Dodd-Frank protection against steering is the inclusion of loan originator payments in the calculation of points and fees for QM and HOEPA purposes. As amended by Dodd-Frank, the Truth in Lending Act now defines points and fees in relevant part as including "all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator

[4] *See* Jackson & Burlingame, *Kickbacks or Compensation* at 312; Woodward & Hall, *Diagnosing Consumer Confusion* at 3253 (5).

[5] N.C. Gen. Stat. § 53-243.10 (2002) (repealed and replaced by the North Carolina Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act of 2009, N.C. Laws S.L. 2009-374); *see also* N.M. Stat. Ann. § 58-21B-20(A)(5); Me. Rev. State tit. 9-A, § 10-303-A(1)(F).

[6] Cal. Civ. Code § 2923.1(a) (providing that mortgage broker is "fiduciary" of the borrower); Wash Rev. Code § 19.146.095 (imposing "fiduciary duty" on mortgage broker to borrower).

from any source." 15 U.S.C. § 1602(aa)(4). Counting these fees that lenders pay brokers is necessary to provide the most pressure to counteract the impact of reverse competition.

Given the reverse competition dynamic, individual creditors cannot counteract the inflationary effect of payments to brokers on the cost of loans to borrowers -- the lenders must join in the competition to attract broker loans, and these fees add to the cost paid by the borrowers. In the past, some lenders have attempted to restrain excessive broker fees, always without success. Option One, a major lender, at first refused to make large creditor fees to brokers, denouncing it as an abusive practice. Subsequently, in order to gain broker loans, competitive pressure compelled it to reverse course and join in the practice, to the detriment of its customers. Similarly, other lenders attempted to cap broker fees at reasonable levels, but competition for loans pushed them to abandon the policy and join in the bidding war to attract broker loans.

Finally, fully counting creditor-paid broker fees also levels the playing field between consumer-paid upfront broker fees, which everyone agrees should be fully counted without offset, and creditor-paid broker fees, which are supposed to be a direct substitute for upfront broker fees. These upfront fees are more transparent for borrowers and less confusing. This is particularly true given the CFPB's decision to use its exception authority to permit these creditor broker fees even when the borrower is also paying upfront creditor origination fees. These mixed fees have been shown to be confusing for borrowers, as they have to calculate the counteracting effects of buying up the loan interest rate with the yield spread premium and buying down the rate by paying upfront points. This is why the Federal Reserve prohibited brokers from being paid through this dual compensation. The CFPB loan-officer compensation rule now reauthorizes this mix of confusing loan terms. The proposed YSP counting rule would, however, go much further and strongly favor this confusing mix by not counting the full fees when there is a creditor-paid fee, but fully counting them when the fees are all paid upfront by the borrower. This means that a loan with confusing fees would be deemed compliant with QM and HOEPA while an equivalent loan with upfront transparent pricing would not.

Options in the CFPB proposal

The CFPB has set out an option in its proposed rule that would offset creditor-paid broker payments by the amount of any borrower-paid origination fees to the creditor. This option is not supported by either argument or experience, and it would have disastrous effects. The argument provided for this option is that it would treat loan officers and mortgage brokerages equally. This argument fails on numerous grounds. Any difference in impact on brokers results from the fact that lenders have different roles and expenses than brokers. No amount of rulemaking can change that. The importance of fully including broker fees is clarified by an examination of the role of loan officers (and their employer creditors) in contrast with brokers. Creditors, including their employees, provide loans, with all of the financial and legal obligations that entails. Brokers, in contrast, identify borrowers and then strongly impact the lender and loan to which they are directed. Loan officers represent only one lender (and affiliates), while brokers can direct borrowers to any lender the broker chooses, all of whom are competing to get the broker to send them the loan. Also, borrowers can directly pay fees to mortgage brokers; they cannot pay fees to loan officers, only to creditors. The courts have recognized the critical differences between brokers, loan officers and creditors in upholding the Federal Reserve loan officer compensation rule that distinguished brokers from the retail players and treated them differently.

See Nat'l Ass'n of Mortgage Brokers v. Board of Governors of the Fed. Reserve Sys., 773 F. Supp. 2d 151, 173-76 (D.D.C. 2011).[7]

Underlying this option set out in the proposed rule is an erroneous assumption that the borrower-paid fees to the creditor will in turn be used to pay the fees to the broker, and so these pass-through fees should not be counted. There is, of course, no legal requirement that these fees in fact be used in this manner. The creditor may, and typically does, use them to cover other expenses and overhead of its own. Second, if that result is intended, no such complicated machinations and conjecture is required; the borrower can simply pay the broker directly, which is also more transparent and understandable for the borrower. Finally, experience shows that, in fact, borrower-paid fees to creditors do not go to pay broker fees. The above cited studies of FHA loans and the Howell Jackson study all found that these fees were additive, not substitutes. That is, in loans with both borrower-paid and creditor-paid fees, borrowers paid much more in fees. The fees did not offset each other.

The impact of such an offsetting, particularly with subprime loans, would be disastrous. It would facilitate targeting borrowers for more expensive loans, and it would fuel the reverse competition that drives that result. It would also blow holes in the QM and HOEPA fee thresholds, effectively repealing these Congressionally-set standards and permitting 6, rather than 3, points, for a QM loan, and 10, rather than 5, points for a HOEPA loan. Dodd-Frank deliberately amended the points and fees definition and thresholds to make them lower and more inclusive. In doing so, it followed the example of numerous states from around the country that had done the same, including North Carolina, which was often held up as a model for the Dodd-Frank mortgage provisions. Not fully counting creditor-paid broker fees in the points-and-fees definition would nullify one of the cornerstone mortgage protections of Dodd-Frank and legitimize the overcharging and targeting of borrowers to more expensive and riskier loans than they qualify for.

In summary, there is no basis for failing to fully count all payments for mortgage broker services in the points-and-fees calculations, particularly for subprime loans. The steering of borrowers to more expensive, more risky loans by mortgage brokers was a primary cause of the financial crisis and caused immense harm to families. While the other anti-steering provisions of Dodd-Frank establish a general anti-steering duty and prohibit directly tying loan terms and broker compensation, powerful incentives remain for brokers to steer borrowers to more expensive loans that are coupled with the largest broker payments. The inclusion of creditor-paid broker fees is a critical protection and counter balance to this harmful incentive. It also puts the less transparent creditor-paid broker fees on par with the clear upfront broker fees, which are fully included in the points and fees determination. We urge the Bureau to implement and enforce this critical protection as it is set out in the Dodd-Frank statute.

Sincerely,

AFL-CIO
Alliance for a Just Society

[7] AFR groups address in their individual comment letters the question of whether there are additional reasons for using the additive approach for loan officer compensation as well.

Americans for Financial Reform
California Reinvestment Coalition
Center for NYC Neighborhoods
Center for Responsible Lending
Connecticut Fair Housing Center
Consumer Action
Consumers Union
Cypress Hills Local Development Corp.
Empire Justice Center
ESOP: Empowering and Strengthening Ohio's People
Greenlining Institute
Inland Fair Housing and Mediation Board
JASA/Legal Services for the Elderly in Queens
Legal Services NYC
Long Island Housing Services, Inc.
NAACP
National Association of Consumer Advocates
National Consumer Law Center (on behalf of its low-income clients)
National Council of La Raza
National Fair Housing Alliance
National People's Action
NEDAP
Pratt Area Community Council
Public Counsel
South Brooklyn Legal Services
Staten Island Legal Services
The Leadership Conference on Civil and Human Rights
Westchester Residential Opportunities Inc.
Western New York Law Center, Inc
Woodstock Institute

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services

- Home Defender's League
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS

- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Affiliates

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA

- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M

- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET