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CFPB Offers A View Of Profit Sharing

The CFPB recently announced that it will update the TILA loan originator compensation rule (Rule) in July of 2012. The updated rule may cause some new concerns regarding the implementation of the current Rule or it just may actually provide some sorely needed repairs for issues, strange and otherwise, that have dogged the Rule from the very start.

One issue in particular has been fomenting all along: the FRB's interpretation of the Rule (and the interpretation informally adopted by the FDIC) regarding contributions made to retirement plans on behalf of loan originator employees. The FRB deemed such contributions to be compensation and subject to the restriction that compensation cannot be based on the terms and conditions of the loan transaction. This is because the FRB asserted that profits were considered a proxy for loan terms and conditions.

Recently, the CFPB has weighed into this matter by declaring that employers should be permitted to contribute to "Qualified Plans" out of a profit pool derived from loan originations.

So let's discuss what this all means and if this issue is really resolved! *

IN THIS ARTICLE

Profit Sharing Debacle

Contributions to a profit sharing plan pose a significant challenge to mortgage brokers or bankers whose sole source of profitability is from the origination of loans. If the broker only brokers loans, then the income received was already subject to the restriction that it could not be based on the terms and conditions of the credit extended.

Thus, the profit sharing contribution also would not be based on the terms and conditions.

If, on the other hand, a mortgage banker funds the loans with its own money and makes a profit from a true secondary market transaction that is allowed to be dependent on the terms and conditions of the credit extended, it will be much harder to make a profit sharing contribution and effectively assert that the payment is not dependent on the terms and conditions of the credit extended.

For those entities, there might be a need to revise the 401(k) plan to make it a nondiscretionary plan so that such profits play no part in determining whether a contribution is made or the amount of the contribution.

There has been considerable debate on how or whether profit sharing plan contributions may accept compensation. If the contribution is tied to profits, and profits are tied to the origination of loans, a portion of which might be determined by the terms or conditions of the transaction originated, then the FRB asserted that no contribution could be made. This becomes particularly problematic because Employee Retirement Income Security Act (ERISA) rules generally do not allow for contributions to be made for some employees but not for other employees. Thus, this would have the effect of eliminating contributions for all employees.

So here is the debacle: In order for a lender to make the contributions for loan originators without running afoul of the Rule, it is the lender's responsibility to show that the contribution was not based on the terms and conditions of the credits extended.

Contortions

I will list just some of the contortions that loan originators have had to deal with thus far, depending on the profit sharing plan:

Plans with matching contributions: There would be no difficulty in showing the amount of the contribution was independent of the terms and conditions of the credit transaction because the amount of the contribution is based on the amount contributed by the employee.

Non-discretionary plans: Where the contributions must be made in a fixed amount irrespective of "profits," there would be a valid case that the amount of the contribution is not based on the terms and conditions of credit extended.

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Discretionary non-elective or matching contributions: That are not tied directly to specific profit targets, is a more complicated issue, but could be supported by the point that all employees, mortgage originators or not, receive the same amount. In other words, no originator received compensation tied to the loan terms and conditions because others were compensated equally irrespective of loan terms and conditions.

Discretionary plan tied to specific profit targets: Would likely need to exclude the income from loan originations to avoid a challenge that the payment was based on the terms and conditions.

And, of course, any plan that sets the amount of the contribution based entirely on the income an originator generated would definitely violate the regulation.

Bulletin 2012-02

Since the CFPB issued its April 2, 2012 CFPB Bulletin 2012-02 (Bulletin) that dealt, in part, with profit sharing, various media outlets and industry associations have applauded it for "clarifying" that the Rule does not ban loan originators from participating in employee stock ownership plans (ESOPs) or 401(k) plans - so-called "Qualified Plans."

One prominent law firm provides the Bulletin's exact text, which states that "employers of loan originators may make contributions to employees' qualified profit sharing, 401(k), and stock ownership plans (qualified plans) out of a profit pool derived from loan originations."

Another highly-respected law firm issued a notice, stating the CFPB "has confirmed that Regulation Z (which implements the Truth in Lending Act) does not prohibit mortgage loan originators from participating in qualified profit-sharing 401(k) or employee stock ownership plans (Qualified Plans)."

The plain reading of the Bulletin's text seems to provide a somewhat more nuanced view!

Interpreting the Bulletin

Here's what the Bulletin actually states:

> "Until final rules are adopted by the Bureau, the Bureau believes it is important to clarify how the Compensation Rules apply to Qualified Plans. **To provide clarity at this juncture**, 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. That is, financial institutions may make contributions to Qualified Plans for loan originators out of a pool of profits derived from loans originated by employees under the Compensation Rules." (My Emphasis)

To put this statement into more conventional language, the CFPB is seeking to clarify - not by providing rulemaking guidance! - its future position with respect to contributions made to Qualified Plans.

Note that the Bulletin does not offer any opinion about how the Rule may apply to profit-sharing arrangements or plans that are not considered Qualified Plans.

Indeed, here is the CFPB's quite tentative statement:

> "The Bureau has also received questions about how the Compensation Rules apply to profit-sharing arrangements/plans that are not in the nature of Qualified Plans. Many of the questions have been fact-specific and the Bureau does not believe it is practical to provide guidance in this Bulletin about such plans. We anticipate providing greater clarity on these arrangements in connection with a proposed rule on the loan origination provisions in the Dodd-Frank Act."

So, a word to the wise:

> Consult with a risk management firm or an appropriate law firm before implementing profit sharing plans!

"Heads-Up" Regulating

I have to admit that I am somewhat astonished by how the FRB, and now the CFPB, have handled their rulemaking responsibilities.

It has been challenging enough to provide reliable guidance to our clients in the absence of substantive rulemaking, but, from the start, all the ongoing informal oral conversations with the public, telephonically and webinar-based, and the semi-formal written statements, only serve to unnerve market participants - those who want to abide by the rule of law, if they were only given the rule of law to abide by in the first place.

So here we have the CFPB wishing "to provide clarity at this juncture," but not by providing clear and unambiguous guidance with respect to implementing the Rule's actual requirements vis-à-vis profit sharing plans. Simply put, it is offering a "heads-up" approach to what it will likely codify through rulemaking.

For the record, under the Dodd-Frank Act, the CFPB must adopt the loan originator compensation final rule by January 21, 2013, or the provisions are self-effectuating on that date. I see no reason why the profit sharing issue has to wait even one minute longer for a final rulemaking disposition.

It is just past one year since the Rule became effective.

Is one year not enough time to have fully vetted this issue?

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Labels: CFPB, CFPB Bulletin, CFPB Rulemaking, Consumer Financial Protection Bureau, FRB, Loan

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▼ April (2)
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► March (5)
► February (2)
► January (6)
► 2011 (106)
► 2010 (86)
► 2009 (8)

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