

# **EXHIBIT 1**

**UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA**

_____	)	
National Association of	)	
Mortgage Brokers,	)	
	)	
Plaintiff,	)	
	)	No. 1:11-cv-00506 (BAH)
v.	)	
	)	
Board of Governors of	)	
the Federal Reserve System, et al.,	)	
	)	
Defendants.	)	
_____	)	

_____	)	
National Association of Independent	)	
Mortgage Professionals, Inc.	)	
	)	
Plaintiff,	)	
	)	No. 1:11-cv-0489 (BAH)
v.	)	
	)	
Board of Governors of	)	
the Federal Reserve System,	)	
	)	
Defendant.	)	
_____	)	

**BRIEF OF CMBP AS AMICI CURIAE IN SUPPORT OF PLAINTIFFS**

The Community Mortgage Banking Project and the Community Mortgage Banking Research Fund (collectively, “CMBP”), through counsel, hereby submits this *amici curiae* brief.

Date: March 24, 2011

Respectfully submitted,

/s/ Deborah J. Israel

Deborah J. Israel (Bar No. 430841)  
Lawrence H. Norton (Bar No. 978212)  
Alida M. Dagostino (Bar No. 493665)  
WOMBLE CARLYLE SANDRIDGE & RICE, PLLC  
1401 Eye Street, N.W., 7<sup>th</sup> Floor  
Washington, DC 20005  
(202) 857-4466  
(202) 261-0034 (facsimile)  
[disrael@wcsr.com](mailto:disrael@wcsr.com)

Donald C. Lampe  
*Of Counsel*  
WOMBLE CARLYLE SANDRIDGE & RICE, PLLC  
301 South College Street  
Charlotte, NC 28202  
(704) 350-6398  
(336) 574-4530 (facsimile)  
[dlampe@wcsr.com](mailto:dlampe@wcsr.com)

*Counsel for Amici Curiae,  
Community Mortgage Banking Project, and  
Community Mortgage Banking Research Fund*

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## **CORPORATE DISCLOSURE STATEMENT**

Mortgage Banking Initiatives, Inc., d/b/a The Community Mortgage Banking Project is a Virginia corporation. The Community Mortgage Banking Research Fund is a Virginia nonstock corporation. Neither corporation is publicly held and there are no parent corporations.

## **STATEMENT**

CMBP received no outside assistance from any of the parties to this action, or their counsel, either in the authoring of this brief or in its funding.

## INTRODUCTION

The Community Mortgage Banking Project and the Community Mortgage Banking Research Fund (collectively, the “CMBP”) submit this brief in support of Plaintiffs, National Association of Mortgage Brokers and National Association of Independent Housing Professionals, Inc. (“Plaintiffs”). CMBP respectfully requests that this Court set aside the *Loan Originator Compensation and Anti-Steering Rule*, 12 CFR Part 226.36(a), (d), and (e) (the “Final Rule”), recently promulgated by the Board of Governors of the Federal Reserve System (the “Board”).

No sooner had Congress passed landmark legislation, ultimately transferring the Board’s authority over residential mortgage practices and giving it to a newly-created agency, than the Board announced radical new rules that upend the manner in which industry professionals are compensated. These rules come just two years after the Board conducted an extensive rulemaking proceeding on the same issue, commissioned consumer testing, and concluded that no new rules on compensation were necessary. In issuing the Final Rule, the Board fails to reference anything that has changed in the intervening period or any new information that compels a different conclusion. Indeed, the Board inexplicably ignores its own findings from the earlier rulemaking that counseled avoiding this type of regulation.

In short, the only thing that has changed since the Board sanctioned longstanding compensation practices is that the Board is poised to lose its authority. As discussed below, the Board’s extraordinary action circumvents strict rulemaking procedures that Congress vested with a new agency, exceeds the Board’s authority under the Home Ownership and Equity Protection Act, and violates well-settled requirements of the Administrative Procedure Act.

Neither The National Association of Mortgage Brokers nor The National Association of Independent Housing Professionals speaks to the interests of independent mortgage bankers. The Rule, unlike any known regulation of an entire lawful industry, micro-mandates the terms of employment of individual loan originators employed by mortgage bankers. The Final Rule mistakes ordinary profit in lending transactions for unfair and deceptive practices. Mortgage bankers are losing control over basic employment terms, such as incentives based on company profitability, that have been used over the years to attract and maintain competent employees. The Final Rule prevents mortgage bankers' employees from offering to consumers the full range of competitive loan pricing options. Incredibly, the Final Rule not only prohibits loan originators from arranging loan terms that result in higher consumer costs, the same prohibition applies to offering consumers **LOWER** cost mortgage loans to meet competition and to save the consumer money. The Final Rule will result in discrimination against lending programs designed to benefit low-to-moderate income borrowers. In this regard, the Board somehow concluded in the Supplementary Information published with the Final Rule: “[a]llowing compensation to vary with loan type, such as loans eligible for consideration under the [Community Reinvestment Act] would permit unfair compensation practices to persist in loan programs offered to consumers who may be more vulnerable to such practices.” 75 Fed. Reg. 58523. Finally, given the severe, loan-by-loan and class action remedies that may accrue under the Final Rule, retail mortgage bankers will encounter new, undefined and virtually limitless legal and economic risks under the Final Rule.

## ARGUMENT

### I. Congress Gave The CFPB Exclusive Authority Over Loan Originator Compensation Practices.

On July 21, 2010, Congress enacted the DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (the “Dodd-Frank Act”), establishing the Consumer Financial Protection Bureau (the “CFPB”) and expressly vesting the CFPB with exclusive rulemaking authority to implement Federal consumer financial law. *See generally* the Dodd-Frank Act, Pub. L. No. 111-203, § 1011, 124 Stat. 1376, 1964 (2010) (to be codified at 12 U.S.C. § 5491); *Id.* § 1022, 124 Stat. at 1980-1985 (to be codified at 12 U.S.C. § 5512). The Dodd-Frank Act embodied the MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT, and amended the TRUTH IN LENDING ACT (“TILA”) and, *for the first time*, expressly established loan originator compensation and anti-steering standards. Dodd-Frank Act § 1400 *et seq.*, 124 Stat. at 2136. Moments after Congress announced that it transferred the Board’s authority to the CFPB, the Board jumped ahead into the CFPB’s jurisdiction and forced upon the industry an upheaval of longstanding compensation practices. In short, after years of inaction on this issue, the Board promulgated the *Loan Originator Compensation and Anti-Steering Rule* (the “Final Rule”), 12 CFR Part 226.36(a), (d), and (e), and claimed authority to do so under TILA.<sup>1</sup> The Board’s action was contrary to Congress’ intent, arbitrary and capricious, and without statutory authority,

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<sup>1</sup> Specifically, the Board cites to its authority under 15 U.S.C. § 1639(1)(2) which is a provision under the Home Ownership and Equity Protection Act (“HOEPA”), a subpart of TILA. *See* further discussion *supra* at Part II.

in violation of the ADMINISTRATIVE PROCEDURE ACT (“APA”) 5 U.S.C. § 706(2). The Final Rule must be set aside.

The Dodd-Frank Act clearly *vests the CFPB with exclusive rulemaking authority* to implement federal consumer financial law. Dodd-Frank Act § 1022(b)(4), 124 Stat. at 1981 (to be codified at 12 U.S.C. § 5512(b)(4)). Prior to the Dodd-Frank Act, there was no “federal consumer financial law” governing creditor loan originator compensation practices; the Dodd-Frank Act itself created such a law. Further, Section 1022 requires that courts defer to the CFPB regarding “the meaning or interpretation of any provision of a Federal consumer financial law” notwithstanding actions by other federal agencies. *Id.* Finally, Section 1022 heightens the standard for promulgation of rules. *Id.* § 1022(b)(2), 124 Stat. at 1980-1981 (to be codified at 12 U.S.C. § 5512(b)(2)). By the plain language of the statute, it is clear that Congress intended to bestow the CFPB with authority to (1) promulgate loan originator compensation rules according to heightened rulemaking standards, and (2) have exclusive and final say as to how such compensation practices are to be regulated.

Further, the Dodd-Frank Act amends TILA to include new Section 129B, which specifically addresses residential mortgage loan origination and compensation practices. The stated purpose of Section 129B is “to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive.” Dodd-Frank Act § 1402(a)(2), 124 Stat. at 2139 (to be codified at 15 U.S.C. § 1639B(a)(2)). To that end, the Dodd-Frank Act expressly prohibits steering incentives, stating that “no mortgage originator shall receive from any person and no person shall pay to a mortgage originator . . . compensation that varies based on the terms of the loan (other than the amount of principal).” *Id.* § 1403, 124 Stat. at 2139-2141 (to be

codified at 15 U.S.C. § 1639B(c)). Prior to the enactment of the Dodd-Frank Act, TILA *did not address* loan originator compensation or anti-steering practices. The Board was not granted authority to regulate loan originator compensation generally.<sup>2</sup> That power falls solely to the CFPB. It is notable, as well, that the Final Rule differs from the Dodd-Frank Act in significant respects. In fact, the very definition of “loan originator” in the Final Rule conflicts with the Dodd-Frank Act definition of this term (“mortgage originator”).

Yet, within mere days of the Dodd-Frank Act’s enactment, the Board passed the Final Rule purportedly pursuant to HOEPA and bypassed the Dodd-Frank Act rulemaking procedures to regulate under substantive law found only in the Dodd-Frank Act. It is clear – any purported authority by the Board to legislate in this arena pursuant to HOEPA was forestalled by the Dodd-Frank Act. In the context of Congress’ transfer of authority from one agency to another, the Federal Circuit has recognized that the subsequent, more explicit, legislation pre-empts the prior legislation under the doctrine of implied repeal. “We have recognized that, where intended by Congress, ‘a precisely drawn, detailed statute pre-empts more general remedies.’ This can occur either where the two enactments are in ‘irreconcilable conflict’ or where the latter was clearly meant to serve as a substitute for the former.” *F.T.C. v. Ken Roberts Co.*, 276 F.3d 583, 592 (D.C. Cir. 2001) (citing and quoting *Galliano v. United States Postal Serv.*, 836 F.2d 1362, 1367 (D.C. Cir. 1988); *Brown v. Gen. Servs. Admin.*, 425 U.S. 820, 834 (1976); *Posadas v. Nat’l City Bank*, 296 U.S. 497, 503 (1936)). Thus, assuming *arguendo*, that the Board’s discretion under HOEPA does encompass loan originator compensation (which it does not, *see discussion supra*

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<sup>2</sup> That power falls solely to the CFPB. The Dodd-Frank Act does not even empower the CFPB, much less the Board, to promulgate any regulation under the new law prior to the Congressionally-imposed “designated transfer date.” The transfer date is July 21, 2011. *See* Dodd-Frank Act § 1400(c).

Part II), Congress' intent in enacting the Dodd-Frank Act is clear: the CFPB is to have exclusive and final say on loan origination compensation issues.

Further, by its terms, the Final Rule is inconsistent with the Dodd-Frank Act. Pursuant to the Dodd-Frank Act, Congress mandated heightened rulemaking standards for loan originator compensation regulations, *see* Dodd-Frank Act § 1022(b)(2), 124 Stat. at 1980-1981 (to be codified at 12 U.S.C. § 5512(b)(2)), which the Board did not adhere to in the promulgation of its Final Rule.<sup>3</sup> And, perhaps more importantly, the Board admits that the Final Rule fails to fully implement all the substantive requirements that the Dodd-Frank Act sets forth for loan originator compensation in Section 129B: "The Board has decided to issue this final rule on loan originator compensation and steering, even though a subsequent rulemaking will be necessary to implement Section 129B(c)." 75 Fed. Reg. 58509, 58509 (Sept. 24, 2010). Thus, the Final Rule fails to adhere to both the procedural and substantive requirements that Congress intended for loan originator compensation regulations.

As a result, the Board has created a risk that either (1) conflicting loan originator compensation rules could soon exist, or, (2) the industry will be forced to comply with a loan originator compensation rule that is incomplete and doomed to be short-lived. Neither circumstance is tenable by law. Under these circumstances, interagency deference is required: "As the Supreme Court has repeatedly emphasized, '[f]requently the entire scope of Congressional purpose calls for careful accommodation of one statutory scheme to another, and it is not too much to demand of an administrative body that it undertake this accommodation without excessive emphasis upon its immediate task.'" *N.Y. Shipping Ass'n, Inc. v. Fed. Maritime Comm'n*, 854 F.2d 1338, 1365 (D.C. Cir. 1988) (quoting *S. S.S. Co. v. NLRB*, 316 U.S.

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<sup>3</sup> 5 U.S.C. § 553 (discusses the general requirements for agency rulemaking).

31, 47 (1942)); *see also* *Gottfried v. F.C.C.*, 655 F.2d 297, 308 (D.C. Cir. 1981) (noting “settled proposition that a federal agency, in construing the requirements of the ‘public interest’ under its governing statute, must at least give weight to federal laws and public policies addressed to similar purposes”), *judgment rev’d in part on other grounds*, 459 U.S. 498 (1983); *Commonwealth of Pa. v. I.C.C.*, 561 F.2d 278, 292 (D.C. Cir. 1977) (commending agency for “giving heed to the legal objections raised by its sister agency”). That is particularly true, where as here, the Board has rushed the Final Rule purposefully to avoid the heightened standards of the Dodd-Frank Act.

Further fatal to the Board’s position is the fact that the Board has already *conceded* that it must defer to the CFPB. The Board recently elected to take no further action on *all* of its other pending rules that would amend mortgage lending regulations under TILA, except this one.<sup>4</sup> While changes and inconsistencies in agency policy are generally not considered “per se arbitrary and capricious action,” an inquiry must be made into whether the policy change has been adequately explained and justified so that the parties upon whom the policy will have an impact understand the newly adopted agency position.” *I.C.C.*, 561 F.2d at 291. Here, the Board’s inconsistent action is not only unlawful under the APA, beyond its power under HOEPA, and in circumvention of the Dodd-Frank Act, it cannot be explained or justified.

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<sup>4</sup> *See* Fed. Reserve Bd. Press Release (Feb. 1, 2011), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20110201a.htm> (last modified Mar. 24, 2011). Further, members of the U.S. Senate and the U.S. House of Representatives have recently requested that the Board delay implementation of the Final Rule. *See* Letter from David Vitter and John Tester, Senators, U.S. Senate, to Ben Bernanke, Chairman, Federal Reserve Board (Mar. 11, 2011), available at <http://www.ncsha.org/resource/senators-letter-federal-reserve-board-requesting-delayed-implementation-loan-officer-compensation-regulations> (last modified Mar. 24, 2011); Letter from Spencer Bachus, Chairman, U.S. House of Representatives, Committee on Financial Services, to Ben Bernanke, Chairman, Federal Reserve Board (Mar. 15, 2011).

**II. The Board Violated The APA By Exceeding Its Authority Under The Home Ownership And Equity Protection Act (HOEPA), 15 U.S.C. § 1639(l)(2).**

The underlying intent of Section 1639(l)(2) makes clear that the Board's authority is constrained to the promulgation of rules that prohibit unfair, deceptive, or evasive practices as to certain defined loans. The Board's discretion was to be limited to the prohibition of acts and practices in connection with mortgage loans and refinancing mortgage transactions; it was not to be exercised *carte blanche* to police every possible practice inherent to the mortgage industry, such as creditor compensation to employees. If so, Section 1639(l)(2) would subsume completely the Board's general rulemaking authority under TILA. Moreover, the Board's enactment of the Final Rule is inconsistent with TILA itself, because in the Final Rule the Board creates new classes of regulated parties that are not even defined by TILA. Consequently, pursuant to the APA, the Final Rule must be set aside.

The D.C. Circuit has made clear that this Court “*shall* ‘hold unlawful and set aside agency action . . . found to be . . . in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.’” *Colo. Wild Horse & Burro Coal. v. Salazar*, 639 F. Supp. 2d 87, 90-91 (D.D.C. 2009) (quoting 5 U.S.C. § 706(2)(C)) (emphasis in original). A determination of whether the Board exceeded its statutory authority under 5 U.S.C. § 706(2)(C) requires the Court to apply the two-step inquiry required by *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837 (1984).<sup>5</sup>

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<sup>5</sup> *Id.* at 90-91. Under *Chevron*, the Court first looks to “whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” *Chevron*, 467 U.S. at 842-43. “A court does not defer to the agency in determining whether a statute is ambiguous.” *Am. Mining Congress v. U.S. Army Corps of Eng’rs*, 951 F. Supp. 267, 271 n.6 (D.D.C. 1997) (citing *Cajun Elec. Power Coop., v. FERC*, 924 F.2d 1132, 1136 (D.C. Cir. 1991)). If the Court determines that “‘the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.’” *Colo. Wild Horse & Burro Coal.*, 639 F. Supp. 2d at

Here, the underlying purpose of the statute and its legislative history clearly illustrates that the Board exceeded its authority under this provision. Specifically, Section 1639(l)(2) states as follows:

The Board, by regulation or order, shall prohibit acts or practices in connection with –

- (A) Mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and
- (B) Refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.

15 U.S.C. § 1639(l)(2). The statute references, generally, “mortgage loans” and “refinancing of mortgage loans,” and Congress did not intend to grant the Board open-ended authority to prescribe new business practices and limit existing business practices that had been accepted in the residential mortgage lending industry. In fact, HOEPA provisions address creditor disclosures, prepayment penalties, default limitations, balloon payments, negative amortization, credit extensions, and home improvement contracts in connection with a newly-defined class of high cost home mortgages.<sup>6</sup> *See* 15 U.S.C. §§ 1639(a)(i).

Congress did not in 1994 open up the floodgates for every conceivable consumer mortgage rule. Most informative on the scope of the Board authority is the Congressional debate regarding the Board’s discretionary authority, which clearly demonstrates that the Board’s

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91 (quoting *Chevron*, 467 U.S. at 843). In order to be sustained under the APA, the agencies’ action must be “reasonable in light of the language, legislative history, and policies of the statute.” *Natural Res. Def. Council, Inc. v. E.P.A.*, 822 F.2d 104, 111-112 (D.C. Cir. 1987). In doing so, the Court does not owe the agency deference with regard to the agency’s interpretation of its jurisdiction or “delimiting its jurisdiction as against that of the authorities charged with administration” of other laws. *N.Y. Shipping Ass’n, Inc.*, 854 F.2d at 1362-1363.

<sup>6</sup> Notably absent from the express provisions of Section 1639 is any reference to loan originator compensation. Further, Congress did not intend, and the Courts have not construed, HOEPA to impart authority on the Board to promulgate regulations regarding loan originator compensation. Indeed, Congress’ explicit inclusion in the Dodd-Frank Act of regulatory authority over loan originator compensation practices strongly suggests that Congress did not believe HOEPA addressed this aspect of the mortgage lending business.

authority was limited to regulation of emerging products and practices deemed to be harmful to consumers. *See* S. REP. 103-169, 27, 1993 WL 444316, at \*2, 1994 U.S.C.C.A.N. 1881, 1911 (describing the discretionary authority as a means for the Board to govern “High Cost Mortgages” and make exceptions for certain mortgage products, waive certain limitations imposed by HOEPA, and address “*new* products and practices [*that*] *may emerge* that facilitate reverse redlining”) (emphasis added). In sum, Section 1639(1)(2) was not meant to bestow the Board with unlimited power to prescribe all practices that possibly could be associated with residential mortgage lending.

Disregarding its mission under HOEPA, however, the Board prescribed an extremely broad rule to mandate wide-ranging business practice changes under the assumption that consumer protection would follow. For example, rather than merely targeting the use of YSPs for mortgage broker compensation, the Board declared generally that relying on ordinary company profits to compensate loan originators is unfair and deceptive. Notwithstanding Congress’ intent, the Final Rule is not limited in its reach to new unfair or deceptive credit products or practices. Rather, the Final Rule imposes an entirely novel, comprehensive regime over a new class of parties known as “loan originators.” In fact, TILA grants remedies to consumers against “creditors” who violate TILA and its implementing regulations and provides no rights of action against parties that variously may be called “mortgage brokers” or “loan originators.” 15 U.S.C. § 1640(a). Consequently, the Board has exceeded its authority under Section 1639(1)(2), and the Final Rule must be set aside.

### **III. The Final Rule Violates The Administrative Procedure Act.**

The Final Rule is subject to judicial review pursuant to the APA. While judicial review under the APA is deferential, an agency whose actions are challenged under the APA nonetheless must provide a reasoned analysis in support of its conclusions.<sup>7</sup> This Court has recognized that an agency has a higher burden where, as here, it changes longstanding policy. *Shays v. FEC*, 511 F. Supp. 2d. 19, 29 (D. D. C. 2007) (*Shays III*).

As explained below, the Final Rule fails to meet this higher burden and should be vacated as arbitrary and capricious because the Board (1) failed to supply a reasoned analysis for departing from its longstanding policy on loan originator compensation; (2) failed to supply a reasoned analysis for its conclusion that loan originator compensation is an unfair practice; and, (3) failed to consider or offer reasoned explanations for rejecting reasonable alternatives.

#### **A. The Board Failed to Supply a Reasoned Analysis for Departing from Its Longstanding Position on Loan Originator Compensation.**

##### ***1. Compensation to Mortgage Brokers***

Before promulgating the Final Rule, the Board had *explicitly declined, based on the same record as the Final Rule*, to ban the widespread industry practice of compensating brokers through a yield spread premium. The Final Rule constitutes a complete, and unexplained, reversal of this policy. The “failure to come to grips with conflicting precedent constitutes ‘an inexcusable departure from the essential requirement of reasoned decision making.’” *Ramaprakash v. FAA*, 346 F.3d 1121, 1125 (D.C. Cir. 2003) (citing *Columbia Broad. Sys. v. FCC*, 454 F.2d 1018, 1027 (D.C. Cir. 1971)). It is settled law that where, as here, “an agency

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<sup>7</sup> Under the APA, a Court must “hold unlawful and set aside agency action, findings, and conclusions found to be \*\*\* arbitrary, capricious, and an abuse of discretion, or otherwise not in accordance with law” or “in excess of statutory jurisdiction, authority, or limits, or short of statutory right.” 5 U.S.C. § 706.

departs from established precedent without a reasoned explanation, its decision will be vacated as arbitrary and capricious.” *ANR Pipeline Co v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995).

In January 2008, the Board proposed a rule that among other things would have prohibited a creditor from paying a mortgage broker compensation based on YSP – *i.e.*, the dollar value of the difference between the lender’s par rate and the actual interest rate charged on the loan. 73 Fed. Reg. 1672, 1698-1700 (Jan. 9, 2008) (the “2008 Proposed Rule”). At the same time, the Board engaged a private firm, Macro International, Inc. (“Macro”), to survey consumers regarding alternative versions of a disclosure statement that explained YSPs. 73 Fed. Reg. 44522, 44564 (July 30, 2008) (the “2008 Final Rule”).

After this consumer testing was completed and the Board analyzed the results, the Board declined to adopt a rule that would prohibit creditor payments to third party mortgage brokers based on the interest rate of the loan. *Id.* at 44563. While noting its concerns with consumers’ understanding of survey-tested disclosure statements, the Board cited “successes,” including consumers’ general understanding of the potential “conflict of interest” for brokers (*i.e.*, that brokers can benefit financially from negotiating a higher interest rate), and “the importance [for consumers] of shopping on their own behalf in the mortgage market.” 2008 Final Rule at 44565. The Board concluded that these “more encouraging results suggest that further development of a disclosure approach to creditor payments to mortgage originators, through additional consumer testing, still may have merit.” *Id.*

Less than 14 months later, the Board reversed itself, concluding that this very same consumer testing established that “disclosure alone is insufficient for most consumers to avoid the harm caused by this practice.” The Final Rule at 58514. This time, the Board ignored the “successes” and “encouraging results” of the 2008 testing and its conclusion that further testing

was warranted. Nor did the Board supply any explanation in the Final Rule as to why further testing was never done.

An agency's view of what is in the public interest may change, either with or without a change in circumstances. But an agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored, and if an agency glosses over or swerves from prior precedents without discussion, it may cross the line from tolerably terse to the intolerably mute.

*Greater Boston Tel. Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970). Furthermore, an agency violates the APA when it summarily concludes that its rule "responds" to earlier studies, when in fact it does not. *Advocates for Highway & Auto Safety v. Fed. Motor Carrier Safety Admin.* 429 F.3d 1136, 1144 (D.C. Cir. 2005) (agency "proclaims that its final rule 'responds' to . . . earlier findings," but "without coherent explanation, has promulgated a rule that is so at odds with the record assembled by DOT that the action cannot stand.").

Here, the Board's reversal demands an explanation. When the Board declined in July 2008 to overturn the well-established industry practice of compensating brokers through a YSP, its decision was the product of an extensive rulemaking proceeding in which the Board received over 4700 comments and commissioned testing of consumers regarding the effect of different types of disclosures. 2008 Final Rule at 44530. The Board must point to *something* that caused it to reevaluate its conclusions about its consumer testing, or an intervening change in the nature or scope of the perceived problem, or some new evidence adduced through the 2010 rulemaking. But the Board has supplied no such evidence or explanation.

## ***2. Compensation by Creditors to their Own Employees***

The Board also fails to offer a reasoned explanation for abandoning its position – clearly stated in the 2008 Proposed Rule – that any prohibition on payments to mortgage brokers in

exchange for higher interest rates *should not be applied to creditor payments to their own employees:*

The Board does not propose, however, to restrict creditor payments to their own employees. The Board is not aware of significant evidence that consumers perceive lenders' employees the way they often perceive independent brokers – as trusted advisors who shop for the best loan for a consumer among a wide variety of sources. *Accordingly, it is not clear that a key premise of the proposal to restrict creditor payments to brokers – that consumers expect a broker has a legal or professional obligation to give disinterested advice and find the consumer the best loan available – holds true for creditor payments to their own employees. In addition, extending the proposal to creditor payments to their employees could present difficult practical problems.*

2008 Proposed Rule at 1700 (emphasis added).

The Board reverses direction here, too, banning creditors from closing loans at interest rates above par in order to make a profit, and then compensating their employees accordingly. The Board's explanation for this dramatic change in policy is contained in a single paragraph, which cites unspecified "anecdotal evidence" purportedly indicating "that creditors' loan officers engage in such pricing discretion that directly harms consumers." Final Rule at 58517. The only other "authority" cited by the Board is contained in a footnote, but in those cases, "the primary legal theory concerned disparate treatment by race in the imposition of overages" and therefore have no bearing on the issue presented here.

Moreover, the Board cited no evidence in the record to contradict its conclusion in 2008 that consumers *do not* perceive lenders' employees the same way as they perceive independent brokers. And the Board does not even attempt to address the "difficult practical problems" cited in the 2008 Proposed Rule as additional reasons for declining to impose restrictions on direct lending by creditors. 2008 Proposed Rule at 1700.

This Court has set aside agency rules when reliance on "flimsy anecdotal evidence" was "not sufficient to enable [the Court] to conclude that the [Final Rule] was the product of reasoned

decisionmaking.” *Penobscot Indian Nation v. Dep’t. of Hous. & Urban Dev.*, 539 F. Supp. 2d 40, 52 (D.D.C. 2008) (citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 36, 43 (1983) and *Ass’n of Data Processing Serv. Orgs., Inc. v. Bd. of Govs. of Fed. Reserve Sys.*, 745 F.2d 677, 683 (D.C. Cir. 1984) (Section 706(2)(A) of the APA “enable[s] the courts to strike down, as arbitrary, agency action that is devoid of needed factual support”). Moreover, it is well-settled that when an agency “has adopted a rule with little apparent connection to the inadequacies it purports to address . . . it fails review under § 706(2)(A).” *Advocates for Highway & Auto Safety*, 429 F.3d at 1144.

**B. The Board Failed to Supply a Reasoned Analysis for Its Conclusion that Loan Originator Compensation is an “Unfair” Practice.**

Under the FTC Act, an act or practice is considered unfair when it (1) causes or is likely to cause substantial injury, (2) is not reasonably avoidable by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. 15 U.S.C. § 45(n) (1994). The Final Rule wipes out longstanding and widespread industry norms based on its conclusion that they are “unfair” within the meaning of that term as used in Section 5 of the FTC Act.

In lieu of reasoned analysis, however, the Board’s argument that well-settled compensation arrangements are “unfair” is replete with bald assertions and speculation. *See* Final Rule at 58515 (“Brokers *may* impose a direct fee on the consumer, which *may* lead consumers to believe that the direct fee is the sole source of the broker’s compensation.”; “Instead [consumers] are more likely to rely on the loan originator’s advice, and, as a result, *may* receive a higher rate or other unfavorable terms solely because of greater originator compensation.”; “Consumers also *may* reasonably believe that the fee they pay is the originator’s sole compensation. This *may* lead reasonable consumers erroneously to believe that loan

originators are working on their behalf. . . .”; “Consumers *may* regard loan originators as ‘trusted advisors’ or ‘hired experts,’ and consequently rely on originators’ advice.”) (emphases added). Such empty rhetoric is no substitute for reasoned judgment based on the administrative record.

Counsel for the Board argues that the Board’s conclusion that loan originator practices are unfair is “based on the Board’s consideration of the testimony from two years of public hearings, the public comments to the 2008 disclosure rulemaking proposal, the 2008 consumer testing of the proposed model disclosures, and the public comments to the proposed 2009 rule.” (Board’s Mem. in Opp’n to Applications for Temporary Restraining Order and Preliminary Injunction at 32.) Except for the consumer testing, however, none of the other record evidence cited by the Board’s attorneys was cited by the Board in applying the three unfairness factors. Moreover, despite repeated assertions that disclosures would be unworkable in its unfairness analysis, the Board determined in 2008, based on the Macro studies, that disclosure *could* be effective in educating consumers and that further testing could lead to enhancements that could improve consumer understanding. In *Penobscot Indian Nation*, HUD similarly argued that this Court should uphold [a] challenged rule because “the Administrative Record shows that a plethora of material supports the [Final Rule.]” 539 F. Supp. 2d at 52 (citation omitted). In invalidating the rule, the Court observed:

[T]he APA imposes on HUD a duty to publicly “identif[y] a reasonable basis in the record” for its conclusions. *Int’l Union, United Mine Workers of Am. v. Fed. Mine Safety & Health Admin.*, 920 F.2d 960, 964 (D.C. Cir. 1990). It is not the Court’s responsibility on review to pore through the record and validate the agency’s decision. *See Hornbeck Offshore Transp. v. United States Coast Guard*, 424 F. Supp. 2d 37, 45 (D. D. C. 2006) (a reviewing court may not attempt itself to make up for any deficiencies in the agency’s decision or rationale by supplying ‘a reasoned basis for the agency’s action that the agency itself has not given’) (quoting *Motor Vehicle Mfrs. Ass’n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. at 43).

*Id.* at 54.

Finally, the Board ignored the conclusion it reached in issuing the 2008 Final Rule that consumers understand the importance of looking out for their own interests and shopping for the best rate. In withdrawing its proposal on loan originator compensation, the Board characterized as one of the “successes” of the Macro testing that “language intended to convey to consumers the importance of shopping on their own behalf in the mortgage market appeared to be successful.” 2008 Final Rule at 44565.

The FTC’s Policy Statement on Unfairness states, in pertinent part:

Finally, the injury must be one which consumers could not reasonably have avoided. Normally we expect the marketplace to be self-correcting, and we rely on consumer choice – the ability of individual consumers to make their own private purchasing decisions without regulatory intervention – to govern the market. *We anticipate that consumers will survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory. However, it has long been recognized that certain types of sales techniques may prevent consumers from effectively making their own decisions, and that corrective action may then become necessary. Most of the Commission’s unfairness matters are brought under these circumstances.*<sup>8</sup>

Letter from Federal Trade Commission to Senators Wendell H. Ford and John C. Danforth (Dec. 17, 1980), reprinted in H.R. Rep. No. 156, Pt. 1, 98<sup>th</sup> Cong., 1<sup>st</sup> Sess. 33-40 (1983) (emphasis added).

The Board’s finding that through proper disclosure consumers are able to make their own decisions means that this is *not* the type of practice that the FTC commonly views as unfair and thus *not* the type of matter that the FTC would likely challenge through its unfairness

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<sup>8</sup> The Board also ignored its obligation under the unfairness test to consider countervailing benefits to consumers. As the Board itself has acknowledged, the Rule will prevent retail lenders from offering consumers the full range of loan pricing options and discriminate against lending programs that benefit low-to-moderate income borrowers. Supplementary Information of the Final Rule, 75 Fed. Reg. 58523. (“Allowing compensation to vary with loan type, such as loans eligible for consideration under the [Community Reinvestment Act] would permit unfair compensation practices to persist in loan programs offered to consumers who may be more vulnerable to such practices.”).

jurisdiction. Yet two years later, in a rush to dictate industry compensation practices, the Board ignored this finding altogether. The APA demands a more complete and forthright analysis than this.<sup>9</sup>

**C. The Board Fails to Offer Reasoned Explanations for Rejecting Reasonable Alternatives.**

The law in this Circuit is clear that an agency must consider less restrictive alternatives and offer a reasoned explanation for its rejection of such alternatives in favor of its chosen policy. Disclosure is an obvious and significant alternative to the Board's decision to prohibit YSPs altogether. Another obvious, less restrictive alternative would have been to limit loan originator compensation only when increased loan costs are imposed on borrowers as a result of unjustified higher loan originator compensation. Rather than promulgating a rule to eliminate inappropriate compensation incentives for loan originators, the Board instead prohibited any variation in compensation to loan officers based on loans terms – even when the loan originator may receive lower compensation with the benefit of lower loan pricing provided to the consumer.

As discussed above, the Board ignored *its own conclusion* in the 2008 rulemaking that as the testers strengthened the disclosure statement, it produced more “encouraging results, suggest[ing] that further development of a disclosure approach to creditor payments to mortgage originators, through additional consumer testing, still may have merit.” 2008 Final Rule at

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<sup>9</sup> The Board concedes that a disclosure statement mandated by HUD through Regulation X is “perhaps an improvement over previous rules,” but concludes that it is inadequate “by itself” to prevent consumers from incurring substantial injury. Final Rule at 58515. This cannot be a license for the Board to abdicate its own jurisdiction or fail to consider whether other formulations might be adequate. It is the Board's responsibility to enforce the Truth in Lending Act, not HUD's. See *Shays v. FEC*, 337 F. Supp. 2d 28, 128 (D.D.C. 2004) (court found that Federal Election Commission could not defer to IRS interpretations in discharging its responsibility to enforce the Federal Election Campaign Act).

44565. Moreover, in the two rulemakings, the Board characterizes certain aspects of the consumer testing in diametrically opposed terms. For instance, in 2008 the Board concluded that based on consumer testing, “*consumers generally appeared to understand the language describing the potential conflict of interest . . . even though it often was ignored because of seemingly conflicting information.*” *Id.* (emphasis added). In 2010, the Board reached the opposite conclusion about the same study: “*Consumers in these tests did not understand yield spread premiums and how they create an incentive for loan originators to increase consumers’ costs.*” Final Rule at 58515 (emphasis added).

Such lack of consideration regarding its prior views of the potential efficacy of disclosure shows that the Board did not engage in reasoned decisionmaking. *See Covad Comm’s Co. v. FCC*, 450 F.3d 528, 550 (D.C. Cir. 2006) (an agency “need not address every comment, but it must respond in a reasoned manner to those that raise significant problems”); *Canadian Ass’n of Petroleum Producers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001) (“Unless the Commission answers objections that on their face seem legitimate, its decision can hardly be classified as reasoned.”). “The failure of an agency to consider obvious alternatives has led uniformly to reversal.” *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1169 (D.C. Cir. 1987) (citations omitted).

#### CONCLUSION

For the foregoing reasons, the Court should set aside the Final Rule, or, alternatively, delay the effective date of the Final Rule to permit the properly empowered agency, the CFPB, to take action as prescribed by Congress.

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Respectfully submitted,

/s/ Deborah J. Israel

Deborah J. Israel (Bar No. 430841)  
Lawrence H. Norton (Bar No. 978212)  
Alida M. Dagostino (Bar No. 493665)  
WOMBLE CARLYLE SANDRIDGE & RICE, PLLC  
1401 Eye Street, N.W., 7<sup>th</sup> Floor  
Washington, DC 20005  
(202) 857-4466  
(202) 261-0034 (facsimile)  
disrael@wcsr.com

Donald C. Lampe  
*Of Counsel*  
WOMBLE CARLYLE SANDRIDGE & RICE, PLLC  
301 South College Street  
Charlotte, NC 28202  
(704) 350-6398  
(336) 574-8057  
(336)-574-4530 (facsimile)  
dlampe@wcsr.com

*Counsel for Amici Curiae,  
Community Mortgage Banking Project, and  
Community Mortgage Banking Research Fund*