

Professionals, Inc. (“NAIHP”) submits this memorandum in reply to Defendants Board of Governors of the Federal Reserve System’s (“Board”) Memorandum In Opposition To Plaintiffs’ Applications For Temporary Restraining Order And Preliminary Injunction (“Opposition”). While the Board rehashes at length the conclusory statements that accompanied the Final Rule, it utterly fails to demonstrate that it has authority to promulgate the Final Rule which purports to regulate loan originator compensation with respect to all mortgage loans under the Truth in Lending Act (“TILA”), 15 U.S.C. §§ 1601 *et seq.* Moreover, even assuming that the Board has authority under TILA to regulate loan originator compensation, it has utterly failed to demonstrate that the current loan originator compensation practices which it seeks to proscribe are unfair, deceptive or abusive and hence subject to what the Board claims is its discretionary UDAP authority. The Board’s opposition also confirms the utter paucity of support for its suppositions with respect to the alleged injury to consumers and the unavailability of such alleged injury by consumers. Indeed, the Board readily concedes that its conclusion that the disclosures, that the Board is unquestionably authorized to require, are ineffectual rests entirely upon two “studies,” a summary of the interviews of 35 hand-picked individuals from three cities and a four-page report on a telephone survey of citizens over 65 years of age.

Instead of empirical analysis and hard data, the Board has larded the record and its brief with nothing more than uninformed, conclusory supposition to support a supposed consumer protection measure that incredibly leaves fully 90% of the relevant consumer market completely unprotected. Indeed, not only does the Board leave 90% of the consumer market devoid of the protection it contends consumers desperately and immediately need, but it actually enshrines in the Final Rule the ability of the creditors who control 90% of the mortgage loan origination market to impose with impunity across-the-board interest rate premiums on all mortgage products. *See* Affidavit of Paul Muolo ¶ 7. (Ex. 1) The Board’s alleged concern for consumer protection when

juxtaposed with the reality of the Final Rule’s exclusion of 90% of the consumer market from such protection clearly demonstrates the arbitrary and capricious nature of the Board’s rulemaking.

ARGUMENT

I. PLAINTIFFS ARE LIKELY TO SUCCEED ON THE MERITS BECAUSE THE FINAL RULE EXCEEDS THE BOARD’S RULEMAKING AUTHORITY AND IS ARBITRARY AND CAPRICIOUS.

A. The Board’s Own Argument Demonstrates that It Has Exceeded Its Authority In Promulgating The Final Rule.

The Board concedes that “[s]ection 105(a) of the TILA authorizes the Board to promulgate regulations to carry out the purposes of the Act [TILA]” and “to provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of the [Act] . . . or to facilitate compliance therewith.” Opposition at 3 quoting TILA section 105(a), 15 U.S.C. § 1604(a). But as the Board must concede, it purported to promulgate the Final Rule pursuant to its authority under TILA section 129(1)(2), 15 U.S.C. § 1639(1)(2), to prohibit unfair or deceptive acts in connection with certain mortgage loans subject to TILA section 129. Opposition at 3-4.

The gravamen of the Board’s statutory authority argument is that TILA section 129 (1)(2) granted it broad authority with respect to all mortgages “to prohibit, by regulation or order acts or practices in connection with mortgage loans that [it] finds to be unfair, deceptive, or designed to evade the disclosure provisions of [section 129].” Opposition at 28 quoting 15 U.S.C. § 1639(1)(2). In that connection, the Board also cites *TRW, Inc. v. Andrews*, 534 U.S. 19, 31 (2001), for the proposition that “[i]t is a cardinal principle of statutory construction that the statute ought, upon the whole, be so construed that if it can be prevented, no clause, sentence or word should be superfluous, void or

insignificant.” Opposition at 28. The Board further argues that “had Congress intended to limit the Board’s discretionary regulatory authority to issue prohibitions only with respect to the abusive practices of creditors or only with respect to high-cost loans, it would have done so.” *Id.* at 28-29.

In fact, that is exactly what Congress did. It is well settled that courts must assume that Congress knew what it was doing when it enacted legislation and was aware of the law when it acted. *See generally Cannon v. Univ. of Chicago*, 441 U.S. 677, 696-98 (1979); *Consumers Union of U.S., Inc. v. Fed. Reserve Brd.*, 736 F. Supp. 337, 341 (D.D.C. 1990). Significantly when Congress saw fit to grant the Board the discretionary power upon which it purports to rely in promulgating the Final Rule regulating loan originator compensation, Congress placed that discretionary authority in TILA section 129 rather than TILA section 105, which governs, as the Board concedes, its general rule making power. By contrast, TILA section 129 is a much more narrowly focused provision.

By its express terms, TILA section 129 applies only to mortgages “referred to” in section 1602(aa). 15 U.S.C. § 1639. TILA section 129 expressly provides that “[i]n addition to other disclosures required under this [subchapter, *for each mortgage referred to in section 1602(aa) of this title*], the creditor shall provide the following disclosures in conspicuous type size” *Id.* at § 1639(a)(1) (emphasis added). TILA section 129 then describes in detail the disclosures which are required to be “in conspicuous type.” *Id.* at §§ 1639(a)(1)-(2).

Section 1602(aa), the section to which TILA section 129(a)(1) refers for purposes of defining the mortgages subject to its provisions, in turn, expressly provides that:

A mortgage referred to in this subsection means a consumer credit transaction that is secured by the consumer's principal dwelling, other than a residential mortgage transaction, a reverse mortgage transaction, or a transaction under an open end credit plan, if —

(A) the annual percentage rate at consummation of the transaction will exceed more than 10 percentage points the yield on Treasury securities having comparable periods of maturity on the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor; or

(B) the total points and fees payable by the consumer at or before closing will exceed the greater of —

(i) 8 percent of the total loan amount; or (ii) \$400.

15 U.S.C. § 1602(aa)

Section 1639(1)(2) provides that

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 (1)(2)(A)-(B) (emphasis added).

By placing the UDAP authority in TILA section 129 rather than TILA section 105, Congress made clear that the UDAP authority applies only to the high-cost mortgages which are the subject of 15 U.S.C. § 1639, as defined by 15 U.S.C. § 1602(aa). Moreover, Congress must be assumed to have known what it was doing when it chose to place the UDAP authority in TILA section 129 rather than TILA section 105. *See Cannon*, 441 U.S. at 696-98. Indeed, under the maxim *expressio unius est exclusio alterius*, if “Congress includes particular language in one section of a statute but omits it

in another . . . , it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.” *Russello v. United States*, 464 U.S. 16, 23 (1983) (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)); *see also GM Corp. v. United States.*, 496 U.S. 530, 538 (1990); *Village of Barrington v. Surface Transp. Bd.*, No. 09-1002, 2011 U.S. App. LEXIS 5014, at * 32 (D.C. Cir. Mar. 15, 2011).

The Board’s argument that the court should defer to its reading of TILA section 129 (Opposition at 29) is flawed in at least two respects. First, as the foregoing discussion makes clear, the Board’s interpretation is contrary to the express language of TILA section 129 because TILA section 129 is limited to mortgages described in 15 U.S.C. § 1602(aa). Second, under the very authority cited by the Board as providing the “cardinal principle of statutory construction,” the Board’s reading of the statute would render not merely a word but whole clauses and sentences of the statute superfluous or void in direct contravention of that “cardinal principle of statutory construction.” *TRW, Inc.*, 534 U.S. at 31. *See* Opposition at 28.

With respect to the first point, where as here, the statutory language is clear, the court is not free to defer to a contrary agency interpretation. As the Supreme Court has made clear,

[i]f 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

. . . .

The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to the clear congressional intent.

Chevron U.S.A., Inc. v. Natural Res. Def. Counsel, Inc., 467 U.S. 837, 842-43 (1984) (footnotes omitted).

With respect to the second point, the “cardinal principle of statutory construction” invoked by the Board in its citation of *TRW, Inc.* (Opposition at 28) actually supports plaintiff’s reading of TILA section 129 rather than the Board’s reading of that provision. As the Board correctly noted, *TRW* stands for the proposition that “[i]t is a cardinal principle of statutory construction that the statute ought, upon the whole, be so construed so that if it can be prevented, no clause, sentence or word shall be superfluous, void or insignificant.” Opposition at 28 (quoting *TRW*, 534 U.S. at 31). The Board’s reading of the TILA section 129 would render superfluous the reference in TILA section 129(a)(1) to “*each mortgage referred to in section [1602(aa) of this title.]*” 15 U.S.C. § 1639(l)(1) (emphasis added). Similarly, given the express reference to 15 U.S.C. § 1602(aa), the Board’s reading of TILA section 129 would render that explicit limitations on the types of mortgages described in 15 U.S. § 1602(aa) superfluous and void.¹

Significantly, the Board does not directly address the arguments with respect to the express statutory language. Nor does it seem to appreciate the fact that the very rule of statutory construction upon which it heavily relies actually supports plaintiffs’ reading of the statute rather than the Board’s. Indeed, the Board’s entire response to the overwhelming evidence that it lacked the statutory authority to promulgate this clearly over-reaching Final Rule is essentially “trust us when we tell you plaintiffs misread TILA, section 129(l)(2).” See Opposition at 28-29.

B. The Dodd-Frank Act Does Not Support The Board’s Claimed Authority To Promulgate The Final Rule.

Equally unavailing as supports for its claimed rule making authority is the Board’s invocation of the Dodd-Frank Wall Street Reform and Consumer Protection Act,

¹ The Board appears to suggest, without expressly doing so, that the term “mortgage” in TILA section 129(l)(2) should be read to include all mortgages in order to avoid having that term appear superfluous in light of cardinal rule of construction cited in *TRW, Inc.* Such a reading is, however, clearly contrary to use of mortgage in that section and would render the cross reference to 15 U.S.C. § 1602(aa) superfluous and void in violation of “the cardinal rule of statutory construction.” See *TRW, Inc.*, 534 U.S. at 31.

Pub. L. No. 111-203, 124 Stat. 1376 (“Dodd-Frank Act”). Indeed, the Board expressly disavowed any suggestion that it was acting pursuant to the Dodd-Frank Act when it promulgated the Final Rule. 75 Fed. Reg. 58,509 (Sept. 24, 2010). To the contrary, the Board was quite explicit that, in promulgating the Final Rule, it was acting pursuant to its perceived authority under TILA section 129(l)(2). *Id.* As plaintiff clearly demonstrated in its opening memorandum and as the foregoing also makes clear, that authority is expressly limited to creditors who provide high-cost mortgages as defined in 15 U.S.C. § 1602(aa) and to practices found to be unfair, deceptive or abusive with respect to such high-cost mortgages. *See* NAIHP Memorandum at 15-17.

Similarly, the Board’s contention that the Dodd-Frank Act represents an endorsement of its Final Rule or a justification for it pressing forward with the Final Rule when it has elected to defer implementation of other provisions that it had considered in conjunction with the Final Rule is also unavailing. Opposition at 23-25. Indeed, as the Board concedes, while Dodd-Frank imposes certain limitations on who may compensate mortgage loan originators for their loan origination services in a new section 1639b(c), the Dodd-Frank Act expressly provides that “the Board may, by rule, waive or provide exemptions to this clause if the Board determines that such waiver or exemption is in the interest of consumers and in the public interest.” Opposition at 4 (quoting section 1403 of the Dodd-Frank Act, Pub. Law No. 111-203, 124 Stat. 1376). Significantly, Congress, in the Dodd-Frank Act, has established a new consumer protection agency, the Consumer Financial Protection Bureau (“CFPB”), which, in addition to the relevant authority of the Board with respect to TILA, will acquire the authority of the Department of Housing and Urban Development (“HUD”) with respect to the Real Estate Settlement Procedures Act (“RESPA”), 12 U.S.C. §§ 2600 *et seq.* Congress has not only chosen to transfer authority from the Board to the new CFPB but has also provided an eighteen month period in which the new CFPB can promulgate a comprehensive set of consumer protection regulations that seek, *inter alia*, to balance and

harmonize potential conflicts in competing regulatory schemes that would otherwise arise as a result of patchwork regulation by a variety of agencies. Given the lead time built into the Dodd-Frank Act for rulemaking, the Board's contention that it was compelled to act in the interest of consumer protection in order to further the goals of the Dodd-Frank Act simply does not comport with the timetable that Congress has established for comprehensive consumer protection reform.

Nor is there any support in the record for the Board's claim that it was compelled to act in response to demands by consumer advocates concerned about the alleged abuses of the current loan originator compensation system. According to the Board, it "spent several years attempting to address concerns regarding the effect on consumers of loan originator compensation" and that in 2006 it held hearings in four cities during which "consumer advocates urged the Board to ban yield spread premiums because of their potential to create a conflict of interest between loan originators and consumers." Opposition at 7; *see also* 75 Fed. Reg. at 58,509-510. That claim unfortunately is belied by a review of the record as the Affidavit of William F. Kidwell, Jr. makes clear. As Mr. Kidwell affirms,

I have read the 968 transcript pages from 2006 and reviewed every available public comment sent after those hearings. I have also read the 291 pages and comments that followed the June 2007 wrap up hearing on the same . . . matter. The Board claims a level of consumer comment that is a misrepresentation of the facts. In all of the hearing discussions and the post hearing comments there were virtually no direct references to YSP except that YSP should be included in calculating [Home Owners Equity Protection Act] trigger points and fees. The references to "banning" related only to prepayment penalties. Payment penalties, Option ARM's 2/28 ARM's have all either fallen from the market or have been handled by Interagency Guidelines which made the offending products unavailable.^[2] Any comments relating to yield spread premiums were further made in the context of HOEPA or subprime loans as were any direct comments offered in writing, post hearing. It is important to remember that the Board implies that the 2006 and 2007 hearings are a

² Option ARM's and 2/28 ARM's refer to types of adjustable rate mortgages.

material part of their “research” and “information sources” for the promulgation of the final Rule.

Kidwell Aff. ¶ 6; *see also* ¶¶ 7-10. (Ex. 2)

Moreover, even assuming *arguendo* that there had been a demand for consumer protection regarding loan originator compensation, the Board’s Final Rule is a fatally flawed response to any such demand. Indeed, after conceding that creditors have exactly the same incentives as mortgage brokers and exactly the same ability to determine their own compensation (Opposition at 6), the Board has largely exempted creditors from the Final Rule. Section 226.36(a)(1). 75 Fed. Reg. 58,534.

C. Even Assuming *Arguendo* That The Board Has The Broad Authority It Claims, It Has Failed To Demonstrate That The Current Practices With Respect To Loan Originator Compensation Are Unfair, Deceptive Or Abusive.

The gravamen of the Board’s claimed authority is that the use of the yield spread premium (“YSP”) to compensate mortgage loan originators is unfair within the meaning of that terms as applied by the Federal Trade Commission. According to the Board, use of the YSP to compensate mortgage loan originators is “unfair” because the loan originator allegedly “has a personal incentive to deliver a loan with a high interest rate in order to maximize his or her own compensation” and that “[t]his is a direct conflict with the consumer’s interest in paying the lowest interest possible for which the consumer qualifies.” Opposition at 6-7. However, rather than present actual evidence of deceptive or unfair practices, the Board offers nothing but unsupported supposition and references to the urgings of “consumer advocates.” *Id.* at 7-8. *Compare* Kidwell Aff. ¶¶ 6-10.

The Board concedes that, under settled precedent, in order to find a practice “unfair” for purposes TILA Section 129(1)(2), it must demonstrate that the current practice (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to

consumers. Opposition at 12. Significantly, the Board has failed to offer or point to any credible evidence to support any of the three requisite findings.

1. The Board has failed to show any injury to consumers.

With respect to substantial harm to consumers, the Board offers nothing but its supposition and supposedly that of “consumer groups” that using the YSP as a form of loan origination compensation creates a potential conflict of interest because the consumer allegedly does not know that the mortgage interest rate that he is offered by a mortgage broker or a loan officer may not be the lowest rate for which the consumer might qualify, *i.e.*, that there is a wholesale rate or par rate that is lower than the quoted retail rate. Opposition at 13-15. Under the Board’s theory, all retail sales would be deemed to be unfair so long as the retail price does not equal the wholesale price. Significantly, the Board dismisses, in favor of its unsupported supposition any empirical analyses of the actual comparative cost of broker-originated loans versus lenders originated loans, including a comprehensive study showing broker-originated loans to be less costly than the lender originated loans prepared by an economist currently on the Board’s staff. Opposition at 33 n.12; *see also* 75 Fed. Reg. at 58,517.

Furthermore, all of the “incentives” that the Board contends create an alleged conflict of interest between loan originators and consumers exist with equal force between creditors and consumers, a point that the Board concedes. Opposition at 6. Moreover, creditors control 90% of the mortgage origination market. *Muolo Aff.* ¶ 7; *see also Savitt Aff.* ¶ 8. The Board, however, has largely exempted creditors from the Final Rule. Indeed, so long as the creditors do not tie the compensation of their loan officers to the terms of the individual mortgage transactions, they are free to charge interest rates as high as they wish above the par rate with the explicit blessing of the Board despite the fact that the consumer would have no way of knowing what the par rate

is or what lower rate for which he or she might be eligible. Thus, for example, the Board-approved Staff Comment accompanying the Final Rule specifically states that:

A creditor could also offer different consumers varying interest rates *that include a constant interest rate premium* to recoup the loan originators compensation through increased interest paid by the consumers. . . .

Staff Comment 36(d)(4). 75 Fed. Reg. at 58,536 (emphasis added).

Significantly, there is nothing in the Final Rule that in any way limits the ability of creditors, who control at least 90% of the mortgage loan origination market, to impose such interest premiums on unsuspecting consumers who, according to the Board, would have no way of knowing (i) that such a premium interest rate had been imposed across the board, (2) the level of the interest rate premium or (3) what the par or lowest interest rate for which the consumers would be eligible.

As the foregoing makes clear, not only has the Board failed to demonstrate that the current system of compensating mortgage brokers results in or is likely to result in damage to consumers, it has, by its Final Rule, enshrined for creditors that control at least 90% of the market the potential to inflict the very injury that it supposedly sought to prevent by regulating the compensation of loan originators who serve only 10% of the mortgage loan origination market. *See id.*

2. The Board has Failed to show that the Alleged Injury is Unavoidable.

In support of the findings that the injury cannot be reasonably avoided, the Board relies almost entirely upon a single “study” prepared in 2008 by MACRO International that the Board refers to as the 2008 MACRO Study and a survey conducted by the American Association of Retired People (“AARP”). Opposition at 30-32. In describing the 2008 MACRO Study’s “findings,” the Board repeatedly refers to “many” consumers or study participants or “[a] significant numbers of study participants.” Opposition at 9, 32. Such references are grossly misleading inasmuch as the “study” included only 35

hand-picked participants. *See* Exhibit 2 to NAIHP Memorandum. There is no indication that the participants were randomly selected or typical mortgage consumers. To the contrary “[p]articipants for the interviews were recruited by telephone, and were selected because they had all obtained or refinanced a mortgage in the past two years.” *Id.* at 2. *See also* Affidavit of Sarah Butler ¶ 13. (Ex. 3)³ Indeed, of the 35 participants only 9 had actually dealt with a mortgage broker. *Id.* at 3. Moreover, there is no indication that the participants constituted a sufficient sample from which one might be able to draw statistically significant conclusions. *See* Butler Aff. ¶ 23. Indeed, as Ms. Butler makes clear in her affidavit,

The Board seems to suggest that these results can represent the entire population of U.S. consumers who have recently obtained or may obtain in the future a mortgage. This is not reasonable. It is not plausible to assert that the seven interviewees in Los Angeles can reliably represent the perceptions of all Californians or all mortgage holders on the west coast. Similarly, it is not meaningful to rely on the responses from nine individuals to represent the attitudes and opinions of all consumers who obtained a loan through a broker.

It is important to note that the Macro Study does not attempt to characterize or quantify any of the results by different demographic characteristics nor does the report assert that it selected its respondents to reflect the characteristics of the relevant population. Interviewees were selected to get a “mix” of people, but were not selected to be representative of the total relevant population in this matter.

The Macro Study was not designed to account for the variation across U.S. mortgage consumers nor as it designed to yield results which are projectable back to this population in any reliable or meaningful way.

Id. ¶¶ 14-16; *see also* ¶¶ 17-26 (Ex. 3).

Moreover, as plaintiff noted in its opening memorandum, the 2008 MACRO Study clearly demonstrated that when participants “saw longer, more detailed broker agreements, [they] resented that a broker would focus so much attention on his or her

³ Indeed, Ms. Butler found that the telephone script used to screen participants may have caused the 2008 MACRO Study results to be affected by bias. *Id.* at ¶¶ 27-28.

compensation before providing any services.” NAIHP Memorandum at 13 (quoting the 2008 MACRO Study at 26). Indeed, one participant was quoted as commenting that “all the broker cares about is how he is getting paid.” *Id.* Such comments clearly belie the notion that consumers are confused about either the roll of brokers or how they may be compensated.

Similarly, the Board relies upon a four-page report of telephone interviews of individuals over age 65 to the effect that they viewed mortgage brokers as trusted advisors and reflected the participant’s perceptions. As Ms. Butler makes clear in her affidavit, the AARP study does not have any data on disclosures. Butler Aff. ¶¶ 33-34.

With respect to both studies, Ms. Butler concludes that

Neither of the studies cited are sources which can reliably support the conclusion that disclosures are not effective with the relevant population of consumers.

The Macro Study was not intended to measure the effectiveness of disclosures in the total population. The research was designed to provide qualitative feedback on particular wordings in hypothetical disclosure documents. *The way in which the research was structured; a limited number of in-depth, iterative interviews conducted with a non-representative group of individuals, means the results from this study cannot support conclusions about the total relevant population at issue.*

The AARP Study, while a quantitative study, is limited to only a portion of the relevant consumer population. The results are limited to individuals who refinanced a loan between 1999 and 2000 and were 65 years or older at the time of the interview.

Additionally, the AARP Study does not provide any information about the effectiveness of disclosures and includes only one, somewhat ambiguous, result on the extent to which surveyed individuals “rely on” their brokers.

Id. at ¶¶ 35-38 (emphasis added).

Indeed, it is inconceivable that any confusion could exist regarding the role of brokers in light of the explicit disclosures contained in the typical Mortgage Loan Originator Agreement (Exhibit A to the Savitt Aff.) *See* NAIHP Memorandum at 7-8. The disclosure form makes crystal clear that the mortgage broker is an “independent

contractor,” that he may be paid “by both [the consumer] and the lender” and that the mortgage broker “do[es] not distribute the products of all lenders or investors in the market and cannot guarantee the lowest price or best terms available in the market.” Ex. A to the Savitt Aff.

The Board attempts to dismiss the disclosure by suggesting that it is not clear that the disclosure is in widespread use. Opposition at 31. The disclosure is in fact widely used throughout the industry and has been in widespread use since 2001 and as early as 1996. *See, e.g.*, Affidavit of Rick Roque ¶¶ 2-6 (Ex. 4); *see also* Savitt Aff. ¶ 7. Similarly, the Board argues that the disclosure is somehow defective because it does not explicitly state that there is a conflict of interest between the mortgage broker and the consumer regarding the mortgage interest rate. Significantly, as previously noted, there is an equally theoretical conflict of interest between creditors and consumers, and creditors, unlike mortgage brokers, do not provide any type of disclosure of their compensation or their potential conflict of interest. *See* Savitt Aff. ¶ 24. More importantly, the Board expressly exempts creditors from the Final Rule despite the fact they control 90% of the mortgage loan origination market.

The Board also claims that the disclosures would be ineffective to provide consumers with notice of the supposed conflict of interest that exists between loan originators and consumers. That claim, however, is belied, ironically, by the Board’s own Opposition, which summarized very succinctly the nub of the Board’s concern:

When the yield spread premium is used to compensate the loan officer or mortgage broker’s employee, that employee has a personal incentive to deliver a loan with a high interest rate in order to maximize his or her own compensation. This is in direct conflict with the consumer’s interest in paying the lowest interest rate possible for which the consumer qualifies.

Opposition at 6-7. While the foregoing statement needs to include the fact that creditors have exactly the same theoretical incentive and conflict of interest, the Board has managed in two sentences to capture the essence of the alleged “injury” and to place

consumers on notice regarding the alleged conflict of interest that the Board contends is the source of the alleged “injury.” Such a notice combined with the explicit notices that have been widely used by mortgage brokers since 1996 completely undermines the second required finding to demonstrate unfairness, *i.e.*, that consumers cannot be made unaware of the alleged conflict of interest through disclosures.

3. The Board has failed to show that the alleged injury from the current loan originators compensation system is not outweighed by the consumer benefits.

As previously noted, the Board has utterly failed to offer any evidence of consumer injury but has instead relied entirely upon its own conjecture and supposition and that of so-called consumer advocates. Significantly, the Board concedes, as indeed it must, that the current system provides clear benefits to consumers who might otherwise be unable to purchase homes. For example, the Board expressly found that

Yield spread premium may benefit consumers in cases where the amount is applied to reduce consumers’ upfront closing costs, including originator compensation. *A creditor’s increase in the interest rate . . . may be used to generate additional income* that the creditor uses to compensate the originator, in lieu of adding origination points or fees that the consumer would be required to pay directly from the consumer’s preexisting funds or loan proceeds. This can benefit a consumer who lacks the resources to pay closing costs in cash, or who may have insufficient equity in the property to increase the loan amount to cover these costs.

75 Fed. Reg. at 58,515-16 (emphasis added).

Similarly, as Mr. Savitt made clear in his affidavit,

[a] major obstacle to homeownership is the upfront cost of obtaining a mortgage, a significant part of that cost is closing costs and loan origination fees. One way to handle those costs for consumers who cannot pay such fees out of pocket or seek an alternative means of dealing with those closing costs is to defer them. This affords potential homebuyers a practical way of handling the costs and it facilitates homebuyers. The method of doing this is the yield spread premium or YSP, which is a payment made to a mortgage broker by the lender for the purchase of a broker-originated mortgage loan.

Savitt Aff. at ¶ 4. Against clear benefits to consumers, the Board has offered nothing but its own supposition concerning theoretical injury or an equally theoretical conflict of interest.

It has also chosen to ignore a study, ironically prepared by a current member of its own staff, that shows that broker-originated loans are less costly to borrowers than lender-originated mortgages. Savitt Aff. ¶ 15. It speaks volumes about the Board's decision making that it would completely dismiss an empirical analysis of over a million actual loans (*id.*) in favor of the flawed "study" of interviews of 35 hand-picked individuals, only 9 of whom actually dealt with a broker.

D. The Board's Final Rule Is Arbitrary And Capricious.

As the Board correctly notes, the arbitrary and capricious standard is a deferential standard. Opposition at 26-27. It is also the case that while

the "arbitrary and capricious" standard is narrow and a court is not to substitute its judgment for that of the agency. Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made."

Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 42-43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

The Board's Final Rule clearly fails this lenient test. The gravamen of the Board's finding of injury was that

[w]hen loan originators receive compensation based on a transaction's terms and conditions, they have an incentive to provide consumers loans with higher interest rates or other less favorable terms. Yield spread premiums, therefore, present a significant risk of economic injury to consumers. Currently, this injury is common because consumers typically are not aware of the practice or do not understand its implications, and thus cannot effectively limit the practice.

75 Fed. Reg. at 58,515.

Creditors have precisely the same incentive as any other loan originators and can increase their compensation by providing consumers “with higher interest rates or other less favorable terms.” Indeed, the Board expressly concedes this point noting that “[i]n the retail channel, where the creditor deals directly with the consumer, the creditor generally controls yield spread premium funds sometimes applying them toward closing costs and *sometimes keeping them as additional profit. . . .*” Opposition at 6 (emphasis added). Moreover, consumers are even less likely to know about the service release premium (“SRP”) used by banks and other creditors which sell mortgage loans in the secondary market because, unlike mortgage brokers, creditors do not have to disclose their SRP income. *See Savitt Aff.* ¶ 24. Furthermore, the Board has expressly held that creditors could actually impose an across-the-board interest rate premium on their retail interest rates. *See Staff Comment 36(d)(4)*, 75 Fed. Reg. at 58,536. The Board has effectively exempted creditors from the provisions of the Final Rule so long as they do not pay their loan officers based upon the terms and conditions of the loan transactions. Simply put, there is no need for individual loan officers to place consumers in higher interest rate loans inasmuch as the Board has expressly authorized the creditors to impose, with no apparent limitation, across-the-board mortgage interest rate premiums. Clearly, the Board has utterly failed to provide a “rational connection between the facts found and the choice made.” *Motor Vehicle Mfrs. Ass’n*, 463 U.S. at 42 (quoting *Burlington*, 371 U.S. at 168).⁴

⁴ As further evidence of the Board’s utter failure to provide “a rational connection between the facts found and the choice made” the Board expressly concedes that creditors have the same incentive and opportunity as other mortgage originators to place consumers in higher interest rate mortgages than the interest rates for which the consumer might be eligible to increase their profits. Opposition at 6. Nevertheless, the Board exempts creditor-originated mortgages from the Final Rule because, in the Board’s view, there is a difference between YSP and SRP because in the creditor-originated mortgage, “consumers are not involved in these wholesale market transactions.” *Id.* at 33. Simply put, the Board’s argument makes no sense particularly given the reality that the Board, itself, concedes namely that “[i]n the retail channel, *where the creditor deals directly with the consumer, the creditor generally controls yield spread premium funds . . . sometimes keeping them as additional profit. . . .*” *Id.* at 6 (emphasis added).

As previously noted, all of the Board's concerns about a theoretical injury to consumers or conflict of interest with consumers are equally present in creditor-originated mortgage loans. Moreover, from the stand point of the consumer, a broker-originated mortgage is indistinguishable from a creditor-originated mortgage in terms of process. As Mr. Savitt makes clear in his affidavit,

The Final Rule also picks winners and losers. Mortgage brokers in all areas under TILA are classified as "creditors," with the notable exception of the Final Rule. The line of demarcation under the Final Rule Section 226.36(a) is who funds the loan. If the entity closing the loan uses its own funds from either deposits or a line of credit, it is a creditor as such largely exempt from the Final Rule. If the entity closing the loan uses funds from another source or what is referred to as table funding, the entity is a loan originator subject to the Final Rule. However, from the standpoint of the consumer, the line of demarcation is completely arbitrary. Based on 30 years as mortgage broker, I know that loans are processed and closed exactly alike whether the loan is originated by a mortgage broker or a banker. The only difference is that the broker uses table funding and assigns the loan to a lender at settlement while banks and lenders close in their own names with their own funds and, in most cases, immediately sells the loan.

Savitt Aff. ¶ 18.

The Board's alleged concern for consumer protection rings particularly hollow. Opposition at 29-38. It is simply indisputable that all of the theoretical incentives to charge consumers interest rates higher than the lowest interest rate for which a consumer might be eligible exists with equal force for creditor-originated mortgage loans as exists for broker-originated mortgage loans. As Mr. Savitt also explained,

Unlike any other participants in the residential real estate market, mortgage brokers have been required to fully disclose all of their compensation, including YSPs, on consumer good faith estimates ("GFEs") of settlement costs and in the HUD-1 settlement statement. Like the YSP for brokers, banks have what is known as service release premiums or SRPs, which reflect the present value difference in the mortgage rate and the par rate of the purchasing bank or institution. HUD has long recognized that there is no practical differences between a YSP and SRP. Banks as lenders have never been required to disclose their SRPs, unlike mortgage brokers and their YSPs.

Savitt Aff. ¶ 6.

Yet the Board has largely exempted creditors from the Final Rule despite the fact that creditors control 90% of the mortgage origination market. Muolo Aff. ¶ 7; *see also* Savitt Aff. ¶¶ 8, 18-19. In essence, the Board’s proposed consumer protection initiative has in fact left the vast majority of consumers unprotected. Indeed, the Board has gone so far as to permit creditors to impose arbitrary interest rate premiums upon unsuspecting consumers who will neither know that such premiums have been imposed, their levels or what are the lowest rates for which the consumers might be eligible. *See* Staff Comment 36(d)(4). 75 Fed. Reg. at 58,536. In sum, in its efforts to protect consumers through its Final Rule, the Board has, to paraphrase a Biblical parable, “strain[ed] at a gnat and swallow[ed] a camel.”⁵ In so doing, it has engaged in rule making that is clearly arbitrary and capricious and as such is void pursuant to 5 U.S.C. § 706 (2)(A).

II. THE BOARD FAILED TO CONDUCT A PROPER IMPACT ANALYSIS.

While the Board correctly notes that the Regulatory Flexibility Act, 5 U.S.C. §§ 601-612, is “procedural,” it does require “that the agency file a FRFA demonstrating a ‘reasonable, good-faith effort to carry out [RFA’s] mandate.’” *United States Cellular Corp. v. FCC*, 254 F.3d 78, 88 (D.C. Cir. 2001) (quoting *Alenco Commc’ns, Inc. v. FCC*, 201 F.3d 608, 625 (5th Cir. 2000)). Here, the Board has utterly failed that relatively simple test.

In terms of a statement of need, the Board invokes its misreading of TILA section 129 as the legal authority for addressing “problems that have been observed in the mortgage market.” 75 Fed. Reg. at 58,531. Yet it offers no meaningful discussion of the impact of the Final Rule upon small businesses other than the assessment that it will

⁵ Matthew 23:24 (“Ye blind guides, which strain at a gnat, and swallow a camel.”)

impact all mortgage brokers and that the “costs will have a significant economic effect on small entities, including small mortgage creditors and brokers.” *Id.* at 58,533.

Plaintiffs are not alone in their assessment that the Board has utterly failed to provide a proper economic impact analysis as required by the RFA. Indeed, that view is shared by the Board’s sister agency the Small Business Administration, which is statutorily charged with making an independent assessment of the Board’s compliance with the RFA. The SBA’s Office of Advocacy was quite clear in its assessment of the shortcomings of the Board’s RFA impact analysis. *See* NAIHP Memorandum at 21 and Exhibit 4 thereto. As it did in the preamble to the Final Rule, the Board responds to the Advocacy’s independent assessment that it had not complied with the requirements of the RFA with a conclusory *ipse dixit* that it did comply.

Despite repeated requests to do so, the Board has failed to clarify the Final Rule, leaving small businesses and large creditors alike uncertain as to how to comply with the Final Rule. *Savitt Aff.* ¶ 11; *Kidwell Aff.* ¶ 15. In stark contrast to the Board’s self-serving and conclusory impact statement, HUD issued a 571 page impact statement with respect to its RESPA reform and has 303 frequently asked questions posted on its website. For its part, the Board can merely state that its Final Rule will likely impact all mortgage brokers most of which are small businesses. It cannot even begin to quantify the effect. Indeed, it self-servingly concludes that it “believes . . . that the benefits of the [Final Rule] to consumers outweigh the associated compliance costs.” 75 Fed. Reg. at 58,518. Inasmuch as 100% of small businesses stand to be adversely impacted by the Final Rule, it is highly unlikely that the “benefit” to consumers of a rule that provides no protection to 90% of the target consumer market will offset that cost to small businesses.

III. PLAINTIFF HAS SHOWN IMMINENT IRREPARABLE HARM.

In opposing the TRO and preliminary injunction, the Board cites the usual litany of cases for the notion that irreparable harm must be imminent and not theoretical and

that economic harm is generally insufficient to establish irreparable harm. Opposition 17-26. Those cases are simply inapposite.

In his affidavit, Mr. Savitt cited concrete examples of business that will be immediately lost to his company as a result of the implementation of the Final Rule that will result in the loss of “a substantial amount of [his] business.” Savitt Aff. ¶ 22. For example, under the Final Rule, a loan originator cannot lower his fee to meet competition, while creditors are given flexibility to set loan terms. *Compare* Staff Comment 36(d)(5) and 36(d)(4). 75 Fed. Reg. at 58,536. Mr. Savitt also affirmed that the Final Rule “has further hobbled independent mortgage originators in their efforts to compete.” Savitt Aff. ¶ 24. While the Board cavalierly dismisses such claims, its argument is wide of the mark. First, while it is generally true that economic loss alone is insufficient to establish irreparable harm, that is true because there is the possibility of an adequate recovery or other corrective relief at a later date. *Wis. Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985). Here the losses will not be recoverable because plaintiff can only challenge the Final Rule, which causes the losses, under the Administrative Procedure Act, 5 U.S.C. §§ 552 *et seq.*, and the government has not waived its immunity with respect to monetary damages. *See* 5 U.S.C. § 702.

Similarly, the Board’s suggestion that Mr. Savitt has not demonstrated whether “he could make up that business through other means” (Opposition at 20) bespeaks the arrogance of someone who has probably never had the responsibility of meeting a payroll and displays a breathtaking ignorance of economics. Indeed, even assuming, *arguendo*, that Mr. Savitt could “make up that business through other means,” unless there were some constraint on his company’s capacity to handle “other” business, the business lost would still constitute an irreparable loss. In other words, absent some constrain on his ability to take on additional business, any new business would be in addition to existing business. The Board seems to suggest that there is some set limit on the amount of business Mr. Savitt’s company can handle.

Moreover, as Mr. Savitt made clear in his affidavit, mortgage brokers have been under an “unprecedented regulatory assault by agencies which have sought to scapegoat independent loan originators for the recent economic crisis.” Savitt Aff. ¶ 8. These assaults have resulted in a precipitous drop in market share from “just over 50%” to approximately 10%. *Id.*; *see also* Muolo Aff. ¶ 7. The Final Rule represents the latest and perhaps most pointed attack on independent loan originators ever. Once again, plaintiffs are not alone in their assessment of the imminence of the threat. Indeed, the SBA’s Office of Advocacy has warned the Board that

Advocacy is concerned with this proposal going forward when so little is known about its potential costs, at a time when other major changes to the industry are on the horizon. . . . These burdensome changes may lead to small entities leaving the mortgage industry which could have a negative impact on the availability of mortgages, competition and the consumer.

Exhibit 4 to NAIHP Memorandum at 3.

Clearly, plaintiff has demonstrated some irreparable injury. Moreover plaintiff has made a strong showing with respect to the likelihood of success and the public interest as a result of the clear lack of statutory authority for the Board’s Final Rule. Similarly, plaintiff has made a strong showing with respect to the arbitrary and capricious manner in which the Board has, in an alleged attempt to protect consumers in the mortgage loan origination market, actually left 90% of the market unprotected and at the mercy of creditors who, as the Board concedes, have the same conflict of interest with the consumer that it sought to proscribe. Under such circumstances, the D.C. Circuit has made clear that

[a] district court must ‘balance the strengths of the requesting party’s arguments in each of the four required areas. If the showing in one area is particularly strong, an injunction may issue even if the showings in other areas are rather weak.

Chaplaincy of Full Gospel Churches v. England, 454 F.3d 290, 297 (D.C. Cir. 2006) (quoting *CityFed Fin. Corp. v. Office of Thrift Supervision*, 58 F.3d 738, 747 (D.C. Cir. 1995)).

IV. ON BALANCE THE EQUITIES FAVOR A PRELIMINARY INJUNCTION AND IT IS CLEARLY IN THE PUBLIC INTEREST.

The Board’s contention that a preliminary injunction will “harm consumers nationwide by subjecting consumers to the existing practice of paying loan originators compensation that is tied to the terms and conditions of the loans being marketed to those consumers” is utterly without merit. Opposition at 41-42. As the Board itself concedes, creditors have exactly the same theoretical incentive and conflict of interest as other mortgage loan originators. *See* Opposition at 6 (“where the creditor deals directly with the consumer, the creditor generally controls yield spread premium funds sometimes applying them toward the consumer’s closing costs and sometimes keeping them as additional profit – and sometimes some of each.”). Despite this fact, the Board has, for all practical purposes, exempted creditors from the Final Rule and creditors have a 90% share of the mortgage loan origination market. Moreover, not only has the Board exempted creditors from the Final Rule, but it has also expressly authorized them to impose upon unsuspecting consumers across-the-board mortgage rate premiums without any apparent limitation. *See* Staff Comment 36(d)(4). 75 Fed. Reg. at 58,536.

The Board’s claim that a preliminary injunction will harm consumers is further undercut by the Dodd-Frank Act. Congress passed the Dodd-Frank Act three weeks before the Board announced the issuance of the Final Rule. Significantly, Congress allowed one year for the new CFPB to come into existence and provided an additional eighteen month period in which the new agency could promulgate regulations pursuant to its newly transferred regulatory authority including the Board’s TILA authority. Indeed, the Board spoke most candidly to the public interest when it announced its decision on

February 1, 2011, not to proceed with certain proposals that it had considered along with the Final Rule. *See* NAIHP Memorandum at 24 and Exhibit 5 thereto.

V. *AMICI* IN SUPPORT OF THE BOARD OFFER NO SUPPORT FOR THE FINAL RULE.

In their memorandum in support of the Board, *amici curiae* Center for Responsible Lending and National Consumer Law Center (“CRL” and NCLC”) offer lengthy attacks on the YSP as a form of loan origination compensation and the alleged increased costs associated with broker-originated mortgages versus creditor-originated mortgages. Thus, for example, they argue that (1) the YSP is inappropriate as a form of loan originator compensation (CRL Brief at 7-9), (2) broker-originated loans are more costly than creditor originated loans (*id.* at 9-13); (3) certain types of loans are problematic (*id.* at 14-20), and (4) the YSP provides incentives to steer consumers to risky loan products. *Id.* at 20-24. Their arguments are wide of the mark.

First, CRL and NCLC offer no support whatsoever for the fundamental flaw in the Board’s rulemaking, namely its statutory authority to promulgate this over-reaching Final Rule. As plaintiffs have shown, the Board has utterly failed to demonstrate that it has the authority pursuant to TILA section 129(1)(2) to promulgate the Final Rule.

Second, while CRL and NCLC argue at length about the allegedly perverse incentives that are created by the YSP, they critically ignore, just as the Board does, the fact that the Board concedes that creditors have precisely the same incentives as brokers. Opposition at 6. Yet despite that fact and the fact that creditors control 90% of the mortgage loan origination market, the Board has, for all practical purposes, exempted creditors from the Final Rule.

As for the claim that broker-originated mortgages are more costly than creditor-originated mortgages, plaintiff has previously noted the comprehensive study by a current Board staff member that demonstrated that broker-originated loans are less costly than creditor-originated loans. More importantly, however, the Board expressly disavowed

reliance upon cost studies. Opposition at 33 n.12; *see also* 75 Fed. Reg. at 58,517. In that connection, it is well-settled that the court can affirm an agency decision solely upon the reasons given by the Agency. *SEC v. Chenery*, 318 U.S. 80, 87 (1947); *American Equity Investment Life Insur. v. SEC*, 572 F.3d 923, 934 (D.C. Cir. 2009); *Northern Municipal Distributors Group v. FERC*, 165 F.3d 935, 941 (D.C. Cir. 1999).

Finally, to the extent that CRL and NCLC discuss at length the risks and costs of various allegedly problematic mortgage products, they merely highlight the arbitrary and capricious nature of the Board’s instant rulemaking. As Mr. Savitt noted in his affidavit quoting from a recent Harvard University study,

[p]roperly viewed the problem in nonprime lending stemmed from the financial institutions that established the underwriting standards, the agencies that rated the securities backed by them, the firms that wrote credit default swaps against them and the regulators that were entrusted with policing the system. *It was they - not mortgage brokers, mortgage bankers, or borrowers - that determined the products that could be offered, the underwriting standards that would be tolerated, the requirements for capital reserves against losses, and the incentive structure for mortgage brokers, mortgage bankers, and broker-dealers that rewarded volume more than long-term loan performance. In hindsight these were significant regulatory and market failures.*

Savitt Aff. ¶ 9 (emphasis added). Moreover, as Mr. Kidwell affirms, the products about which CRL and NCLC complain are no longer available. Kidwell Aff. ¶ 6.

Simply put, all of the alleged incentives that CRL and NCLC attack at length exist with equal force, as the Board itself concedes, for creditors. Opposition at 6. However, in addition to having the same incentives, creditors have the ability to “determine[] the products that could be offered, [and] the underwriting standards . . . that would be tolerated” Yet the Board has exempted creditors from the Final Rule and CRL and NCLC fully support that arbitrary and capricious result.

CONCLUSION

For the foregoing reasons and for the reasons set forth in its initial memorandum, NAIHP requests that its application for a TRO be granted, that a preliminary injunction

be granted barring enforcement of the Final Rule until a final disposition of this matter is reached.

Respectfully submitted,

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