

Alert: CFPB Takes Action Against Franklin Loan Corporation for Illegal Bonus Program

McGlinchey Alert

November 21, 2014

On November 13, 2014, the Consumer Financial Protection Bureau ("CFPB") ordered Franklin Loan Corporation ("Franklin"), a residential mortgage lender, to pay \$730,000 because it paid its loan officers quarterly bonuses in violation of the Federal Reserve Board's Loan Originator Compensation Rule. 12 C.F.R. § 1026.36 (d)(1)(i) (2011) (revised 2014).

According to a complaint filed in the United States District Court for the Central District of California, prior to the Federal Reserve Board's Loan Originator Compensation Rule going into effect, Franklin allowed loan officers to determine the interest rates offered to borrowers after an assessment of borrowers' credit worthiness. Loan officers were then paid a "split commission" equal to "between 65% and 75% of the 'gross loan fees,' which included the origination fee, discount points, and the retained cash 'rebate' associated with the loan." The cash rebate associated with the loan was determined based on a loan's interest rate—the higher the interest rate, the higher the rebate. Loan officers had an option to either pass the rebate on to borrowers or retain the rebate. If the rebate was retained, it was included in the "gross loan fees" used in determining compensation.

When the Federal Reserve Board's Loan Originator Compensation Rule went into effect, Franklin amended its compensation structure, but "still conditioned part of the loan officers' compensation on the terms and conditions of the loans they generated." Specifically, Franklin's revised compensation structure included: (1) an upfront commission based on a percentage of the loan amount, subject to a minimum floor and maximum ceiling; and (2) a quarterly bonus paid from the loan originators' individual "expense account." The first component, in and of itself, would not violate the Loan Originator Compensation Rule (including the revised rule); however, the CFPB took issue with how quarterly bonuses were calculated.

According to the CFPB, quarterly bonuses were being paid based on the retained rebate from each loan. Specifically, Franklin tracked the origination fees and retained rebate for each loan and would set aside 65 to 70% of that amount (the "adjusted compensation amount") to determine contributions to be made to an individual expense account. Franklin would make a contribution to an individual expense account equal to the difference between the adjusted total commission and the upfront commission, but would only make a contribution if the origination fees and retained rebate exceeded the amount of the upfront commission earned on the loan. This resulted in contributions to the individual expense accounts being based, in part, on loans' interest rates. Quarterly bonuses were based on a percentage of the amount in an individual expense account. As a result, the Federal Reserve Board's Loan Originator Compensation Rule was violated.

In addition to a payment of \$730,000, the proposed consent order, among other things, prohibits Franklin from paying loan originator compensation in violation of the Truth in Lending Act and Regulation Z, and requires Franklin to keep records detailing the amounts, dates, components and calculations of all loan originator compensation paid for a period of five (5) years, which must be made available to the CFPB upon its request.

While the CFPB's enforcement action involved violations of the Federal Reserve Board Rule and not the CFPB's new Loan Originator Compensation Rule, the enforcement action is demonstrative of the level of scrutiny sophisticated compensation practices will face, as well as the amount of redress the CFPB could expect when violations are found. Notably, the \$730,000 appears to be an estimate of the quarterly bonuses paid to 32 loan officers over a period of 2 and a half years.

It is also worth noting that the compensation structure at issue would also violate the CFPB's Loan Originator Compensation Rule, which went into effect in January 2014. While the CFPB's Loan Originator Compensation Rule expressly allows non-deferred profits based compensation, such as a quarterly or annual bonus, to be paid to loan originators subject to a 10% total compensation cap, the rule prohibits an individual's bonus from being based on the terms of transactions the individual originated. See 12 C.F.R. § 1026.36(d) (revised 2014). Since the bonuses Franklin was paying were based, in part, on the rate of interest on loans that a loan officer originated, the bonuses would still be prohibited under the revised rule. In addition, if a consumer had brought an action alleging violations, the individual loan originators could have been liable for the greater of actual damages or three times the direct or indirect compensation received in connection with a loan, plus costs and attorneys' fees.

Related Professionals

[Jeffrey Barringer](#)

[Marc J. Lifset](#)

Related Services

[Consumer Financial Services Compliance](#)