

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

NATIONAL ASSOCIATION OF)	
INDEPENDENT HOUSING)	
PROFESSIONALS, INC.,)	
)	
Plaintiff,)	No. 11-5079
)	Consolidated with
v.)	No. 11-5078
)	
BOARD OF GOVERNORS OF THE)	
FEDERAL RESERVE SYSTEM,)	
)	
Defendant.)	

**EMERGENCY MOTION TO STAY IMPLEMENTATION OF
FINAL RULE PENDING APPEAL**

Pursuant to Circuit Rule 8, Plaintiff National Association of Independent Housing Professionals, Inc., (“NAIHP”), hereby moves this Court for order staying enforcement of the Final Rule promulgated by the Board of Governors of the Federal Reserve System (“Board”) restricting certain compensation practices of loan originators relating to mortgage loans (“The Final Rule”), 12 C.F.R. § 276.36(a), (d), (e), Federal Reserve System Final Rule Amending Regulation Z, 75 Fed. Reg. 58,533 (Sept. 24, 2010) (to be codified at 12 C.F.R. pt. 226) pending appeal. Plaintiff has notified counsel for the Board, Katherine Wheatley and Rich Ashton, by telephone and email of this emergency motion. The Memorandum

Opinion of the District Court and the Order are attached as Exs. 1 and 2, respectively.

A stay of the implementation of the Final Rule is essential in order to avoid imminent irreparable harm to NAIHP and its members, who, like the members of the National Association of Mortgage Brokers (“NAMB”), the plaintiff in the consolidation case, Docket No. 11-5078, are mortgage brokers whose very existence is threatened by the Final Rule. NAIHP submits that a stay pending appeal is appropriate because (1) there is a high likelihood that NAIHP will succeed on the merits, (2) failure to stay the Final Rule will result in imminent irreparable harm to mortgage brokers as the district court expressly found, (3) there is no real possibility of harm to others if the stay is granted, and the public interest will be served by granting the stay. *See, e.g., Virginia Petroleum Jobbers Ass’n v. FPC*, 259 F.2d 921, 925 (D.C. cir. 1958), *Serono Labs, Inc. v. Shelala*, 158 F.3d 1313, 1317-1318 (D.C. cir. 1998).

I. THERE IS A HIGH LIKELIHOOD OF SUCCESS

A. The Court’s Findings With Respect To The Likelihood Of Success Does Not Comport With The Clear Meaning Of Section 1639.

The court found that section 129(l) of the Truth in Lending Act (“TILA”), 15 U.S.C. §§ 1601 *et seq.*, grants the Board broad authority to regulate unfair practices with respect to all mortgages. That holding is at odds with the clear

meaning of the statute. First, TILA section 129 is entitled “Requirements for Certain Mortgages.” 15 U.S.C. § 1639. Those certain mortgages are expressly identified in section 1639(a)(1) by referring to “each mortgage referred to in section 1602(aa).” 15 U.S.C. § 1639(a)(1). The district court noted that section 1639(a)(1); (c)(1)(A); (d)-(h) all refer to 1602(aa) but that there is no such explicit reference to section 1602(aa) in section 1639(l). In fact, section 1602(aa) is also referenced in 1639(i). *See* 15 U.S.C. § 1639(i). Significantly, section 1639(l) refers to mortgages referred to in section 1602(aa) because it expressly refers to subsections (c) to (i), in noting that “[t]he Board may, by regulation or order exempt specific mortgage products or categories from any or all of the prohibitions specified in subsections (c) through (i) of the section,” which in turn refer to section 1602(aa).

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 the Board’s general rule

making power. By contrast, TILA section 129 is a much more narrowly focused provision. *Compare* 15 U.S.C. § 1639 and 15 U.S.C. § 1604.

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).

B. Even Assuming *Arguendo* That The Board Had The Claimed Authority, The Board Has Not Satisfied The Requirement For Exercising That Authority.

As the district court correctly noted, “a practice is unfair if it causes or is likely to cause substantial injury to consumers which is not *reasonably* avoidable by consumers . . . and not outweighed by countervailing benefits to consumers or to competition.” Memorandum order at 24 (emphasis added). In support of the findings that the injury could not 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 (Ex. 3) and a survey conducted by the American Association of Retired People (“AARP”). Fed. Reg. 58,509-58,511. Both “studies” are fatally flawed. For example, there is no indication that the

participants were randomly selected or typical mortgage consumers. *See* Affidavit of Sarah Butler ¶ 13. (Ex. 3 to NAIHP's Reply Brief)¹ Indeed, of the 35 participants only 9 had actually dealt with a mortgage broker. (Ex.3 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.

¹ 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. (Ex. 4 attached hereto.)

Furthermore, 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 compensation before providing any services.” 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.) (Ex. 5) 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 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. 6); *see also* Savitt Aff. ¶ 7. To suggest, as the court does, that people might ignore the disclosure and choose not to believe it suggests that so long as anyone might act irrationally, plaintiff and its members are guilty of unfair practices. Such a notion runs counter to the reasonableness standard written into

the requirement that consumer the injury “is not be *reasonably* avoidable” and undercuts the principle of the reasonable man that is a bedrock of our legal system. It also ignores the fact that mortgage brokers, unlike creditors, are the only actors in the market that make such a disclosure. *See* Savitt Aff. ¶ 24. Significantly, the Board expressly exempts creditors from the Final Rule despite the fact they control 90% of the mortgage loan origination market. *See* Affidavit of Paul Muolo ¶ 7.
(Ex. 7)

Furthermore, the claim that the disclosures would be ineffective to provide consumers with notice of the supposed conflict of interest that exists between loan originators and consumers, is belied, ironically, by the Board, which summarized very succinctly the nub of its 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.

C. The Court Does Not Address The Most Egregious Example Of The Arbitrary And Capricious Nature of The Final Rule.

As the district court correctly notes, the arbitrary and capricious standard is a deferential standard. Memorandum Order at 21-22. 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 Final Rule clearly fails this 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.

Significantly, the Board expressly concedes that 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, as the Board succinctly put it, “[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. Indeed, creditors can exploit the conflict of interest to place consumers in higher interest rate mortgages and avoid having to share their profits with their loan officers by simply paying them a salary. Indeed, under the Board's Final rule, malefactors like Countrywide, if they were still in business, would be largely exempt from the Final Rule and could simply compel their employees to market toxic products with impunity as long as they paid them an hourly wage that was not affected by the terms of the individual mortgage transaction. 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).

Simply put, 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.

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 exist 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 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), yet the district court does not even mention, much less address this critical flaw in the link between the Board's findings and the choices it made.

II. PLAINTIFF HAS SHOWN IMMINENT IRREPARABLE HARM.

The court has clearly applied the wrong standard to NAIHP's showing of irreparable harm by insisting that Mr. Savitt affirm that "his business will be irreparably destroyed by the Board's rule" or that the Rule threatens the very existence of his business." Memorandum Opinion at 41.

While the court notes that Mr. Savitt affirms that he will lose "a 'substantial amount of [his] business'" he is faulted for not further explicitly stating that an unreasonable loss of a substantial amount of his business will be "severe." Respectfully, any time a small business person experiences an unrecoverable loss of a "substantial amount of [his] business" that is by definition a severe loss. Similarly, if a business of any size is rendered unable to compete in the market

place the business' very existence is by definition threatened. Indeed, as Mr. Savitt avers "the Board, by its Final Rule, has further hobbled independent mortgage originators in their effort to compete." Savitt Aff. ¶ 24.

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 court minimizes such claims, the criticism is unfounded. 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. Here, the economic loss is unrecoverable and imminent. *See, e.g., Sterling Commercial Credit v. Phoenix Industries*, 2011 U.S.

Dist. LEXIS 8334 at 17-*18 (D.D.C. Jan. 28, 2011); *Clark v. Office of Federal Housing Enterprise Oversight*, 355 F. Supp. 56, 65 (D.D.C. 2004).

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. (Ex. 8.)

Simply put, there is no reasonable dispute that the Final Rule will irreparably harm mortgage brokers, including Mr. Savitt and the members of NAIHP. Both NAIHP and the NAMB represent mortgage brokers as the court expressly found (Memorandum Opinion at 14-15) and there is no difference in the way NAIHP and

NAMB members operate their brokerage businesses. Significantly, the court expressly found that mortgage brokers “will likely be irreparably harmed by the implementation of the Board’s Rule prohibiting dual compensation for loan originators who are paid directly by a consumer.” *Id.* at 41.

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, a factor that the district court did not even address. 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)).

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

Any 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 Consumer Financial Protection Bureau (“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. (Ex. 9)

CONCLUSION

A stay pending appeal is critical to avoid irreparable harm to mortgage brokers. For the foregoing reasons, NAIHP requests that the Court stay implementation of the Final Rule pending appeal.

Respectfully submitted,

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Dated: March 31, 2011

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Emergency Motion were served by electronic mail and hand delivery, this 31st day of March, 2011 upon each of the parties listed below:

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