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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Consumer Financial Protection Bureau,

Plaintiff,

v.

Franklin Loan Corporation,

Defendant.

Case No. 5:14-cv-02324

COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF

JURISDICTION AND VENUE

1. This Court has subject-matter jurisdiction over this action because it is brought under "Federal consumer financial law," 12 U.S.C. § 5565(a)(1), presents a federal question, 28 U.S.C. § 1331, and is brought by an agency of the United States, 28 U.S.C. § 1345.

2. Venue is proper in this district because a substantial part of the events or omissions giving rise to the claims occurred here and Defendant resides here. 28 U.S.C. §1391(b); 12 U.S.C. § 5564(f).

INTRODUCTION

3. For years before the recent mortgage crisis, loan originators often steered consumers into mortgages with terms that were less favorable to consumers but more profitable for the loan originator.

4. Seeking to end this practice, in September 2010, the Federal Reserve Board amended Regulation Z to prohibit any person from compensating loan officers based on a term or condition of a mortgage loan. 12 C.F.R. § 1026.36(d)(1)(i) (2011) (revised 2014) (the Compensation Rule).

5. This Complaint challenges conduct that occurred before January 1, 2014, and refers to the Compensation Rule promulgated by the Federal Reserve Board, 12 C.F.R. § 226.36, recodified at 12 C.F.R. § 1026.36(d)(1)(i), which was effective from April 6, 2011 (the Implementation Date) through December 31, 2013.

6. Franklin Loan Corporation (Franklin or the Company) violated the Compensation Rule by paying its loan officers quarterly bonuses in amounts based on terms or conditions of the loans they closed. Franklin's quarterly bonus scheme provided financial incentives to loan officers to steer consumers into mortgages with less favorable terms, the very practice the Compensation Rule sought to prohibit.

PARTIES

7. The Consumer Financial Protection Bureau (the Bureau) is an independent agency of the United States charged with regulating "the offering and provision of consumer financial products or services under the Federal consumer financial laws," including the Consumer Financial Protection Act of 2010 (the CFPA) and the Compensation Rule. 12 U.S.C. § 5491(a).

8. The Bureau is authorized to initiate federal district-court proceedings, by its own attorneys, to address violations of Federal consumer financial laws and to secure such relief as may be appropriate. 12 U.S.C. §§ 5564(a)-(b), 5565.

9. Franklin is a California corporation, with its principal place of business at 44-800 Village Court, Palm Desert, California. As a significant part of its business, the Company offers and provides mortgage-loan products to consumers primarily for personal, family, or household purposes. Those activities are "consumer financial services or products" under the CFPA. 12 U.S.C. § 5481(5)(A), (15)(A)(i). The Company is therefore a "covered person" under the CFPA. 12 U.S.C. § 5481(6).

FACTUAL BACKGROUND

10. Franklin is a residential-mortgage lender that offers and provides loan products, including conventional fixed loans, adjustable-rate loans, Federal Housing Act loans, and United States Department of Agriculture loans, to consumers seeking to purchase or refinance residential homes. Each of these loans is secured by the dwelling with respect to which the loan was provided.

11. From 2011 through 2013, Franklin originated approximately $887 million in mortgage loans.

12. Franklin has about eighteen offices throughout southern California and one in Chicago.

13. Each office employs loan officers who interface directly with borrowers. Franklin pays its loan officers to assist borrowers with obtaining and arranging credit to be secured by a dwelling.

14. Loan officers take the initial loan applications, assess the borrowers' creditworthiness, and determine the interest rates to offer borrowers for particular loan products.

15. Borrowers do not directly compensate Franklin's loan officers for the loan-origination services they provide.

16. Before the Implementation Date, the Company paid its loan officers a "commission split" – typically between 65% and 70% of the "gross loan fees," which included the origination fee, discount points, and the retained cash "rebate" associated with the loan.

17. Franklin offered loan products at a variety of interest rates, and each interest rate was associated with a specific cash rebate. Loans with higher interest rates generated higher rebates. Franklin's loan officers had complete discretion in determining whether to pass on the cash rebate to the borrower. Any rebate they declined to pass on – *i.e.*, the retained rebate – was included in the gross loan fees and increased their compensation.

18. The commission split thus created an incentive for loan officers to place consumers in higher-interest-rate mortgages – the higher the interest rate of the loan, the higher the retained rebate that could be generated, and the higher the loan officer's compensation.

19. Franklin knew in early 2010 that the proposed Compensation Rule would prohibit the Company's then-existing commission structure.

20. The Company, however, wanted to continue providing financial incentives to loan officers to originate high-interest mortgages. It devised a new compensation plan that still conditioned part of the loan officers' compensation on the terms and conditions of the loans they originated.

21. Franklin's new compensation scheme, which was implemented immediately after the Compensation Rule went into effect, provided for (1) an upfront commission based on a set percentage of the loan amount and (2) a quarterly bonus paid from loan originators' individual "expense accounts."

22. The upfront commission, which was paid on each loan, included a floor and ceiling that dictated the minimum and maximum amounts loans officers could earn on this component of their compensation.

23. The quarterly bonus was based in part on the retained rebate generated from each loan. Franklin would track the origination fees and retained rebate generated from each loan. It then would set aside 65-70% of that amount (sometimes referred to as the "adjusted total commission") to determine the contributions it would make to the loan officer's individual "expense account."

24. Specifically, for each loan, Franklin would place in the loan officer's individual "expense account" the difference, if any, between the "adjusted total commission" and the upfront commission. Franklin would make a contribution to the account only if the origination fees and retained rebate exceeded the amount of the upfront commission earned on the loan.

25. Thus, Franklin funded the loan officers' individual "expense accounts" in amounts that were based in part on the interest rates of the loans the officers' closed.

26. At the end of each quarter, Franklin typically paid 50% to 60% of the amount in the individual "expense account" to the loan officer as a bonus.

27. From June 3, 2011 through October 11, 2013, Franklin paid quarterly bonuses to its loan officers based in part on the interest rates of the loans provided to borrowers – the higher the interest rate of the loans closed during the quarter, the higher the loan officer's quarterly bonus.

28. From June 3, 2011 through October 11, 2013, Franklin paid at least $730,000 in quarterly bonuses to its loan officers.

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COUNT I

Franklin's Violations of the Compensation Rule

29. The Bureau realleges and incorporates by reference paragraphs 1-28.

30. The Compensation Rule provides that "[i]n connection with a consumer credit transaction secured by a dwelling, no loan originator shall receive and no person shall pay to a loan originator, directly or indirectly, compensation in the amount that is based on any of the transaction's terms or conditions." 12 C.F.R. § 1026.36(d)(1)(i) (2011) (revised 2014).

31. Franklin is a "person" under the Compensation Rule. 12 C.F.R. § 1026.36(d)(1)(i) (2011) (revised 2014).

32. Each of Franklin's loan officers is a "loan originator" under the Compensation Rule. 12 C.F.R. § 1026.36(d)(1)(i) (2011) (revised 2014).

33. From June 3, 2011 through October 11, 2013, Franklin paid its loan officers quarterly bonuses that were based on terms or conditions of consumer-credit transactions secured by a dwelling, in violation of 12 C.F.R. § 1026.36(d)(1)(i) (2011) (revised 2014).

34. Franklin directly or indirectly paid about 128 quarterly bonuses in amounts that varied based on the terms or conditions of consumer-credit transactions secured by a dwelling.

35. Each quarterly-bonus payment made by Franklin constitutes a discrete violation of the Compensation Rule, 12 C.F.R. § 1026.36(d)(1)(i) (2011) (revised 2014).

COUNT II

Franklin's Violations of the CFPA

36. The Bureau realleges and incorporates by reference paragraphs 1-28.

37. Franklin's violations of the Compensation Rule, described in Count I, constitute violations of section 1036 of the CFPA. 12 U.S.C. § 5536(a)(1)(A).

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PRAYER FOR RELIEF

The Bureau requests that the Court:

a. permanently enjoin Franklin from committing future violations of the Compensation Rule, 12 C.F.R. § 1026.36, the CFPA, 12 U.S.C. § 5536, and any other provision of "Federal consumer financial law," as defined by 12 U.S.C. § 5481(14);

b. grant additional injunctive relief as the Court may deem just and proper;

c. order Franklin to pay redress to consumers harmed by its unlawful conduct;

d. order Franklin to disgorge all ill-gotten gains;

e. impose on Franklin a civil money penalty;

f. award costs against Franklin; and

g. award additional relief as the Court may determine to be just and proper.

Dated: November 13, 2014

Respectfully Submitted,

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Jeffrey Paul Ehrlich (FL Bar #51561)
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