

Loan Originator Compensation and Anti-Steering Rules Take Effect

For more information about our capabilities, please contact your regular Vorys attorney or one of the following:

Terri Reyerer Abare
trabare@vorys.com
513.723.4001

Elizabeth
(Betsy) T. Farrar
etfarrar@vorys.com
614.464.5607

Jason L. Hodges
jlhodges@vorys.com
513.723.8590

Michael D. Martz
mdmartz@vorys.com
614.464.6451

M. Patricia Oliver
mpoliver@vorys.com
216.479.6137

Kimberly J. Schaefer
kjschaefer@vorys.com
513.723.4068

J. Bret Treier
jbtreier@vorys.com
330.208.1015

John C. Vorys
jcvorys@vorys.com
614.464.6211

Anthony D. Weis
adweis@vorys.com
614.464.5465

On April 5, 2011, the United States Court of Appeals for the District of Columbia (the “Court of Appeals”) took action that allowed the new loan originator compensation and anti-steering rules to take effect. The Court of Appeals dissolved its administrative order that had stayed implementation of previously issued final rules (the “Final Rules”) issued by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) to amend Regulation Z to prohibit certain compensation payments to loan originators and to prohibit the steering of consumers into or away from certain loan products. As adopted by the Federal Reserve on August 16, 2010, the Final Rules would have become effective as of April 1, 2011, however on March 31, 2011, the Court of Appeals issued the administrative stay to consider the merits of two motions filed by the National Association of Mortgage Brokers (the “NAMB”) and the National Association of Independent Housing Professionals (the “NAIHP”) to enjoin the Final Rules or a portion thereof. The NAMB and the NAIHP had been unsuccessful in seeking similar relief at the district court level. The Court of Appeals ultimately determined that the NAMB and the NAIHP had not satisfied the stringent requirements for a stay pending appeal and therefore dissolved the administrative stay. At this time, it is unclear what further legal measures, if any, the NAMB or the NAIHP will take regarding the Final Rules. As a result of the Court of Appeals action, the Final Rules are currently effective.

Scope of Application

The Final Rules apply to all closed-end consumer loans secured by a dwelling or real property that includes a dwelling (regardless of price or lien position), including closed-end reverse mortgages. The Final Rules do not apply to home-equity lines of credit or to loans secured by a consumer’s interest in a time-share. Additionally, the Final Rules do not apply to loans secured by real property if such property does not include a dwelling.

The Final Rules apply to all persons covered under the definition of a “loan originator,” which includes any “person who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person.” As adopted, the scope of the “loan originator” definition is broad, making the Final Rules generally applicable to: (i) mortgage brokers and employees of a mortgage broker or creditor who are compensated for arranging, negotiating, or otherwise obtaining a consumer loan for another person; and (ii) mortgage brokers and creditors who close a loan in their name, but use table-funding from a third party to fund the loan. The Final Rules clarify that they do not apply to: (i) creditors that originate loans closed in their own names and with their own source of funds; (ii) servicers when the servicer modifies an existing

This Client Alert and other published materials are available on our website, www.vorys.com

loan on behalf of the current owner, as long as the modification does not rise to the level of a refinance under Regulation Z; or (iii) managers, administrative staff and other employees of a creditor or loan originator who do not originate loans and whose compensation is not based on the origination of loans.

Prohibition on Loan Originator Compensation Related to Loan Terms and Conditions

As adopted, the Final Rules impose stringent prohibitions and rules regarding compensation payments to loan originators, including a prohibition on loan originators receiving any compensation that is directly or indirectly based on any loan terms or conditions. In adopting the Final Rules, the Federal Reserve has sought to address concerns over abusive mortgage loan tactics and the conflict of interest that exists for many loan originators when their personal compensation structures provide them with an incentive to offer loans with higher interest rates or less attractive loan features than those for which a consumer qualifies.

Under the Final Rules, “compensation” is broadly defined and may include both base salary and commissions. In clarifying what constitutes the terms or conditions of a loan, the Final Rules provide that compensation to a loan originator for a transaction based directly or indirectly on that transaction’s interest rate, annual percentage rate, loan-to-value ratio or the existence of a prepayment penalty is prohibited. In addition, the Final Rules prohibit compensation to a loan originator that is directly or indirectly based on a factor that is a proxy for a transaction’s terms or conditions, such as a consumer’s credit score or debt-to-income ratio. The Final Rules also provide guidance regarding the structure of loan originator compensation that is based on permissible compensation factors.

Prohibition on Loan Originator Compensation from Multiple Sources

The Final Rules also prohibit loan originators from receiving compensation from multiple sources in a loan transaction. Specifically, in consumer-pay transactions where the consumer pays the loan originator, such loan originator may not also be paid by any other person or entity in connection with the transaction. This prohibition was adopted by the Federal Reserve in order to alleviate transparency concerns created by loan originators receiving compensation from both consumers and creditors.

Prohibition on Steering

The Final Rules prohibit loan originators from “steering” a consumer to a transaction based on the fact that the transaction will increase the loan originator’s compensation, as compared to other transactions the originator offered or could have offered, unless the transaction is in the consumer’s best interest. The Final Rules provide that loan originators may seek protection through compliance with a “safe harbor” provision, by presenting prospective borrowers with at least three loans for each transaction type in which they are interested (*e.g.*, fixed-rate, variable, or reverse mortgage), from a significant number of the creditors with whom the loan originator regularly does

business. The options presented to prospective borrowers must include certain criteria to qualify for safe harbor protection and the loan originator must have a good faith belief that the prospective consumer is likely to qualify for the loan options presented. In addition, for each type of transaction, to the extent a loan originator presents more than three loan options, the loan originator must highlight to the potential consumer the loans that satisfy the provisions of the safe harbor. Finally, the loan originator may present fewer than three loans and still qualify for safe harbor treatment if the loans presented satisfy all of the safe harbor loan criteria.

Record Retention

The Final Rules require creditors to maintain records of the compensation it provided to the loan originator as well as the compensation arrangement or agreement in place on the date the interest rate for the loan transaction was set.

This client alert is for general information purposes and should not be regarded as legal advice.

IRS CIRCULAR 230 DISCLOSURE: In order to ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of (i) avoiding penalties that may be imposed under the U.S. Internal Revenue Code or (ii) promoting, marketing, or recommending to another person, any transaction or other matter addressed herein.