



**REAL ESTATE SETTLEMENT PROCEDURES ACT
(RESPA)**

**THE EFFECT OF RECENT COURT DECISIONS AND NEW LEGISLATION ON
OUR CLIENT'S LIABILITY IN REAL ESTATE TRANSACTIONS**

NBI CLE: 2009 REAL ESTATE LAW UPDATE

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RESPA OVERVIEW

A. General Purpose

The Real Estate Settlement Procedures Act of 1974 (12 USC § 2601) (“RESPA”), together with HUD’s Regulation X (24 CFR § 3500) promulgated by the Department of Housing & Urban Development (“HUD”), seeks to create a uniform disclosure and settlement procedure for residential mortgage transactions. RESPA prohibits kickbacks and referral fees and reduces the amounts permitted to be held in escrow accounts. Regulation X establishes additional requirements to facilitate uniformity in disclosures for certain federally related mortgage loans (as defined in § 3500.2).

B. Key Definitions

The term “federally related mortgage loan” is broadly defined to include any loan (other than temporary financing, such as a construction loan) that is secured by a first or subordinate lien on residential real property designed principally for the occupancy of one to four families, including a refinancing, and which:

- is made in whole or in part by any federally insured or federally regulated lender;
- is made in whole or in part, or insured, guaranteed, supplemented or assisted in any way by the Secretary of HUD or any other officer or agency of the federal government or under or in connection with a housing and urban development program administered by the Secretary of HUD or a housing or related program administered by any other such officer or agency;
- is intended to be sold by the originating lender to one of the Government Sponsored Enterprise (“GSE”) - Fannie Mae, Ginnie Mae or Freddie Mac or a financial institution from which it is to be purchased by Freddie Mac; or
- is made in whole or in part by any “creditor” (as defined in TILA) who makes or invests in residential real estate loans aggregating more than \$1 million per year.

C. Disclosure Requirements

RESPA requires the following disclosures in connection with federally related mortgage loans:

1. *Special Information Booklets; Good Faith Estimates of Settlement Services.* Special information booklets and good faith estimates of settlement services must be given to mortgage loan applicants/borrowers within a prescribed period of time after receipt of an application. If the lender requires the use of a particular provider of settlement services and the borrower is required to pay any portion of the costs of such services, then the lender must include an additional disclosure as part of the good faith estimate of closing costs.

2. *HUD-1/1A Settlement Statement.* A uniform settlement statement must be delivered at closing and must be made available for inspection one business day prior to the closing.
3. *Servicing.* Disclosures about servicing and transfers of the loan are required at the time of application and at the time a loan is transferred.

D. Kickbacks and Unearned Fees

RESPA prohibits the payment or acceptance of any fee, kickback or “thing of value” pursuant to any agreement or understanding that is incident to or a part of a settlement service shall be referred to any person. Further, RESPA prohibits the payment or acceptance of any portion, split or percentage of any charge made or received for the rendering of a settlement service other than for services actually performed. Special rules govern “affiliated business arrangements” which are defined as arrangements in which:

- a person who is in a position to refer business incident to or a part of a settlement service involving a federally related mortgage loan (or an associate of such person), has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and
- either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider.

However, an affiliated business arrangement is not a violation of RESPA’s general prohibition on referral fees and kickbacks if certain conditions are satisfied.

E. Title Insurance

No seller of residential real property purchased with the assistance of a federally related mortgage loan may require as a condition to selling the property that title insurance be purchased from a particular company.

F. Escrow Accounts

RESPA establishes maximum amounts that a lender may require to be deposited in escrow accounts. If an escrow account has been established, RESPA requires that the servicer disclose at the closing of the loan estimated taxes, insurance premiums and other charges that are reasonably estimated to be paid from the escrow account during the initial 12 months and the anticipated dates of such payments. Similar disclosures are required periodically thereafter. RESPA also contains detailed rules regarding the administration of escrow accounts.

G. Exemptions

RESPA and Regulation X generally do not apply to a loan secured by property of 25 acres or more, to a business-purpose loan, to temporary financing (such as a construction loan), to a loan secured by a vacant lot or unimproved property, to an assumption in which the lender does not have an express approval right, to a loan conversion or a *bona fide* transfer of a loan obligation in the secondary-market transaction (which expressly does not include table-funded transactions).

H. No Fee

No fee may be charged for preparing and distributing the settlement statement, any escrow account statement or any disclosure required by the TILA.

I. Civil Liability

Failure to comply with the requirements of § 6 of RESPA (relating to servicing of loans and the administration of escrow accounts) can result in the imposition of the following liability: (i) actual damages, (ii) in an individual action, additional damages as the court may allow; in the case of a pattern or practice of noncompliance, in an amount not to exceed \$1,000, (iii) in a class action, additional damages as the court may allow; in the case of a pattern or practice of noncompliance, in an amount not greater than \$1,000 for each member of the class (with a cap of the lesser of \$500,000 or 1 percent of the net worth of the servicer), and (iv) in the event of a successful action, reasonable attorney's fees and court costs.

Failure to comply with the requirements of § 8 of RESPA (relating to kickbacks and referral fees) may result in a fine of not more than \$10,000 or imprisonment for not more than a year, or both. Additionally, any person who violates § 8 is liable to the person charged for the settlement service involved in the violation in an amount equal to three times the amount of the charge paid for such settlement service.

Failure of any seller to comply with the requirements of § 9 of RESPA (relating to requiring use of a particular title company) is liable to the buyer in an amount equal to three times all charges made for title insurance.

1. THERE IS A SPLIT OF AUTHORITY REGARDING WHETHER STAND-ALONE MARK-UPS VIOLATE RESPA § 8(b) IF NOT MADE IN CONNECTION WITH A FEE-SPLITTING ARRANGEMENT WITH A THIRD PARTY.

***Morales v. Countrywide Home Loans, Inc.*, 531 F. Supp. 2d 1225 (S.D. Ca. 2008)**

There is a split among the U.S. Circuit Courts of Appeal regarding whether RESPA § 8(b) is violated by a mark-up which is **not** accompanied by fee-splitting with a third party. § 8(b) provides, “No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.” The Second, Third and Eleventh Circuits have held that markups, standing alone, are impermissible. *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2nd Cir. 2004); *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3rd Cir. 2005); *Sosa v. Chase Manhattan Mortgage Corp.*, 348 F.3d 979 (11th Cir. 2003). The Fourth, Seventh and Eighth Circuits have determined that stand-alone mark-ups are acceptable. *Boulware v. Grassland Mortgage Corp.*, 291 F.3d 261 (4th Cir. 2002); *Echevarria v. Chicago Title & Trust Co.*, 256 F.3d 623 (7th Cir. 2001); *Haug v. Bank of America*, 317 F.3d 832 (8th Cir. 2003). The Southern District of Ohio held that stand alone mark-ups are RESPA compliant.¹

In *Morales*, the putative class plaintiff filed an action against Countrywide claiming that its markup and retainer of fees for tax services and flood certifications provided by a third party vendor violated RESPA § 8(b), 12 U.S.C. § 2607(b); 24 CFR § 3500.1. Specifically, plaintiff alleged that Countrywide charged marked-up fees for tax and flood certification by engaging third party vendors to perform these services and then charging plaintiff a much higher rate. The argument was that Countrywide paid the vendor for the actual services rendered and then pocketed the mark-up without providing any additional service to plaintiff. Shortly after the case was removed to federal court, Countrywide filed both a motion to dismiss and a motion to strike class allegations. The motion was granted.

The *Morales* court analyzed the case strictly under § 8(b) of RESPA and Regulation X. The court acknowledged that the Ninth Circuit has not addressed this issue directly but that the courts who have addressed this issue are split. The split results from a disagreement between the circuits as to whether the text of § 8(b) is clear and unambiguous. The *Morales* court followed the majority rule holding that mark-ups were not a violation of RESPA § 8(b) for two reasons:

First, the court found the phrase “no person shall give and no person shall accept . . .” is clear and unambiguous and must be read in the conjunctive.

Second, the minority position effectively imports a price control into § 8(b) in violation of Congressional intent. The legislative history is clear that RESPA was not a price-control statute. *See Haug*, 317 F.3d at 837 (noting a price control version of RESPA was considered and rejected). Accordingly, the court ruled that Countrywide could charge customers any rate for services that it performs without violating RESPA.

¹ For a comprehensive and detailed analysis, See Jonathan P. Solomon, Comment, Resolving RESPA’s § 8(b) Circuit Split, 73 U. Ch 1. L. Rev. 1487 (2006).

2. RESPA DOES NOT APPLY TO ANY CLAIMS THAT OCCUR AFTER A MORTGAGE LOAN IS CLOSED.

***Molosky v. Washington Mutual Bank, et al. v. Washington Mutual Bank*, No. 07-CV-11287, 2008 U.S. Dist. Lexis, 3896 (E.D. Mich. 2008)**

A purchaser who, among other things, alleged that Washington Mutual violated RESPA by charging a \$30 payoff statement fee and a \$14 recording fee when the purchaser paid off his loan prior to maturity had his claims dismissed for failure to state a claim. The Plaintiff alleged that by assessing these fees defendants breached the party's contract and RESPA by charging these fees well in excess of the amount it cost to generate the payoff fee and to record the payoff. While *Molosky* seemed to state a typical overcharge claim, the court held that plaintiff failed to state a claim under RESPA for two reasons. First, the fees at issue were not received for the rendering of a real estate settlement service as required by 12 U.S.C. § 2607(b). RESPA defines "settlement services" as "includ[ing] any service providing in connection with a real estate settlement . . ." 12 U.S.C. § 2602(3). The court held there is persuasive authority supporting the proposition that "settlement" means "the final transaction between the buyer and seller, whereby the conveyancing documents are concluded and the money and property are transferred," and that RESPA therefore has no application to "satisfaction, prepayment, or release of a mortgage." *Molosky* at p. 5, citing *McAnany v. Astoria Financial Corp.*, 357 F. Supp. 2d 578, 590 (E.D. N.Y. 2005), quoting Black's Law Dictionary (8th Ed. 2004).

The *Molosky* court went on to state that even if RESPA were expanded to apply the fees assessed in connection with a payoff of a mortgage loan, plaintiff's allegations in the present case would still fail to state a claim because there was no allegation of unlawful fee splitting.

3. FLAT FEE PRICING IS NOT A VIOLATION OF RESPA EVEN WHEN THOSE FEES CROSS-SUBSIDIZE OTHER MORTGAGE CUSTOMERS.

***Krupa v. LandSafe, Inc.*, 514 F.3d 1153 (11th Cir. 2008)**

LandSafe, Inc. (Landsafe) a credit reporting agency had a flat fee pricing agreement with Countrywide Home Loans, Inc. ("Countrywide") where it charged Countrywide a \$25 flat fee for each credit report that Countrywide ordered. Countrywide passed that cost onto each customer who "locked in" a loan. The cost of the credit report Countrywide ordered for a customer who did not ultimately get a loan through Countrywide could not be passed on but was instead absorbed by Countrywide. After absorbing fees over time, Countrywide proposed to LandSafe that it increase the charge for a credit report from \$25 to \$35 for all customers who actually locked in a loan with Countrywide and charge nothing for those customers who did not get a loan.

In this class action the customers alleged this repricing of services by LandSafe was in effect an illegal kickback under RESPA § 8(a) which prohibits kickbacks for referral of business. § 8(a) provides in relevant part:

No person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, the business incident to or part of a real estate settlement service involving a federally related mortgage loan shall be offered to any person.

12 U.S.C. § 2607(a). In interpreting this provision HUD has said:

When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business

24 C.F.R. § 3500.14(a). However, the *Krupa* court reasoned that

in order for there to have been a forbidden kickback, there would have to have been an agreement between the two that Countrywide would give LandSafe more of its credit reporting business than it was giving LandSafe before the agreement, or at least an agreement that it would not give LandSafe any less of that business.

Krupa, 514 F.3d 1156. The Court acknowledged the change in pricing was a “thing of value” to Countrywide, i.e., the ability to pass along to its customers the cost of all of the credit reports it orders instead of just part of them. Still, there was no violation of RESPA’s anti-kickback provision unless the agreement had also provided or promised LandSafe Countrywide’s business in return. In this case it did not. The Court relied on a Ninth Circuit decision rejecting an attempt to challenge the reasonableness of flat fee pricing structures, notwithstanding that “cross-subsidization between customers is inherent in such an arrangement.” *Lane v. Residential Funding Corp.*, 323 F.3d 739, 742-46 (9th Cir. 2003). The Court also agreed with the Second and Third Circuits, and declined to evaluate whether prices were “too high” under RESPA. *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2d Cir. 2004); *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384, 387 (3d Cir. 2005).

4. “SERVICES RENDERED” UNDER RESPA IS CONSTRUED VERY BROADLY BY THE COURTS.

***Friedman v. Market Street Mortgage*, 520 F.3d 1289 (11th Cir. 2008).**

The courts have been very liberal in determining that services were “actually performed” under RESPA § 8(b). Even minimal services will be deemed to comply with § 8(b).

In *Friedman*, the borrowers refinanced their home mortgage in late 2002. In accordance with the mortgage contract with Market Street Mortgage Corporation (“Market Street”) the borrower was required to make monthly payments into an escrow for taxes, insurance, etc. The Friedmans, however, preferred to assume this responsibility on their own and pay the taxes and insurance directly. Accordingly the Friedmans retained control over the money until they were required to make the payments directly. At closing, Market Street charged the Friedmans an Escrow Waiver Fee of 1% of the total loan, which in this case amounted to \$556.25. The

Friedmans signed a standardized escrow waiver agreement prior to closing. Pursuant to that agreement the Friedmans agreed to make timely payments to the appropriate tax and insurance entities and to provide copies of the receipts to Market Street as evidence that the payments were made.

Market Street subsequently sold the Friedmans' mortgage loan on the secondary market to Washington Mutual. When the Friedmans received notification of the transfer of the loan servicing rights to Washington Mutual, they filed suit alleging that no services were performed by Market Street in exchange for the escrow waiver fee in violation of § 8(b) of RESPA. In part, the Friedmans were troubled that they were actually charged a tax service fee of \$70.00 on their settlement statement when they had assumed the responsibility for paying their own taxes.

Plaintiffs' claims were dismissed and the court found that Market Street had performed settlement services even though they were no longer servicing the loan. In the ruling it appears the court was persuaded by the fact that Market Street (1) set up the servicing system for the loan prior to its transfer to Washington Mutual; (2) captured and entered the tax and hazard insurance information; (3) made arrangements for and payments to a tax service company in connection with the servicing of the loan, and (4) followed up with Washington Mutual for several months to ensure the tax and insurance information was correctly transferred. The *Friedman* case, therefore, underscores that the court will look closely at any service that is provided as part of a fee agreement.

5. GOOD FAITH ESTIMATES THAT MAKE NO MENTION OF YSPs PAID TO BROKERS ARE INADEQUATE UNDER RESPA; GOOD FAITH ESTIMATES IDENTIFYING A YSP RANGE BUT FAILING TO SPECIFY AN AMOUNT MAY RAISE AN ISSUE FOR TRIAL.

***Pierce v. Novastar Mortgage, Inc.*, No. Co5-5835RJB, 2007 U.S. Dist. Lexis 18336 (W.D. Wash. 2007)**

Details included on mortgage companies' GFE forms can determine whether RESPA is violated as a matter of law or a fact dispute exists as to a RESPA violation. RESPA requires borrowers to be provided with a good faith estimate ("GFE") listing the "amount or range" of settlement charges within three days of receiving a loan application." 12 U.S.C. § 2604(c); 24 C.F.R. § 3500.7(c). To comply with RESPA, a GFE must include "indirect payments or back-funded payments to mortgage brokers that arise from the settlement transaction" and "mortgage broker fee[s]." 24 C.F.R. § 3500, App. A § L; *Anderson v. Wells Fargo Home Mort., Inc.*, 259 F. Supp. 2d 1143, 1146 (W.D. Wash. 2003).

In *Pierce*, a proposed class of borrowers who had loans with Novastar Mortgage, Inc. ("Novastar"), claimed they were deceived by Novastar's failure to disclose the payment of broker fees commonly referred to as yield spread premiums ("YSPs") on its GFE disclosure forms. Plaintiffs sued under Washington's Consumer Protection Act, which incorporates RESPA. The plaintiffs challenged three different alleged Novastar practices: (1) use of GFEs that did not mention YSPs where YSPs were nevertheless assessed; (2) use of GFEs with a stated

YSP ranging from zero percent and totaling \$0; and (3) use of GFEs that mentioned YSPs, but did not include any indication of a supposed dollar amount.

The District Court easily concluded that all of the GFEs which were silent about the possibility of YSP payments violated RESPA. The Court also ruled that these GFEs were *per se* unfair and deceptive under Washington's Consumer Protection Act. However, the Court declined to rule that GFEs with a stated YSP ranging from zero percent and totaling \$0, or GFEs which mentioned YSPs but did not include a dollar amount, violated RESPA as a matter of law. The Court explained that a GFE "is indeed merely an estimate and not a promise or guarantee." Given there was evidence that the YSP could range from zero to four percent, the Court held there was a question of fact regarding whether Novastar's failure to specify the amount of YSPs in its GFEs was done in good faith.

6. PREDATORY LENDING AT ITS WORST.

Valdez v. Downey Savings and Loan, No. C 06-2541 2008 WL 4452116 (N.D. Cal.)

The unreported Valdez case is a sad example of predatory lending. Ms. Valdez was an 81-year-old widow living on \$1,500 a month that came from Social Security and her husband's pension. Ms. Valdez was contacted by a phone bank also known as a "meat shop" for Prime West, a broker. To get Ms. Valdez interested, Prime West promised Ms. Valdez that she could lower her loan payment and that her current loan did not have a prepayment penalty. Prime West also promised that the fees involved would be approximately \$3,000 to \$4,000 which she could "roll into" the new loan. Several Prime West employees met with Ms. Valdez at her home to close the loan. The employees presented Ms. Valdez with a large stack of documents, but she was not afforded the opportunity to read them thoroughly. However, Ms. Valdez still signed the loan documents believing that Prime West and its employees were acting in her best interest and that the documents contained the terms previously promised to her.

Upon later review of the loan documents Ms. Valdez discovered that her loan had included a \$6,075 broker fee to Prime West and a \$12,150 rebate paid to defendant Prime West by the lender Downey Savings and Loan. In addition, Ms. Valdez had incurred a \$7,011.91 prepayment penalty on her previous loan. When Ms. Valdez contacted Prime West, they said it was too late to rescind her agreement. However, the Prime West employee told Ms. Valdez that she could recoup the prepayment penalty by referring more business to Prime West.

Ms. Valdez eventually discovered that her loan application was full of misrepresentations. These included: (1) She had been self-employed for 10 years at a business called "Valdez Sewing and Embroideries;" (2) She owned \$1,125,018.62 in total assets, including two properties collectively valued at \$999,000 and a Toyota Camry valued at \$35,000; and (3) She earned a monthly income of \$8,031.00.

The fees charged in this case are astounding. Prime West received \$6,075 in broker fees directly from Ms. Valdez, an amount that represents 1.5% of the loan value. When the \$12,150 yield spread premium is added to this amount, the total compensation to defendants was \$18,225

or roughly 4.5% of the value of Ms. Valdez's loan. Eventually counsel for defendants withdrew. During the litigation, Ms. Valdez passed away and her son substituted in as the named plaintiff. He was awarded \$39, 927.21 in damages. On February 5, 2009, the court awarded plaintiff his attorneys of \$163,528.75 and costs in the amount of \$1,051.24. It is unlikely that plaintiff or the attorneys will collect a dime.

HUD Issues its Final RESPA Rule

On November 17, 2008, HUD published its long awaited rule amending HUD's Regulation X. The new rule makes sweeping revisions to the Good Faith Estimate ("GFE") and corresponding modifications to the Uniform Settlement Statements (the "HUD-1" and the "HUD1-a"). It also contains a new definition of "application" that may change the point at which many GFEs will be provided. Even more significantly, RESPA will require that the GFE be "binding" for at least 10 business days, and it will limit the amount by which many of the estimated fees may increase before closing.

The new rule allows for limited average cost pricing². However, HUD has withheld authorization of volume discounts and it has strengthened the rule on the "required use" of affiliated settlement service providers. It also includes a new definition of "required use", but HUD has twice postponed the effective date of the new definition. In addition to the fact that HUD has postponed the effective date of "required use" to July 16, 2009, it is soliciting comments on whether it should be withdrawn from the new RESPA rule altogether. As of, January 16, 2009, "required use" will include providing incentives to use an affiliate's services. The latter change may even prohibit long-accepted practices between affiliated institutions. Finally, the rule makes some technical amendments, including implementing the 1996 statutory changes to the servicing disclosure statement.

On December 19, 2008, the National Association of Mortgage Brokers filed suit to enjoin implementation of the rule. Assuming that they don't prevail, lenders will have until January 1, 2010, to start complying with most of the new rule. However, the guidelines for average cost pricing and the technical amendments were effective January 16, 2009.

The New Definition of "Application"

Under the new rule, lenders and brokers will be required to issue GFEs within three business days after receiving an application. The final rule defines "application" as:

"... the submission of a borrower's financial information in anticipation of a credit decision relating to a federally related mortgage loan, which shall include the borrower's name, the borrower's monthly income, the borrower's social security number to obtain a credit report, the property address, an estimate of the value of the property, the mortgage loan amount sought, and any other information deemed necessary by the loan originator."

² For the purposes of this paper, average cost pricing is when a lender, rather than charging the average cost of a service, calculates the total cost over time and then develops a fixed fee for the certain service. In some cases this results in cross-subsidization. For example, a 1% loan fee across the board is an example of average cost pricing.

The phrase “and any other information deemed necessary by the loan originator” may be deceiving. Although the rule is unclear, it appears that HUD expects loan originators to issue GFEs once they have received the six enumerated data points. The final rule says that lenders and brokers may request more information (such as a full 1003), but it doesn’t seem to anticipate they would wait until they receive more information before issuing the GFE. The rule expressly precludes lenders and brokers from requiring documentation verifying the information before they provide the GFEs.

The New Good Faith Estimate

The new GFE will be three pages long and will be divided into several sections. As a general rule, the disclosed terms must be valid for at least 10 business days. In addition, lenders and brokers may not charge any fee (other than a credit report fee) until the applicant expresses an interest in proceeding with the loan.

The estimated settlement charges must now be lumped into two different groups and must be itemized and totaled in the applicable section and then totaled together. Allocating fees to the right group is critical, as this assignment will partially dictate how much those fees may increase after the lender or broker issues the GFE. The new GFE will also include some key loan terms that are not required to be disclosed on the current GFE. These include the interest rate, whether the interest rate and payment may increase and when, whether negative amortization may occur, whether the loan has a prepayment penalty or fee and how much it can be, whether the loan calls for a balloon payment, and whether the loan carries an escrow account for taxes and insurance.

The new sections of fees are “Adjusted Origination Charges” and “Charges for All Other Settlement Services.” The Adjusted Origination Charges include all origination fees imposed by the lender and broker. They include a typical origination fee, discount points, yield spread premium (“YSP”), and other loan processing and closing charges imposed by the lender and broker. (No longer will YSPs be disclosed as fees paid outside of closing.) In the case of the YSP, the GFE must disclose whether the YSP is being credited to other fees.

The “Charges for all other settlement services” are broken into nine subsets: 1) Required services for which the lender or broker select the provider; 2) Title services and lender’s title insurance; 3) Owner’s title insurance; 4) Required services for which the borrower may shop; 5) Government recording charges; 6) Transfer taxes; 7) Initial escrow deposits; 8) Daily interest charges; and 9) Homeowners Insurance.

Tolerances; May the Estimated Fees Increase?

If the interest rate is not locked at the time the GFE is issued (or, if it was locked, the lock has expired), then the interest rate and the charges based on the rate (e.g., per diem interest) may change. Otherwise, the Adjusted Origination Charges and the transfer taxes may not increase unless there has actually been a “change in circumstances.” (See below.) In other words, HUD is assigning a zero tolerance to these estimates.

In the case of: 1) lender required settlement services where the lender or broker select the provider; or 2) lender required services, title services and lender title insurance and owner's title insurance when the borrower uses a provider identified by the lender or broker, the fees may not increase by more than 10 percent. There is no limit by which all other disclosed charges may increase (unless, of course, the GFE is so erroneous that it fails to qualify as a good faith estimate at all).

HUD will be issuing additional guidance on what constitutes "changed circumstances." When the circumstances change, the lender or broker must provide a new GFE within three business days after the change. The applicable tolerances then apply to the newly disclosed terms.

Changes to the HUD-1s

The new HUD-1s will contain revisions corresponding to the changes to the GFE. These will include grouping the settlement fees into the same categories. The settlement agents will also be required to identify how the fees have changed. In other words, the HUD-1s will highlight any increases that exceed the permitted tolerances. The HUD-1s will also include the same additional loan terms (interest rate, whether the interest rate and payment can increase, etc.) that must be included on the new GFE.

Average Cost Pricing, Volume Discounts and Required Use

The new rule provides some guidance on average cost pricing. Average cost pricing will be permissible if: 1) it is no more than the average amount paid for the service on a particular class of transactions; and 2) the total of the average amounts paid by borrowers and sellers for the service does not exceed the actual costs paid to the service providers. Lenders and brokers will have some flexibility in establishing the "class of transactions." However, the transactions 1) must have occurred during a period of at least 30 days and no more than six months prior to the current loan, 2) must have occurred in a designated geographic area and 3) may be transactions of a specified loan type. Note, however, that average cost pricing will not be allowed for any fees that may vary by loan amount or property value.

Contrary to the hopes of the industry, the final rule does not permit volume discounts. Rather, HUD has reserved the issue for further consideration. HUD is also modifying the definition of "required use" for purposes of the limitations on affiliated business arrangements. With some exceptions, RESPA prohibits settlement service providers from requiring the use of affiliated service providers. If HUD proceeds with the definition contained in the final rule, "required use" will include requiring the use of an affiliate in order to receive some "distinct ... discount, rebate or other economic incentive." The final rule will still permit discounts resulting from combined or packaged services as long as use of the packaged services is optional and the discounts do not result in higher costs elsewhere in the transaction.

So Where Do We Go From Here?

As is the case with many major regulatory revisions, the new rule raises almost as many questions as it answers. Just a few of the issues we will be assisting clients with over the next several months are:

- Once the new rule is effective, may lenders and brokers still offer prequalifications and preapprovals without triggering the new definition of “application”?
- May a lender reject a broker submitted application because it doesn’t contain all six elements of an “application” without triggering adverse action requirements under Regulation B?
- Can the GFE provide a date by which the loan must go to settlement as a condition for the disclosures to remain valid?
- In a brokered transaction, can a lender issue its own GFE and avoid being bound by the broker’s GFE? If not, what processes must a lender implement to ensure the accuracy of the broker’s disclosures? If the lender can issue its own GFE and does so, does that release the broker from its GFE?
- If the loan originator provides some bona fide settlement services, are those fees still separately itemized or will they have to be lumped together with the origination charge?
- How are broker required services to be treated under the new rule?
- Do the new requirements for average cost pricing mean lenders can no longer reduce or waive those fees from time to time?
- We will also need guidance from the Federal Reserve Board on if and how some of the new RESPA disclosure requirements will impact the required Truth-in-Lending disclosures (this includes treatment of fees as finance charges under Regulation Z).
- How, if at all, do the new disclosure requirements conflict with state laws and, in the case of conflicts, what are the state regulated brokers and lenders to do?