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## RESPA REFORM: Déjà Vu All Over Again

The wait is over. On Friday, March 14, 2008, the U.S. Department of Housing and Urban Development (“HUD” or “Department”) published its proposed regulations to reform the Real Estate Settlement Procedures Act (“RESPA”). This rule comes nearly two and half years after HUD held a series of RESPA roundtables and invited settlement service providers, industry trade associations, and consumer groups to comment on the simplification of RESPA’s disclosure requirements. These roundtables resulted from the overwhelming response HUD received to its 2004 proposed rule, which was defeated when settlement service providers joined forces to persuade HUD to abandon its plan. Now, RESPA reform is back.

HUD partially titles its rule a “Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages”; however, the rule appears to be far from simple. While settlement service providers will not be surprised that HUD proposes to modify the Good Faith Estimate (“GFE”), the proposed rule goes well beyond mere changes to this disclosure. HUD proposes to introduce tolerances for settlement charges, require a new format for disclosure of yield spread premiums, modify the HUD-1 Settlement Statement (“HUD-1”), introduce a new closing script, and amend certain established RESPA definitions, to name a few. As a result, RESPA reform is never without controversy, and HUD appears to have created a complicated and controversial rule that is unlikely to be widely embraced by settlement service providers. Accordingly, this client alert summarizes the most important changes proposed by HUD’s rule, as well as provides our initial observations as to how the rule may affect and be received by settlement service providers.

### I. Good Faith Estimate

The GFE is the signature piece of the 2008 proposed RESPA rule. Not only did HUD drastically change the look of the form itself, but the Department has proposed to alter the way certain fees are disclosed, as well as subject mortgage lenders and brokers to specific tolerances for the change in settlement charges at closing. We describe these specific GFE changes in more detail below.

#### A. Standardized GFE Form

HUD’s proposed rule takes the current one-page, suggested form for the GFE and requires a mortgage originator to provide a four-page standardized form within three days of receiving a “GFE application.”<sup>1</sup> This proposed form would include a summary of the key terms of the loan, as well as an estimate of total settlement charges.<sup>2</sup>

- The key loan terms would include the following: (1) the initial loan amount; (2) the loan term; (3) the initial interest rate; (4) the initial monthly mortgage payment; (5) whether the interest rate, the loan balance and the monthly payment may rise; (6) whether the loan has a prepayment penalty and balloon payment; and (7) whether the loan includes a monthly escrow payment for property taxes and other obligations. HUD proposes for these items to be disclosed on page one of the form.
- The proposed GFE also provides for the estimate of total settlement costs in the following ten categories: (1) the originator’s service charge, which would include any internal processing and underwriting fees; (2) a credit or charge for the interest rate chosen, which yields “adjusted origination charges”; (3) required services selected by

the lender, such as appraisal and flood certification fees; (4) title service fees and the cost of lender's title insurance; (5) other required services for which the consumer may shop; (6) government recording and transfer tax charges; (7) reserves or escrow; (8) daily interest charges; (9) the cost of homeowner's insurance; and (10) the cost of optional owner's title insurance.<sup>3</sup> HUD proposes for these settlement charges to be disclosed on page two of the GFE.

In general, the rule would require a mortgage lender or broker to keep the GFE's offer for settlement costs open for 10 business days to allow the consumer to comparison shop with other loan originators. With regard to the initial interest rate, the GFE must identify that the rate is available until a specified date. Until that rate is locked, however, the initial interest rate may continue to float.<sup>4</sup>

Page three of the proposed GFE form would require a lender or broker to present a borrower with two additional loan options in a chart format – one with a higher interest rate and one with a lower interest rate. The purpose of the comparison would demonstrate how a higher interest rate could reduce up front settlement costs and a lower interest rate could increase the charges a consumer would pay at the closing table. After seeing these options, if a consumer desires a loan product with a higher or lower interest rate, the lender or broker would be required to provide the consumer with a new and different GFE.<sup>5</sup>

Finally, because HUD is focused on creating a GFE form that allows consumers to shop for a mortgage loan, page four of the proposed form contains a blank chart that would allow consumers to write in the loan terms of four lenders' offers of credit. The last page also contains estimates for other items, such as property taxes and homeowner's insurance, but warns that such items should not be used to compare settlement charges among lenders.<sup>6</sup>

## B. Tolerances

Related to the estimate of settlement charges on the GFE, HUD proposes to create three separate categories of settlement charges and subject them, absent "unforeseeable circumstances,"<sup>7</sup> to different tolerances.<sup>8</sup> The first category of fees would be subject to a zero tolerance standard, meaning the fees estimated on the GFE may not be exceeded at closing.

- Zero tolerance fees would include: (1) the lender or broker's own service charge (i.e., processing and underwriting fees); (2) the credit or charge to the borrower for the interest rate chosen (i.e., yield spread premium or discount points); and (3) government recording and transfer tax charges.

HUD would subject the sum of the fees in the second category to a 10% tolerance. While each individual fee may increase or decrease, the sum of the total increases may not exceed 10% at closing.

- 10% tolerance fees would include: (1) lender-required settlement services where the lender selects the third party provider (i.e., appraisal fees and tax search fees); (2) lender-required services where the borrower selects a third party provider recommended by the lender (i.e., title insurance and closing services and lender's title insurance); and (3) optional owner's title insurance when the borrower uses a provider identified by the lender.

The final category of fees would be subject to no restriction, meaning HUD would not limit the amount of any increase in the fees. These fees, therefore, may increase by more than 10% at closing.

- No restriction fees would include: (1) reserves or escrow; (2) daily interest charges; (3) homeowner's insurance; and (4) lender-required services where the borrower shops and selects his or her own third party provider (i.e., title insurance and closing services and lender's title insurance).

## C. Disclosure of Yield Spread Premiums

Although current RESPA regulations require yield spread premiums to be disclosed as paid to a mortgage broker outside of closing, HUD's proposed rule would require such fees to be disclosed on the second page of the new GFE form as a "credit or charge for the specific interest rate chosen."<sup>9</sup> The "credit" in this case encompasses a yield spread premium and the "charge" is meant to denote the presence of discount points.

To accomplish this, the rule would require a mortgage broker to disclose all internal origination fees on page two of the GFE as "our service charge." If a mortgage lender will pay a broker a yield spread premium on the loan, the mortgage broker would be required to disclose the premium as a credit "for the interest rate of \_\_\_%" and subtract it from "our service charge" to arrive at the "adjusted origination charge."<sup>10</sup> Conversely, if a

borrower elects to pay discount points to reduce the interest rate on the loan, the amount of the discount points would be added to the “our service charge” to arrive at the “adjusted origination charge.” Be advised that nowhere on the new GFE form does HUD propose to label the disclosure with the terms “yield spread premium.”

#### **D. GFE Fees**

In modifying the GFE, HUD states its preference that mortgage lenders and mortgage brokers not impose any charges for a GFE. The Department, however, acknowledges that there may be incidental or nominal costs in providing GFEs to prospective borrowers. The rule, therefore, proposes to permit a lender to charge a fee, but limits the amount to a lender’s actual costs, including the cost of an initial credit report.<sup>11</sup>

#### **E. FHA Origination Fees**

Finally, under current FHA regulations, HUD limits the amount of an origination fee a mortgagee may collect to 1% of the loan amount. In the proposed rule, HUD has recommended that this limitation be removed.<sup>12</sup> The Department appears to believe that its new rule on the disclosure of settlement charges and tolerance limitations will force lenders to reduce their origination prices, which, in turn, will alleviate any need for a maximum FHA origination fee.<sup>13</sup>

#### **F. Observations and Questions Regarding the Proposed GFE**

HUD’s intentions may have been honorable in attempting to create user-friendly documents that arm a consumer with more information about his or her loan, but the new GFE hardly appears to be simpler. Not only must a prospective borrower wade through the settlement charges on page two of the proposed form, the GFE would arm consumers with loan information and alternative loan products that assume consumers understand what the varying terms are intended to convey. It, therefore, remains to be seen whether consumers will understand what appears to be a confusing and complicated form.

##### **1. Tolerances**

HUD’s proposed tolerances for settlement charges also appear to be one of the more controversial aspects of the rule, as these fee limitations raise questions as to who will control a borrower’s selection of third party service providers. Some non-lender settlement

service providers already have suggested that the rule’s zero and 10% tolerance requirements will promote the bundling of settlement services or lender-owned affiliated business arrangements. In other words, if HUD is to hold a lender or mortgage broker accountable for the settlement charges it estimates on a GFE, these originators have more incentive to assert control over a borrower’s selection of settlement service providers and resulting settlement charges. The concern for these non-lender providers is that consumers will always select the lender-recommended providers to avoid the uncertainty of increased closing costs, which will discourage consumers from shopping for other providers.

##### **2. Yield Spread Premiums**

The disclosure of the yield spread premium is another issue that will get the attention of both mortgage brokers and mortgage lenders. First, the proposed “credit” appears to require a dollar-for-dollar reduction to the broker’s origination fee to account for the payment of a yield spread premium. Rather than reduce a consumer’s settlement costs, one must question whether this disclosure will force mortgage brokers to increase their up-front origination fees to offset the effects of the credit, particularly when the courts have determined that a yield spread premium is a permissible way to pay mortgage brokers for the origination services they perform. This appears to be one example of HUD’s failure to consider the real effects of its proposed changes.

Second, the disclosure of the yield spread premiums has always been a significant issue for mortgage brokers who argue that such fees are no different than the undisclosed secondary market compensation mortgage lenders receive on the sale of a loan. In response to this argument, HUD has proposed the inclusion of language on page four of the GFE to notify consumers that lenders can receive additional fees by selling the loan after settlement.<sup>14</sup> Mortgage lenders, however, are likely to push back on this issue and argue that the fees received from the sale of a loan in the secondary market are exempt from HUD scrutiny. Lenders are likely to suggest that any such disclosure is beyond the coverage of RESPA’s statute and should not be included on the GFE.

##### **3. Fees**

Although the proposed rule does allow mortgage lenders and brokers to charge for the preparation of

a GFE, HUD limits this charge to the originator's actual cost of preparing the document. Yet, Congress and several federal courts have said on numerous occasions that RESPA is not a rate-setting statute; in other words, the Act does not authorize the Department to set limits on the reasonableness of fees charged for settlement services. One, therefore, must question whether HUD has the legal authority to limit the GFE fee a lender or broker may charge, and we expect mortgage lenders and brokers to take up this issue with HUD. Moreover, this proposed limitation appears to be another example of HUD's failure to anticipate the unintended consequences of its rule. If the new GFE form is designed to facilitate consumer shopping and lower settlement fees, one must question whether a consumer will elect to pay a \$35-\$50 fee to obtain a GFE from multiple lenders. If HUD truly intended to decrease a consumer's origination fees, perhaps the Department should have focused its reform efforts on proposals that will not increase settlement service providers' internal costs to comply with the rule.

#### 4. Enforcement of New GFE Requirements

At the end of the day, HUD has spent considerable time crafting a new GFE form and modifying the settlement charges requirements. In an attempt to give these changes some teeth, HUD proposes to make any violations of these requirements a violation of Section 5 of RESPA. But, should lenders and mortgage brokers really be concerned about GFE violations; what is the penalty if a lender, for instance, exceeds the 10% tolerance? The answer: nothing. RESPA's statute contains no penalties for a violation of RESPA's disclosure requirements, and HUD has acknowledged that it has an enforcement dilemma. In fact, HUD indicates in the preamble to the proposed rule that it plans to approach Congress for authority to impose civil money penalties, as well as injunctive and equitable relief for violations of Section 4 and Section 5 of RESPA.<sup>15</sup> Until HUD is granted that authority, however, neither the proposed rule nor the regulations in their current form provide for any penalty to punish those settlement service providers that fail to comply with HUD's proposed changes.

This does not mean that settlement service providers are completely out of the woods. If certain of a consumer's final settlement charges exceed the 10% tolerance, there is a possibility that a consumer could sue the lender under a breach of contract theory or bring a cause of action based on an unfair and deceptive

trade practice for increased closing costs. Recovery in these instances, however, likely would be minimal, as the consumer would be entitled only to the amount in excess of the 10% tolerance. In most cases, this is likely to be a mere \$20-\$50. While a consumer might be unwilling to pursue these types of actions,<sup>16</sup> these, nevertheless, are the types of issues that underscore the fact that RESPA's statute, as well as HUD's proposed rule, provides no remedy to address violations of the GFE disclosure requirements.

## II. HUD-1 Settlement Statement

### A. HUD-1 Form

While the current GFE and HUD-1 do not match or allow for easy comparison, HUD proposes to alter the HUD-1 form to allow a consumer to directly compare the fees identified on the GFE to those fees charged at closing.<sup>17</sup> Currently, page two of the HUD-1 includes a number of itemized settlement charges, as well as space for the inclusion of other fees assessed to borrowers at closing. The proposed rule does not change this structure for the HUD-1, but it would identify the settlement charges using the same terms as proposed on the new GFE (i.e., "our service charge" for lender origination fees). The Department also proposes to bold certain text and include bracketed language that identifies the section of the GFE where a consumer will find the estimated charge.<sup>18</sup> For instance, the appraisal fee and credit report fee would be estimated in Item 3 of the proposed GFE. To allow a consumer to compare these fees with those reflected on the HUD-1, the new HUD-1 would include "**(from GFE #3)**" next to the itemized entry for the appraisal and credit report in the 800 series of the HUD-1.

In addition, while the current HUD-1 requires a lender or mortgage broker to itemize their internal origination charges, such as processing fees and document preparation fees, the modified HUD-1 would require only the lender's bundled "service charge" to be disclosed at closing.<sup>19</sup> Similarly, rather than itemize fees for primary title services, such as the title search, title examination, and title binder, to name a few, the modified HUD-1 provides for a single "title services and lender's title insurance" fee to be disclosed on the HUD-1.<sup>20</sup> This category of fee matches that on the proposed GFE form. Note, however, that this fee may not encompass every title-related fee. The proposed rule does recognize instances where additional fees may need to be separately itemized, including cases where

separate third party vendors perform closing-related services, such as attorneys or escrow companies. In these circumstances, the proposed rule would require the fees paid to the attorney or escrow company to be separately itemized in the 1100 series of the modified HUD-1.<sup>21</sup>

Ultimately, the rule's changes to the HUD-1 are much fewer than those proposed to the GFE, but these modifications nonetheless raise certain issues. Notably, if HUD's rule is intended to provide consumers with full disclosure, we question how bundled fees on the HUD-1 provide borrowers with more information about the settlement fees they pay at closing. HUD also has consistently taken the position that all fees paid by a borrower at closing should be separately itemized on the HUD-1. With this proposed rule, however, HUD appears to have had a change of heart.

Furthermore, the proposed HUD-1 includes two additional disclosures that HUD does not propose for the GFE. In lines 1113 and 1114 of the new HUD-1, a title agent/closing agent would be required to disclose the title agent's portion and title underwriter's portion of the total title premium.<sup>22</sup> Yet, in the Appendix to the rule, the Department expressly states that it removed the premium breakout from the GFE, as the title agents argued that itemizing the premium split is costly and serves no useful purpose.<sup>23</sup> If this is the case, then what useful purpose does the disclosure serve on the HUD-1? No other insurance agents (*i.e.*, homeowners, auto, and life insurance) are required to disclose the percentages of insurance premium they receive as compensation. Moreover, if the disclosure of the agent and underwriter portions of the title premium is intended to allow the consumer to negotiate a different title rate, the disclosure of this split just one day prior to closing is too late to allow a consumer to shop for another provider. These are examples of the types of concerns we expect the title industry to raise with HUD in response to the proposed rule, and more specifically, the modified HUD-1.

### **B. Mark Up of Third Party Fees**

In addition to the changes HUD proposes to make to the HUD-1 form itself, the rule proposes to include new language in Section 3500.8 of the RESPA regulations. This language would state as follows: "The amount stated on the HUD-1 or HUD-1A for any itemized service cannot exceed the amount actually received by the third party for that itemized service.

unless the charge is based on an average cost price in accordance with paragraph (b)(2) of this section."<sup>24</sup> If read literally, this language seems to suggest that the mark-up of third-party fees would be prohibited under the new rule.

Under Section 8(c)(2) and HUD's Statement of Policy 2001-1, the mark-up of a third party vendor's fee is permissible under RESPA. The lender (or other provider) must perform additional services to justify the additional charge and the amount of the mark up must be reasonably related to the value of the additional services. Despite these current requirements, however, the language above seems to suggest that a settlement service provider would be prohibited from marking up any third party fee (unless the fee is based on an average cost). If this is HUD's intent with the language, this could present a problem for vendor management companies, which traditionally mark up the prices of third party service providers in the companies' network. Without the ability to mark up third party fees and pass them through to the consumer, a vendor management company may be required to create a separate line item on the HUD-1 to charge for its services. As HUD is essentially silent in the rule with regard to this issue, we expect this will be a provision that makes vendor management companies and other settlement service providers very nervous.

### **III. Closing Script**

The rule also proposes to create a new addendum to the HUD-1, or a closing script, which the settlement agent is tasked with preparing, reading aloud to the consumer at closing, and providing in hard-copy format to obtain the consumer's written acknowledgment.<sup>25</sup> Essentially, the rule would require the settlement agent, through the closing script, to explain specific loan terms as stated in the mortgage note, such as interest rate, monthly payment amount, and the presence of a prepayment penalty and balloon payment, to name a few. The settlement agent also must compare the loan's terms and settlement charges to those estimated on the GFE and indicate whether certain settlement charges exceed the 10% tolerance. The Appendix to RESPA's regulations would contain the closing script form, as well as detailed instructions and examples a settlement agent would use to complete the document.<sup>26</sup>

The proposed closing script raises a host of issues the title insurance and settlement industries are likely to target in responding to HUD's rule. First, as the rule

would require settlement agents to determine whether the settlement charges reflected on the GFE and the final HUD-1 exceed the 10% tolerance and report this fact to the consumer, how should a settlement agent proceed if the lender violates the tolerance requirement? Should a settlement agent close the loan when it knows the loan is in violation of Section 5 of RESPA? Moreover, is a settlement agent really supposed to stop a \$500,000 sale when the 10% tolerance is exceeded by a mere \$15 overage? Why is the settlement agent even saddled with the responsibility for a lender or broker's charges? These are all questions that remain unanswered by the proposed rule.

Second, one must question whether the preparation and reading of the closing script is a role that the settlement agent should be performing, especially when the closer is supposed to be a neutral party to the transaction. If the proposed rule is meant to reduce settlement costs to consumers, the requirement that a settlement agent spend more man hours preparing the document and reading it aloud to consumers will hardly result in cost savings. In fact, HUD acknowledges in the appendix to the rule that the addition of the closing script to the settlement process will increase the time it takes to conduct a real estate closing by approximately 45 minutes and increase the cost of a settlement by, at least, \$36.<sup>27</sup> Title and settlement agents also will be required to update software and train employees, which only adds to the extra expense. The Department, therefore, should not be surprised to hear from the title and settlement agent industry that the proposed closing script responsibilities will likely yield higher settlement and closing fees in the end.

Finally, the proposed rule would require settlement agents to compare the mortgage and note documents to the loan terms identified on the GFE and explain any inconsistencies between the documents should they arise. In many states, however, judicial statutes and state bars require licensed attorneys to answer specific borrower questions and explain the details of a real estate transaction (a non-lawyer may be allowed to oversee the signing of the documents only). In these circumstances, questions may arise as to whether a non-lawyer settlement agent may legally explain loan terms to a borrower without participating in the unauthorized practice of law. We expect that both title agents and closing attorneys will emphasize this potential legal problem to HUD.

#### IV. Average Cost Pricing

In addition to proposing modifications to actual disclosure forms required under RESPA, HUD's proposed rule targets other aspects of the Act to provide clarity and decrease settlement costs for consumers. One such modification would allow lenders and mortgage brokers to use average cost pricing for settlement services, rather than charge the consumer the exact cost in every circumstance.<sup>28</sup> HUD would allow a lender to determine the average cost by using the actual average cost of a settlement service over the previous six-month period or a tiered pricing approach. If a lender or broker uses one of these methods, HUD will deem the lender to have complied with the requirements of the rule for stating the actual charge.<sup>29</sup>

Considering each of the changes HUD proposes in the rule, we believe average cost pricing may be one of the more beneficial proposals, although it ultimately appears to be inartfully drafted. Notably, the rule refers to the determination of the average cost based on activities of the "loan originator."<sup>30</sup> By using this specific term, one has to question whether only lenders and mortgage brokers may use an average cost for the settlement services they control. HUD seems to ignore the fact that a residential mortgage transaction involves more than the lender and the borrower; other settlement service providers, such as title insurance agents and closing companies, are necessary parties to the transaction. The Department, however, seems to leave other providers out of the equation, which is something HUD should be forced to clarify.

Otherwise, the allowance of average cost pricing appears to be a positive change in the rule, particularly for those fees that are difficult to determine at closing. Using recording fees as an example, while consumers may get the benefit of uncertainty in some cases and pay less than the actual recording fees, in other cases consumers pay more than the actual fees, which has led to class action litigation. The use of average cost pricing, however, should go a long way in alleviating the class action litigation risk that often arises with settlement service fee overcharges.

#### V. Negotiated Discounts

Section 8 of RESPA prohibits any person from giving or receiving a thing of value in return for the referral of business. As currently defined, "thing of value"

includes discounts, and Section 8 prohibits the giving or receiving of discounts in exchange for the referral of settlement service business. The rule, however, proposes to amend the definition to exclude discounts negotiated by settlement service providers in the price of a third party settlement service, as long as no more than the discounted price is charged to the borrower and disclosed on the HUD-1.<sup>31</sup>

Once again, this portion of the proposed rule appears to be inartfully drafted. Although RESPA has always allowed settlement service providers to offer discounts directly to consumers in connection with the consumer's own transaction, HUD seems to be clarifying that settlement service providers may negotiate volume discounts themselves and pass through the savings to the customer without violating RESPA. The language of the proposed rule, however, does not actually have this broad application. Notably, the rule refers only to discounts negotiated and passed through to borrowers. Does this mean that sellers are not able to take advantage of negotiated discounts, particularly when sellers often pay the majority of a borrower's closing costs? Similarly, if a lender negotiates a discount on a service for which the consumer does not pay (i.e., the lender pays the cost of an appraisal in a no-cost loan), must the lender pay full price for the service? The language of the rule seems to suggest that if the negotiated fee is not passed through to the consumer (regardless of whether the seller or the lender pays for the service), the discount is not excluded from the definition of thing of value. If the discount is not excluded, these arrangements could continue to raise concerns under Section 8 of RESPA.

In addition, the language of the amended definition excludes discounts negotiated by "settlement service providers." While the services of lenders, real estate brokers, and title insurance companies fall squarely within the definition of "settlement services," it is unclear under the current statute and regulations whether the sale of a home constitutes settlement services under RESPA, and, thus, whether home builders are settlement service providers under the Act. Accordingly, if a home builder is not considered a "settlement service provider," does HUD intend to exclude builders from the group of providers who may negotiate discounts on behalf of their customers? The language of the proposed rule sure seems to suggest so, but this is yet another question HUD will have to

clarify in order to make negotiated discounts a useful change to RESPA's regulations.

## VI. Required Use

Currently, RESPA's regulations prohibit the required use of a particular settlement service provider; however, discounts, rebates, or customer incentives do not constitute required use, as long as the rebate or incentive is a true discount that is not made up elsewhere in the transaction. HUD's rule proposes to modify this definition of "required use" to include both economic incentives and disincentives that are contingent on a borrower's use or failure to use a particular provider of settlement services. If, however, a settlement service provider offers an optional combination of services at a lower price, these discounted services would not constitute required use.<sup>32</sup> This modification appears to be a direct result of complaints the Department has received concerning home builders' offers of large discounts to their customers who agree to use the builders' affiliated mortgage or title insurance companies.<sup>33</sup>

Like the new language proposed for average cost pricing and negotiated discounts, the Department's changes to the definition of "required use" appear to be poorly drafted. Specifically, the proposed definition allows for a discounted combination of bona fide settlement services only to a borrower. As noted above, however, sellers typically pay the majority of settlement costs in a real estate transaction, including the cost of lender's title insurance and real estate commissions. By limiting the offer of discounted services only to borrowers, are sellers prohibited from receiving discounts and incentives under the new rule? Similarly, the "required use" definition is written to refer to the offering of an incentive by a "settlement service provider." As an argument can be made under current RESPA regulations that a home builder is not a settlement service provider, did HUD intend to preclude home builders from offering bona fide discounts when it used the term "settlement service provider"? Given that HUD focuses on builder practices in the preamble to the rule, perhaps this is the case.

Furthermore, the rule calls into question whether settlement service providers may continue to offer discounts on their own services. As the rule would allow a settlement service provider to offer "an optional combination of bona fide settlement services to a borrower at a total price lower than the sum of

the prices of the individual settlement services,” this language seems to suggest that a provider may only discount a combination of services offered by its affiliate companies. This, however, is not how customer incentives are typically structured (*i.e.*, a builder offers a discount on the price of a home), and HUD appears to ignore the fact that the incentives are, indeed, optional. We, therefore, expect that settlement service providers – particularly those that own interests in affiliated business arrangements – will demand that HUD clarify these apparent ambiguities or perhaps ask the Department to reconsider the proposed approach to required use under RESPA.

## VII. Other Amendments

In addition to the extensive modifications discussed above, the rule proposes to update mortgage servicing disclosure requirements and remove expired provisions of the escrow regulations.<sup>34</sup>

- With regard to mortgage servicing disclosures, HUD revises certain language to make reference to HUD’s newly proposed GFE application and eliminates the requirement that applicants acknowledge the disclosure.
- With regard to escrow requirements, the rule would require all escrow limits to be determined using the aggregate accounting method and prohibit the practice of pre-accrual.

The rule also would amend RESPA’s regulations to recognize the applicability of ESIGN, which would allow disclosures to be provided to consumers in electronic form.<sup>35</sup> Consumers would be required to consent to the electronic receipt of documents, and a lender must ensure it meets all other ESIGN requirements.

## VIII. Conclusion

Despite HUD’s stated purposes for the proposed RESPA rule, the Department has delivered a confusing and complicated rule that could have the effect of overhauling the delivery of settlement services. Rather than create simple consumer disclosures, HUD has proposed a four-page GFE, which requires substantially more information and may actually make it harder to compare prices. Moreover, rather than propose changes to lower consumer prices and promote comparison shopping, the rule may actually discourage

shopping, as consumers may be unwilling to incur the cost of obtaining multiple GFEs or take the risk that settlement charges could increase without limit if the consumer shops for service providers.

The rule also will prove to be controversial, and every corner of the settlement service industries likely will raise an objection to some piece of HUD’s proposals. For instance, mortgage lenders may take issue with the 10% tolerance imposed on third party fees the lenders are unable to control. Mortgage brokers are likely to argue against the disclosure of the yield spread premium as a dollar-for-dollar reduction, and the title industry will not be happy about the responsibilities and ambiguities surrounding the closing script. Home builders are likely to feel like a direct target in HUD’s rule, and we estimate that affiliated business arrangements will take strong objection to the proposed revisions to “required use.” Settlement service providers may find themselves expressing the same fears that came with the Department’s 2004 attempt at RESPA reform, and HUD is likely to find itself in a familiar position – back at the drawing board.

Finally, the timing of the Department’s proposed rule is curious. With the market in the midst of a credit crunch, one must question why HUD would overhaul consumer disclosures that will require settlement service providers to expend considerable time and money to update necessary systems and train employees. The rule also may have little shot at becoming reality. The last time HUD attempted to reform RESPA, it received over 46,000 public comments. We expect HUD will receive a similarly staggering number of comments to this proposed rule, which will take the Department months to read and categorize. By that time, a new President will be elected, and a new Administration will take over at HUD, which could result in wholesale changes to the proposed version of the rule or complete abandonment. Well, buckle your seatbelts. It’s RESPA reform time, and that means *déjà vu* all over again.

If you have any questions about the proposed changes discussed herein or would like a more detailed explanation of the modified rules, please contact Phillip L. Schulman (202) 778-9027 / [phil.schulman@klgates.com](mailto:phil.schulman@klgates.com) or Holly M. Spencer (202) 778-9853 / [holly.spencer@klgates.com](mailto:holly.spencer@klgates.com).

## Endnotes

- <sup>1</sup> GFE application is defined as the receipt, whether by written or oral communication, of borrower information necessary to arrive at a preliminary credit decision, including social security number, property address, monthly income, borrower's estimate of sales price, and amount of mortgage loan sought. 73 Fed. Reg. 14030, 14056 (Mar. 14, 2008).
- <sup>2</sup> See 73 Fed. Reg. at 14057, 14093-14094.
- <sup>3</sup> The GFE would require the lender or broker to total the estimated settlement charges and include them in a summary section prominently displayed on the first page of the GFE. See *id.* at 14093.
- <sup>4</sup> See *id.* at 14057.
- <sup>5</sup> See *id.* at 14094.
- <sup>6</sup> See *id.*
- <sup>7</sup> "Unforeseeable circumstances" are defined as (1) acts of God, war, disaster, or other type of emergency that makes it impossible or impracticable for the originator to perform; or (2) circumstances that could not be reasonably foreseen at the time of the GFE application, that are particular to the transaction and that result in increased costs, such as a change in the property purchase price, boundary disputes, or environmental problems that were not described to the loan originator in the GFE application, the need for a second appraisal, and flood insurance. If any of these unforeseeable circumstances occur, the lender or broker would not be held to the tolerance limitations imposed for settlement charges reflected on the GFE. The lender or broker must document these unforeseeable circumstances to be deemed in compliance with RESPA. *Id.* at 14056.
- <sup>8</sup> 73 Fed. Reg. at 14057.
- <sup>9</sup> See *id.* at 14041-14043, 14093. A "credit or charge for the specific interest rate chosen" is defined as the difference between the initial loan amount and the payment to the mortgage broker (*i.e.*, the sum of the price paid for the loan by the lender and any other payments to the mortgage broker from the lender). When the amount paid to the mortgage broker exceeds the initial loan amount, there is a credit to the borrower and it is entered as a negative amount on the GFE. When the initial loan amount exceeds the amount paid to the mortgage broker, there is a charge to the borrower and it is entered as a positive amount on the GFE. *Id.* at 14056.
- <sup>10</sup> See *id.* at 14093.
- <sup>11</sup> See *id.* at 14057.
- <sup>12</sup> See *id.* at 14055.
- <sup>13</sup> See *id.* at 14048-14049.
- <sup>14</sup> 73 Fed. Reg. at 14047, 14098.
- <sup>15</sup> See *id.* at 14033.
- <sup>16</sup> While a \$20-\$50 recovery may be minimal, we note that this amount multiplied by a large number of borrowers could invite class action plaintiffs to consider state UDAP claims, particularly where those statutes provide double or triple damages and attorney's fees. Moreover, HUD is soliciting comments on whether to add a provision that would allow mortgage lenders and brokers, for a limited time after closing, to address the failure to comply with the tolerances. For example, HUD is considering providing that if, within 14 business days after closing, a lender or broker identifies a charge that exceeded the tolerance and repays the excess amount of the charge to the consumer, the lender or broker would be in compliance with Section 5. See *id.* at 14041.
- <sup>17</sup> See *id.* at 14058.
- <sup>18</sup> See *id.* at 14063.
- <sup>19</sup> See *id.* at 14060.
- <sup>20</sup> 73 Fed. Reg. at 14060.
- <sup>21</sup> *Id.*
- <sup>22</sup> See *id.* at 14063.
- <sup>23</sup> See *id.* at 14109.
- <sup>24</sup> See *id.* at 14058.
- <sup>25</sup> See *id.*
- <sup>26</sup> See 73 Fed. Reg. at 14066-14092.
- <sup>27</sup> See *id.* at 14124.
- <sup>28</sup> See *id.* at 14058.
- <sup>29</sup> If a lender charges the average cost for settlement services, the rule would require the lender to document its determination of the average cost and maintain this documentation for three years. See *id.*
- <sup>30</sup> See *id.*
- <sup>31</sup> See *id.* at 14059.
- <sup>32</sup> HUD proposes to define "required use" to mean "a situation in which a borrower's access to some distinct service, property, discount, rebate, or other economic incentive, or the borrower's ability to avoid an economic disincentive or penalty, is contingent upon the borrower using or failing to use a referred provider of settlement services. However, the offering by a settlement service provider of an optional combination of bona fide settlement services to a borrower at a total price lower than the sum of the prices of the individual settlement services does not constitute required use." 73 Fed. Reg. at 14056 (emphasis added).
- <sup>33</sup> See *id.* at 14053.
- <sup>34</sup> See *id.* at 14059.
- <sup>35</sup> See *id.* at 14059-14060.

K&L Gates' Mortgage Banking & Consumer Finance practice provides a comprehensive range of transactional, regulatory compliance, enforcement and litigation services to the lending and settlement service industry. Our focus includes first- and subordinate-lien, open- and closed-end residential mortgage loans, as well as multi-family and commercial mortgage loans. We also advise clients on direct and indirect automobile, and manufactured housing finance relationships. In addition, we handle unsecured consumer and commercial lending. In all areas, our practice includes traditional and e-commerce applications of current law governing the fields of mortgage banking and consumer finance.

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