

Mortgage Banking Commentary

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HUD'S PROPOSED RESPA REFORM PACKAGE: Is the "Solution" Worse Than the Problem?

The Department of Housing and Urban Development ("HUD") has issued a long-awaited Proposal to amend its regulations implementing the Real Estate Settlement Procedures Act of 1974 ("RESPA") (12 U.S.C. §§ 2601–2617). HUD published its proposal (the "Proposal" or the "Rule") in the *Federal Register* on July 29, 2002 for a 90-day public comment period. The Proposal contains three major provisions: (1) enhanced disclosure of mortgage broker/loan originator compensation; (2) revisions to the Good Faith Estimate ("GFE") disclosure; and (3) the availability of guaranteed mortgage packages ("GMPs"), including guaranteed settlement costs and interest rate, with a "safe harbor" that exempts such packages from the referral fee and fee-splitting prohibitions under Section 8 (12 U.S.C. § 2607) of RESPA.

I. OVERVIEW

In a supreme bit of irony, HUD laments that "the process of financing or refinancing a home, which is regulated under RESPA . . . remains too complicated, too costly, and too opaque for many borrowers." HUD itself, however, has engaged in a multi-year effort to require lenders to dissect settlement fee disclosures into ever smaller and more complicated increments, which, many would argue, may be the cause of the current confusion. Building upon the layers of additional disclosures required by HUD in its 1992 revisions to the RESPA regulation (also known as "Regulation X"), HUD's current Proposal would transfer these complications, costs, and opacities to the settlement service industry.

A number of stated and unstated principles underlie HUD's proposed revisions, as follows:

- Borrowers do not fully understand the role of mortgage brokers and the extent to which borrowers may influence the terms of their loans and the method and amount of total compensation paid to brokers directly and indirectly.
- Compensation paid by lenders to mortgage brokers in the form of points should bear a direct, one-to-one relationship with a reduction in the compensation that the borrower otherwise would pay a mortgage broker directly, notwithstanding any services or facilities performed or provided by the mortgage broker for the benefit of the lender.
- Much like broker-dealers facilitating the purchase and sale of stocks, the Proposal assumes that mortgage brokers should be able to fix their compensation up front, even though the price of the related mortgage loan may vary as a result of market conditions.
- The GFE has failed to serve as the shopping tool that Congress intended when it enacted RESPA in 1974, because the form is given too late to facilitate comparison shopping and the information disclosed on the form may be wholly unreliable.

- If lenders were subject to penalties for under-disclosing settlement costs on the GFE, they would be more likely to provide precise, accurate disclosures at the time of loan application.
- The mortgage lending process has changed dramatically since the enactment of RESPA 28 years ago, and the law’s prohibitions may unintentionally stifle innovation that otherwise could reduce the total cost of mortgage credit to consumers. Given RESPA’s policy objective to eliminate practices that tend unnecessarily to increase closing costs, the law actually may contribute to the problem that Congress intended to eliminate.

Nearly all of these points can be found in the Joint Report to the Congress Concerning Reform of the Truth in Lending Act and the Real Estate Settlement Procedures Act that HUD and the Board of Governors of the Federal Reserve System issued in July 1998 (“Joint Report”). Indeed, it appears that the Proposal seeks to codify those four-year-old recommendations of the Clinton Administration.

The Joint Report at least recognized that Congress must amend RESPA in order to effect several of the suggested changes. Surely HUD must know that it needs statutory authority to implement many of the suggested changes, such as the requirements described below to refund all moneys paid by a borrower if the understatement in the GFE exceeds an artificial tolerance or to require mortgage brokers to fix their compensation at the time of loan origination. The obvious question, accordingly, is what is the real motivation here? Is it a sincere, laudable attempt to reform perceived abuses? Is HUD trying to “make nice” to all sides without any real expectation of change? Is it a “stalking-horse” for a recommendation to Congress to take up substantive RESPA reform? Or is it merely a “placeholder” for future HUD initiatives?

One clear conclusion emerges from even a cursory review of the extraordinarily complex Proposal, however. Namely, the Proposal pits providers of settlement services against one another in a way that parallels a fight scene from the movie *Gladiator*: mortgage brokers versus mortgage lenders; large settlement service providers versus small ones; lender packagers versus non-lender vendor management companies; and mortgage lenders and mortgage brokers versus consumers. Only time will tell who will be left standing should HUD issue a final rule; the smart money’s on the lions. In any event, unless HUD breaks up a final regulation into smaller, bite-size pieces on which some consensus is possible, don’t expect a final rule anytime soon.

We detail the proposed changes below.

II. ELEMENTS OF THE PROPOSAL

A. Disclosure of Mortgage Broker Compensation

HUD proposes several changes to the RESPA regulations related to disclosures of mortgage broker or loan originator compensation. RESPA’s primary disclosure requirements are the GFE and the HUD-1/1A Settlement Statement. The GFE requirement arises in Section 5 of RESPA, which requires each lender to provide to a prospective borrower “the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary.” The GFE must be provided within three business days of an application. The HUD-1/1A requirement arises in Section 4 of RESPA, which requires the person conducting the settlement to provide the borrower, at or before settlement, a standard HUD-developed form that itemizes all settlement costs imposed upon the borrower.

HUD’s Proposal would:

- Require that yield spread premiums and other payments from a lender to a mortgage broker, other than for the par value of the loan, be reported on the GFE and the HUD-1 and credited against other origination costs as a lender payment *to the borrower*. For brokered loans, the Rule would also require that any

borrower payments to reduce the interest rate (“discount points”) equal the discount in the price of the loan and be reported on the GFE and HUD-1 as borrower payments to the lender. HUD believes these revisions would illuminate mortgage broker compensation where it might otherwise appear hidden from the borrower—in yield spread premiums on above par loans, and in the retention of borrower-paid discount points that do not serve to reduce the interest rate.

- Revise the GFE to require mortgage brokers and other loan originators to describe their services, and to inform the borrower that the originator does not shop for or offer loans from all mortgage funding sources and cannot guarantee the lowest price or best terms available in the market.
- Revise the GFE to explain the “trade-off” that often occurs between loan originator compensation in the form of the interest rate and up-front closing costs. HUD explains that the GFE will inform borrowers of their choice to pay settlement costs: (a) through cash at settlement, (b) by borrowing additional funds, (c) through a higher interest rate and monthly payment, or (d) through a lower interest rate and monthly payment by paying discount points.
- Revise the GFE to disclose both direct and indirect mortgage broker and lender origination compensation both as a total consolidated figure and itemized as to the lender and the broker, respectively.

Most would agree that there is a benefit to providing the consumer with additional information about the mortgage origination process and methods for compensation. At the same time, it is questionable whether consumers will benefit from an increase in the number, scope, and complexity of disclosures. In addition, in an attempt to clarify the process, HUD is requiring disclosures that may not be true as a matter of fact and are not required as a matter of law.

In a well-intentioned effort to clarify the purpose of lender payments to brokers, HUD’s requirement to characterize all “back-end” broker compensation as a credit to a borrower only obfuscates the issue.¹ HUD states in the preamble to the Proposal that:

These changes will ensure that borrowers receive the *full benefit* of any payments from or to lenders in brokered transactions, either by reducing their up-front settlement costs in exchange for accepting a loan with a higher rate, or by reducing their interest rate and monthly payments by paying additional amounts to the lender at settlement. (emphasis added)

While the industry long and correctly has argued that yield spread premiums may benefit borrowers, there is no legal requirement that such payments *solely* benefit borrowers. RESPA permits the payment of reasonable compensation for services actually performed and facilities actually provided; the statute contemplates that the beneficiary of such effort may be the borrower *or* the lender. By requiring the crediting of such payments to borrowers in all cases, the Proposal fails to account for the legitimate, independent basis for a lender to pay a broker for compensable services and facilities benefiting the lender.

HUD does not appear to have the statutory authority under RESPA to require mortgage brokers to fix or cap their fees at all, much less at the GFE stage (within three days of loan application). This is a perfect example of HUD’s desire to build certainty into the process to enable consumers to engage in meaningful comparison shopping. The flaw in this thinking is that RESPA does not require any settlement service provider to fix its

¹ HUD refers to this form of compensation in a variety of ways throughout its Proposal, most often calling it a “lender payment to the borrower for a higher interest rate.” However, Appendix C of the Proposal indicates that HUD intends to credit the borrower with “any other lender payments for the transaction.” These differing references make the scope of the Proposal unclear.

costs up front. Generally, as a matter of contract, borrowers can control this process by electing to lock in their interest rate and total points. The broker's total compensation may vary after a lock in, but the amount paid by the borrower usually does not. An alternative approach, more consistent with the provisions of RESPA and basic notions of capitalism, is to promote comparison shopping by highlighting in the disclosures whether a mortgage broker has elected to cap its total fees up front.

B. GFE Revisions

The Rule would also make several other revisions to the GFE. Specifically, the Rule would:

- Establish standards for the accuracy and reliability of the information in the GFE, by:
 - (a) Prohibiting loan originators from exceeding the charges stated on the GFE for their own services, lender-required and lender-selected third-party services, and government charges, absent “unforeseeable and extraordinary circumstances” beyond the originator’s control. HUD suggests that these circumstances could include “acts of God, war, disaster, or any other emergency, making it impossible or impractical to perform,” but states that HUD may further define the circumstances in the final rule. The loan originator must document these circumstances. The estimate must be valid for at least 30 days. After the 30 days have passed, the borrower may request the originator to provide a new GFE or ratify the previous one. If the charges at settlement exceed the amounts on the GFE, absent unforeseeable and extraordinary circumstances, the borrower would be permitted to withdraw his or her application and receive a refund of all loan-related fees.
 - (b) Establishing a tolerance range of 10% for certain settlement charge categories, again absent “unforeseeable and extraordinary circumstances.” Those categories include “shoppable” lender-required third-party services, borrower-selected title services and insurance if the borrower selects the provider identified by the loan originator, and reserves/escrow deposits. The tolerance applies to third-party services from providers that the loan originator suggested to the borrower, but not those the borrower selected independently of the originator’s recommendations. Variations in costs for per diem interest, hazard insurance, and optional owner’s title insurance are not subject to any express restrictions or a range of tolerance. Other third-party services from providers the borrower selected are also free of any express restrictions or tolerances. However, as described above, fees for lender-selected title services and insurance must not vary at all from those described on the GFE. The 10% tolerance would apply to the subtotals of settlement costs for shoppable lender-required settlement services, borrower-selected title services and insurance, and reserves/escrow, but not to each individual or separate charge.
 - (c) Imposing a GFE redisclosure requirement when there is a change in circumstances. If the loan originator determines after full underwriting that the borrower does not qualify for the loan product identified in the initial GFE, the loan originator must inform the borrower that the originator does not offer products meeting such circumstances. Alternatively, if the loan originator does offer other products meeting the borrower’s circumstances, the originator must advise the borrower of that fact, and that the borrower may request a new GFE. If the borrower qualifies for the loan product, but elects not to lock in the interest rate and any interest rate- dependent payment quoted on the initial GFE, the loan originator must provide the borrower with an amended GFE if either the rate or payment has changed from that quoted in the initial GFE. The Rule would prohibit an amended GFE from including increased costs for items that are not dependent upon the interest rate.
- Revise the GFE to include the interest rate, annual percentage rate (“APR”), and the loan amount; any mortgage insurance premium included in the APR; information on adjustments to interest rates in adjustable rate mortgages, applicable prepayment penalties, and balloon payments; and a disclaimer that unless the borrower locks in the interest rate, the interest rate may change. HUD states that this information will promote consumer shopping.

- Revise the GFE to disclose subtotals of major categories of settlement costs. The major cost categories would be: (a) lender-required and -selected third-party services; (b) title charges and title insurance premiums; (c) “shoppable” lender-required third-party services; (d) state and local government charges; (e) reserves/escrow; (f) hazard insurance; (g) per diem interest; and (h) optional owner’s title insurance. The GFE would also include the total amount of all settlement charges. HUD intends that such consolidation will eliminate the proliferation of services and the “artificial separation and inflation” of charges for such services, which HUD asserts the current GFE format fosters.
- Revise the GFE to identify separate services that are required or selected by the lender and other third-party services that are required but for which borrowers can shop among providers on their own. The proposed GFE will also include a breakdown of origination charges to the lender and the broker, as mentioned above, and a breakdown of title insurance and title agent compensation.
- Revise the definition of “application” in an effort to ensure that the borrower gets his or her GFE upon providing basic credit information and a property address, but before the payment of any significant fee. Under HUD’s Proposal, an “application” would be deemed to exist when a prospective borrower provides a loan originator sufficient information, whether orally, in writing, or via computer, to enable the loan originator to make a preliminary credit decision (i.e., a social security number, property address, basic employment information, house price or best estimate of property value, and mortgage loan needed). The GFE would, however, be subject to final credit approval, underwriting, and an appraisal.
- Limit fees paid by the borrower for the GFE, if any, to the amount necessary for the originator to provide the GFE itself. Fees paid for the GFE could not include amounts for appraisal and underwriting (the GFE would be subject to an appraisal and underwriting).

1. Impact of Revised Disclosures

Providing subtotals of major categories of settlement costs on the GFE may indeed provide consumers with useful information to allow them to compare different bundles of mortgages and services effectively, and to help them identify unnecessary “junk” fees. Instilling some discipline into the good faith estimate process is also a worthy endeavor. However, these GFE proposals appear to impose substantial compliance costs upon lenders, which may ultimately mean higher prices for consumers. Any major change in required disclosures creates a myriad of compliance hurdles (including systems changes and staff retraining). Lenders in wholesale transactions are likely to discontinue their practice of relying on the GFE provided by the loan originator. This Proposal also makes the GFE disclosure increasingly duplicative when compared with the Truth in Lending disclosure, which is a result that Congress directed HUD and the Federal Reserve Board to address in the Joint Report.

2. Tolerance Restriction and “Unforeseeable and Extraordinary Circumstances” Exception

Forcing lenders to estimate settlement charges within a 10% tolerance range may present a sizable burden, particularly considering that there are certain charges over which lenders have no control (e.g., third parties may raise their prices unexpectedly; or the transaction may require two couriers, rather than one, thereby doubling the cost and perhaps violating the tolerance range). While the Proposal would allow for “unforeseeable and extraordinary circumstances,” the Proposal does not provide much guidance or certainty as to what such circumstances would include. Does it include, for example, changes resulting from misinformation provided by or on behalf of borrowers at the application stage? With this Proposal, HUD essentially has redefined the concept of a “good faith estimate” into a “force majeure” clause—in other words, an estimate is actually a guarantee, where performance is excused only in the narrowly enumerated extraordinary circumstances. Such a narrow definition is a bit cute even by Washington standards of word play. The Proposal may simply have the effect of forcing lenders, particularly smaller lenders or others for which it is difficult to nail down fees

and charges precisely, to provide somewhat higher estimates in order to avoid the substantial risks of underestimating (which would include the possibility of having to refund charges to the borrower for which the lender has already paid, or being forced to absorb any third-party price increases over the tolerance level).

3. Redisclosure Requirement

The preamble of the Proposal describes a requirement for a lender to offer a borrower who does not qualify for a particular product originally offered (and that product's corresponding estimates of charges) another 30-day set of estimates with regard to another loan product, unless the lender does not offer any other products that would meet the borrower's needs or credit status. This Proposal raises compliance questions regarding a lender's inadvertent failure to offer a borrower another product. Furthermore, the Proposal's redisclosure requirement upon changed circumstances would prohibit an amended GFE from including increased costs for items that are not dependent upon the interest rate. Different loan products may, however, have different costs that are unassociated with the interest rate (e.g., different products may require different types of appraisals or different numbers or types of credit reports). Even though the lender would be providing a new, comprehensive 30-day GFE, it appears that the Proposal would prohibit the lender from reflecting such changed costs in the new GFE.

4. Title Insurance and Title Agent Compensation

As mentioned above, the proposed GFE would include a breakdown of title insurance and title agent compensation. The preamble to the Proposal explains that the GFE will:

[B]reak[] out title agent services and title insurance into separate subtotals for the actual title insurance versus compensation to the title agent. Title agents routinely receive direct payments from borrowers for their services as well as commissions from the insurance premium for the sale of insurance. The title agent subtotal will add up these costs so that the borrower can compare, and possibly negotiate, these charges.

This language indicates that, aside from an itemization of title premiums and title services, the new GFE could actually require the disclosure of the portion of the title insurance premium retained by the title agent and the portion rendered to the title insurance underwriter. This is an unprecedented disclosure that would have little benefit to the borrower. Title insurance premiums are fixed under many state laws, and due to state anti-rebating and anti-discrimination prohibitions, the borrower would generally not be able to negotiate any kind of rebate or discount of the premium. Since disclosing the premium split between title agents and underwriters would not facilitate consumer shopping and competition among providers, that proposed itemization appears to be of questionable value.

5. GFE Fee

With regard to the Proposal's restriction on a GFE fee (requiring that a lender may only charge the borrower an amount necessary to provide the GFE itself), interestingly many lenders thought that Section 12 of RESPA presently prohibits the imposition of a fee for the preparation of the GFE. A scramble to the law books after the Proposal's publication revealed that Section 12 applies only to the HUD-1 and not to the GFE. An unintended consequence of this provision might be a newfound willingness by lenders to impose a GFE preparation fee on borrowers. This restriction also raises the question of whether it would prohibit lenders from charging the borrower a credit report fee at this stage; the lender may have incurred such a fee, since the lender may typically rely upon the receipt and review of a credit report and/or FICO score in order to estimate/guarantee certain charges on the GFE.

6. Definition of “Application”

While the preamble of the Proposal seems to suggest that the revision of the definition of “application” is intended to accelerate the provision of the GFE disclosure, the impact of the proposed change appears minimal. The Proposal’s definition of “application,” and consequently the requirement for the GFE, would be triggered by the submission of enumerated pieces of “credit” information, rather than simply by the submission of “financial” information, without enumeration, as in current regulations. The increased specificity of the proposed definition arguably makes it narrower than the current definition, which may then have the opposite effect from what HUD intended. It also appears that the Proposal’s attempt to encompass “oral” applications may have little impact. The receipt of oral information by a lender from a prospective borrower is likely to occur only in a prequalification process, prior to the triggering of any disclosure or notification requirements. Once the lender and the borrower are prepared to move beyond the prequalification stage, the lender is likely to capture the borrower’s information in a written (either hard copy or in electronic format) application. While it appears that HUD is seeking to accelerate the GFE requirement by revising the definition of “application,” it is unclear whether this proposed revision would have the intended effect.

7. Exceeding HUD’s Statutory Authority

Finally, while HUD seeks to make the GFE more concrete, this Proposal raises important concerns regarding whether HUD is acting outside its statutory authority. RESPA requires lenders to provide an *estimate*, in good faith, of the amount or range of charges for services the borrower is likely to incur, and does not expressly authorize HUD to require lenders to guarantee its cost figures at such an early point in the process, much less those charges of third parties that a lender recommends.

In addition, while RESPA provides penalties for certain violations, it does not expressly authorize HUD to create new remedies such as forcing the lender to refund all loan-related fees, out of pocket, if the costs at settlement exceed the amount reported on the GFE. In fact, there is no private right of action under RESPA for violations of Section 5 (which includes the GFE requirement). If a lender were to refuse to refund loan-related fees in violation of the Proposal, there would be no remedy under RESPA.

HUD is aware of this paradox, referring to the refund requirement in the preamble as a consequence of its “zero tolerance policy.” The zero here, however, may well be HUD’s legal authority to implement this particular proposal.” Due to the controversial nature of this Proposal, and recognizing that courts have (especially recently) been willing to rein HUD in when it acts beyond the confines of the statute, these questions about the scope of HUD’s authority could invoke court actions by disgruntled parties attempting to enjoin any final rule.

C. Mortgage Packaging Exception

The Rule would also establish a “safe harbor” from certain RESPA violations for entities that offer “Guaranteed Mortgage Package” transactions. A Guaranteed Mortgage Package (“GMP”) is a contract that contains a guaranteed lump-sum price for virtually all lender- and government-required settlement services, with certain exceptions, including a mortgage loan at a guaranteed interest rate, subject to change under certain circumstances. The “packager” may be a lender or another type of entity so long as the package includes a mortgage loan. The offer must remain open to the borrower for at least 30 days at no cost to the borrower. The packager may charge the borrower a “minimal engagement fee” upon acceptance. Packaging would not be available for loans subject to the Home Ownership Equity Protection Act (“HOEPA”) and may not be available for other types of loans as designated by HUD through this rulemaking.

Upon the borrower’s acceptance of the package, the packager, the lender (if other than the packager), and the borrower must sign the GMP agreement, which would replace the GFE in packaged transactions. The package would be subject to appraisal and underwriting, but otherwise the packager is held to the guaranteed

prices until settlement. The GMP agreement is intended to be a “binding contractual agreement.” HUD states that “borrowers, individually or, where appropriate, as a class, may sue for specific performance or for damages pursuant to applicable State contract law provisions in the event a packager breaches [the] contract.”

A GMP must include and guarantee the costs for, the following settlement services: application, origination, underwriting, appraisal, pest inspection, flood and tax review, title services and insurance, and any other lender-required services, government charges, and up-front costs of mortgage insurance (based upon the borrower’s estimate of property value and the loan amount). The GMP agreement must, however, inform the borrower that the up-front mortgage insurance premium, if any, may decrease or become unnecessary depending on the final appraised value of the property. The reserves/escrow would be subject to a 10% tolerance. In HUD’s Proposal, the only costs that would be excluded from the GMP and not subject to any tolerance would be those that fluctuate depending upon the borrower’s choice, including hazard insurance, per diem interest, optional owner’s title insurance, and other optional settlement services; the agreement must identify and provide estimates for these costs.

HUD is proposing that the package agreement would not have to itemize the specific services to be provided. However, the agreement must identify whether the pest inspection, appraisal, lender’s title insurance, or credit report are anticipated to be included in the guaranteed package. It appears that any required settlement cost not specifically identified on the agreement as being outside the guaranteed package would, under HUD’s proposal, be deemed to be included within the guaranteed price quotation and would thus become the responsibility of the packager. The HUD-1 would list the services ultimately provided, but not the specific charges for those services; an addendum to the settlement statement must nonetheless list the finance charges needed to calculate the APR.

As described above, the package must also include an interest rate that is guaranteed through settlement if the borrower agrees and locks in the rate by a specified deadline. If the borrower does not lock in by that deadline, the agreement must nonetheless provide that the quoted interest rate will not change except in relation to changes in a specified index or “other such appropriate data or means as HUD may determine.” The agreement must also explain to the borrower the option of paying all or part of the stated settlement costs through a higher interest rate and of lowering the stated interest rate by paying discount points at settlement, if the packager offers such options.

HUD recited several obstacles entities currently face to providing a GMP, such as the concern that the compensation arrangements among settlement service providers that would be required in order to offer such a package could constitute unlawful referral fees under Section 8 of RESPA. Another obstacle would be RESPA’s general prohibition against requiring the use of an affiliated settlement service provider. HUD explains that due to these uncertainties about RESPA’s applicability to such arrangements, lenders and others have not generally been willing to offer such packages. The Rule seeks to create an exemption, or “safe harbor,” from Section 8 for such GMPs that conform to the Rule’s requirements.

A Section 8 exemption would allow payments between entities within the guaranteed package, but would not allow unlawful payments from or to entities outside the guaranteed package. The exemption would also allow the required use of affiliated entities as service providers within the package (although it would not displace RESPA’s restrictions on affiliated business arrangements pertaining to a referral from a non-packaging affiliate to an affiliate offering settlement services, such as a referral from a broker-dealer to an affiliated mortgage company). HUD may also create an exemption from the requirements for a GFE, special information booklet, and settlement statement in Sections 4 and 5 of RESPA (12 U.S.C. §§ 2603, 2604) if it deems such an exemption necessary. HUD asserts authority to create such exemptions based upon Sections 8(c)(5) and 19 (12 U.S.C. § 2617) of RESPA. Section 8(c)(5) authorizes HUD to specify, through regulations and after consultation with certain federal agencies, payments or classes of payments or other

transfers that are not subject to the section's prohibitions on referral fees and fee-splitting. Section 19 authorizes HUD to "grant such reasonable exemptions for classes of transactions[] as may be necessary to achieve the purposes" of RESPA.

1. Guaranteed Interest Rate for Thirty Days

HUD has been considering GMPs or "bundled services" for several years. Lenders are the impetus behind the GMP concept, believing sincerely that they can offer real pricing benefits to consumers if they are able to package settlement services without regard to the requirements of RESPA. Yet the Proposal's treatment of GMPs wholly undermines the objective. Requiring a packager to leave its offer open for 30 days for free without a serious indication of interest on the consumer's part could create havoc from a risk management perspective in the "A" market. Lenders do not own loans that a clerk can retrieve from the stock room if and when the consumer reappears and accepts the offer. Even if there were a readily ascertainable index to which one could tie the interest rates over the 30-day "shopping" period, a lender would have no way of predicting what percentage of borrowers will accept the offer. Without having a clue as to how many borrowers will return and close on the loan offer, how does a lender hedge the risk in the volatile secondary market; if they are wrong, lenders will suffer real losses that could have a significant impact on their earnings. This is why most lenders today charge lock-in fees as a form of earnest money deposit to ensure that lenders do not get caught making commitments to deliver loans in the secondary market at specified interest rates, only to find that the borrower "took a hike" and closed with another lender.

We expect the lending industry to argue that any shopping period during which a GMP remains effective be limited to a few days. We also expect this to be a "safety and soundness" issue for depository institutions and their subsidiaries to ensure they have adequate risk management devices in effect. Alternatively, due to these hedging difficulties, lenders may simply find the interest rate constraint infeasible and therefore refuse to offer GMPs. Such a choice would force lenders into the fixed GFE framework described above, which as discussed, represents its own formidable constraints.

2. Who Can Package?

Many of the other obstacles to allowing such packages that have been posed since the beginning of the debate remain. For example, although the Proposal would allow entities other than lenders to provide packaged services, it may be difficult for smaller mortgage lenders and other smaller players to use their market power to arrange competitive mortgage packages. In order to compete, such smaller players would likely have to join up with consortiums of providers, which may, in the end, mean less competition in the mortgage services industry, rather than more. Smaller entities may also face serious market pressure to offer reduced prices for their services in order to join a package. Finally, it is not at all clear that entities such as mortgage brokers would have the capacity to market the packages given their inability to offer the mortgage piece. Since the Proposal would require the lender's signature on the package agreement, mortgage brokers, like other non-lender entities, will apparently have to link up with a mortgage lender in order to provide packages. This puts the current crop of packagers, such as vendor management companies and title underwriter subsidiaries, at a distinct disadvantage. Their only recourse may be to private-label their networks to lenders.

3. Complexity of GMP Scheme

The Proposal for GMPs is anything but simple. While HUD describes the package as guaranteeing "virtually all" lender-required settlement services, the effectiveness of the guaranteed package as a shopping tool is diminished by the complexity of all the items that are excluded from the guarantee. For example, the guarantee is generally anticipated to include (but not itemize) charges for pest

inspections and appraisals, but if the lender does not include such charges in the guarantee, the lender must specifically designate those charges as excluded, or else the Proposal will deem that they (and any other charges not specifically mentioned) are included within the guaranteed price. The interest rate must be included within the guarantee, although it is allowed to vary, but only in accordance with some publicly available methodology that reflects market changes (such as an observable and verifiable index), unless and until the borrower agrees to lock in the interest rate. The up-front costs of mortgage insurance must be guaranteed, although the costs of mortgage insurance are based upon the property's value, so any "guaranteed" costs must be subject to a final appraisal. While the GMP (as well as the guaranteed GFE) is subject to appraisal and underwriting, HUD does not clarify whether "underwriting" would include cost changes that may result from borrowers providing materially false information that the packager subsequently identifies. Additionally, HUD itself recognizes that it is not fully prepared to address the question of the preemption of any inconsistent state laws.

4. Itemization of Finance Charges

The GMP proposal anticipates that the HUD-1 would list the services ultimately provided, but not the specific charges for those services; an addendum to the settlement statement must, nonetheless, list the finance charges needed to calculate the APR. This requirement, like many others, poses a practical compliance problem. In order to list the finance charges needed to calculate the APR, the lender would first need to know which of the fees, within the lump sum for multiple settlement services, are "finance charges" under the Truth in Lending Act ("TILA") (15 U.S.C. §§ 1601 *et seq.*), and which fees are excludable from that calculation (e.g., fees for title examination, document preparation, and other real estate-related services under Section 4(c)(7) of TILA's Regulation Z (12 C.F.R. § 226.4(c)(7)). It appears that the closing agent who prepares the HUD-1 will be forced somehow to make this determination in order to itemize finance charge fees, which only appears possible through instructions from the lender or packager.

5. GMP Fee

Finally, HUD provides that a packager may, only upon the borrower's acceptance of the GMP, charge the borrower a "minimal engagement fee." HUD does not define what such a minimal fee would be. Regardless, while HUD's safe harbor for GMPs purports to exempt packagers from Section 8 scrutiny, HUD appears to use this safe harbor as its own free-for-all actually to regulate the costs of settlement fees.²

6. Enforceable Contract

HUD's Proposal is silent on whether the contract constituting the GMP may be enforced by either side. For example, once a lender is committed by an enforceable GMP contract, may the contract prohibit the borrower from continuing to shop for other lenders? Presumably, the forfeiture of the engagement fee is an incentive for borrowers not to abandon the GMP upon acceptance. If the fee permitted by HUD is too low to provide such a disincentive, what recourse does a lender have against a borrower under the contract?

D. Other Proposals—Negotiated Discounts

HUD's Proposal also seeks to clarify that the anti-referral fee provisions of Section 8 of RESPA do not prohibit a settlement service provider from using its market power to negotiate discounted prices, so long as

² For a further discussion of the regulation of settlement costs, see Section II.D, "Other Proposals—Negotiated Discounts," directly below.

the originator charges the borrower the entire discounted price that the originator has negotiated, and the originator reports the entire discounted price on the settlement statement. This requirement to pass along any negotiated discounts would apply only when a lender opts for the GFE process, rather than the GMP process.

HUD takes this opportunity to restate that its RESPA regulations attempt to prohibit “mark-ups” or “up-charges” of third-party fees. However, HUD fails to mention that two federal circuit courts have recently invalidated that interpretation of the statute; those courts have held that in this context RESPA only prohibits kickbacks and fee-splitting, and have clarified once again that RESPA is not a rate-setting statute.³ Unless and until Congress amends RESPA consistent with HUD’s interpretation, one must again question HUD’s authority for seeking to codify its judicially rejected view.

III. CONCLUSION

All mortgage market participants can surely applaud HUD’s efforts to provide consumers reliable cost information about the real estate settlement process as early in the process as possible, theoretically promoting consumer shopping, competition by service providers, and lower costs. HUD’s Proposal, however, is confusing, even to experts in the industry. It would create a complex disclosure scheme that would raise compliance costs and indirectly use disclosure as a method of regulating pricing. In addition, HUD in several respects appears to move far beyond its statutory authority. The Proposal is surely controversial, and the continued lack of consensus among interested groups is likely to forestall the implementation of final regulations for some time.

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³ See *Echevarria v. Chicago Title & Trust Co.*, 256 F.3d 623 (7th Cir. 2001); *Boulware v. Crossland Mortgage Corp.*, 291 F.3d 261 (4th Cir. 2002).

MORTGAGE BANKING/CONSUMER FINANCE GROUP

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The Mortgage Banking/Consumer Finance Group provides legal advice and licensing services to the consumer lending industry. We counsel clients engaged in the full range of mortgage banking activities, including the origination, processing, underwriting, closing, funding, insuring, selling, and servicing of residential mortgage loans and consumer loans, from both a transactional and regulatory compliance perspective. Our focus includes both first- and subordinate-lien residential mortgage loans, as well as open-end home equity, property improvement loans and other forms of consumer loans. We also have experience in multi-family and commercial mortgage loans. Our clients include mortgage companies, depository institutions, consumer finance companies, investment bankers, insurance companies, real estate agencies, homebuilders, and venture capital funds. Members of the Mortgage Banking/Consumer Finance Group and their telephone numbers and e-mail addresses are listed below:

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