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HUD Adopts New RESPA Regulations

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After years of debate, the U.S. Department of Housing and Urban Development (HUD) has published a final rule that makes several significant changes to its regulations under the Real Estate Settlement Procedures Act (RESPA). The rule was published on November 17, 2008.

HUD intended to have two implementation dates for different segments of the rule, January 16 of this year and January 1, 2010. However, on January 8, HUD announced that it will delay the required-use section of the rule for 90 days, because of a lawsuit filed by the National Association of Home Builders (NAHB) on December 22. The NAHB lawsuit challenged what the builders considered a complete about-face in the rule, which would prohibit builders from offering incentives to steer homebuyers to companies affiliated with them that provide settlement services: primarily lenders and title agencies. HUD insists that the 90-day delay will not kill or alter that section of the rule, however.

Summary of Rule Changes

Settlement agents, lenders and other real estate settlement service providers are required to use new forms and adjust business practices in order to comply with the new regulations. The major changes adopted in the rule are as follows.

- The Good Faith Estimate form (the GFE) is now three or four pages, and must disclose more information, including the amount of any yield spread premium paid. Effective January 1, 2010.
- The HUD-1/1A settlement statement (HUD-1) is changed. The HUD-1, used for purchase money closings, is now three pages long. The HUD-1A, for loan closings only, is still two pages. Both forms, however, have added to them a "Loan Terms" section that identifies ten terms of the loan. Also, there is a new comparison chart showing certain figures from the GFE and the actual charges, so that the borrower can compare actual and estimated charges. There are also changes in some of the line items. Effective January 1, 2010.
- A settlement service provider may use average charges for certain third-party settlement service charges. Effective January 16, 2009.
- The consumer cannot receive an economic benefit or avoid an economic penalty tied to the use of a particular service provider, except under a limited

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exception. Suspended for 90 days from January 8.

- The servicing disclosure statement form has been changed. Effective January 16, 2009.
- Rules have been changed relating to accounting for escrow accounts and to make clear that the Electronic Signatures in Global and National Commerce Act (ESIGN) applies to RESPA. Effective January 16, 2009.
- The new rule does not mandate the use of a closing script by settlement agents. Such a script was part of HUD's initial proposal. The American Land Title Association and others vigorously opposed this change, and it was withdrawn. However, part of the script was inserted in the HUD-1.

This client e-alert will focus on the 2009 implementation-date changes to the regulations. A later client e-alert will describe the 2010 changes in more detail.

Average Charges

Over the past decade, HUD has created a regulatory nightmare concerning marked-up and estimated charges that is not, in the opinion of most courts, within the spirit or the letter of RESPA as adopted by Congress. HUD issued two policy statements, in 1999 and 2001, that interpreted RESPA as prohibiting a lender or other settlement service provider from marking up a third party's charge. For example, it is HUD's position that a closer may not charge $14 for overnight delivery that actually costs $9, or estimate recording fees based on average cost. HUD's position has been that a markup is an "unearned" fee which is a "fee split" prohibited under Section 8 of RESPA.

HUD's position fostered a wave of class action lawsuits by people who claimed that recording fees, delivery charges, appraisal fees, credit report charges and other settlement services had been marked up. Many lawsuits have also been filed alleging a Section 8 violation when a closer or lender estimated charges, such as recording fees, and did not reimburse for overcharges later.

Most courts have rejected HUD's interpretation of RESPA, holding that a "fee split" requires two parties, one giving the unearned fee and one taking it, and that the fee split must be for the illegal purpose of steering the consumer to a settlement service provider. A markup is not a fee split between two parties and thus does not violate the law.

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The real estate industry asked HUD to renounce its position on mark-ups when it adopted a new regulation. HUD responded in typical bureaucratic manner. Rather than drop its position that RESPA bans markups, HUD allows a settlement service provider (in most cases, the lender or title company settlement agent) to charge an average price for certain third party fees. If an average charge is used for any customer, it must be used for all customers. Also, the lender or title company may not use average charges for "any settlement service if the charge for the service is based on the loan amount or property value." § 3500.8(b)(2)(C)(iv). A lender may not use average charges for its own fees and charges, as opposed to a third party's charges.

The lender or title company has to set a period of time, looking backward, from which the average charge is determined. That period of time must be not less than 30 days or more than 6 months. The records used to determine the average must be kept for three years. However, HUD did not describe an exact method to be used to determine the "average" charge. The general idea is as follows. First, you determine the type of third-party charge that you want to average: recording fees, survey, appraisal, delivery or courier service, etc. Then you assemble your records showing what that particular settlement service cost during the chosen span of time, and determine the average price charged (which we assume to be the mean average, or the aggregate cost divided by the number of transactions). You then charge the customer the average price for that service, and decide how often you will adjust the average price. You must adjust the average price at least every 6 months. Each time there is an adjustment, the new charge must be based on the average of the actual cost for the service during the preceding time interval. Thus, you must keep compiling records showing your cost for the service. Finally, if you actually pay less for the service than the average price collected from the consumers during the time period, you must give a rebate.

The rule does not provide a specific method for calculating an average charge. It says that you must charge everyone the same rate for the service, and that the aggregate amount paid by all customers for the service cannot be more than the aggregate cost of those services. This creates what we believe are two major issues you must address if you wish to use average charge pricing: collecting the right data and keeping the right records, and dealing with any money collected from the customers that is more than what the services cost you.

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Collecting the Right Data and Keeping Good Records

The major cost associated with average charge pricing will be the recordkeeping necessary to calculate an average charge for a class of transaction. To implement average charge pricing, a service provider should first define the class of transaction for which it intends to use average charge pricing. Service providers may further define the average charge according to type of loan and geographic area. You must then collect information on the amounts paid to third parties for the service within that class for the chosen time period. Data collection is an ongoing process. You must continue to record actual costs paid for each succeeding interval of time, and recalculate the average charge at least once every six months. You must maintain any records used to calculate the average charge for at least three years from the closings in which those charges were made.

Shortfalls and Surpluses

The rule reflects HUD's stated mission of making sure that the full benefit of any discount obtained by a lender or other settlement service provider from a third party is passed on in full to the consumer. This debate over volume-based discounts, bundling of services and markups even led HUD to change the term in the rule from "average cost pricing," which it thought emphasized the underlying cost, to "average charge," which HUD believes more accurately puts the emphasis on what is charged the consumer.

The unintended potential pitfall in average charges is the possibility that some party will claim that the aggregate amounts collected from borrowers and others will be slightly higher than the amounts actually paid for the services. Because an average charge is defined by past charges, a change in price will result in service providers collecting either too much or too little money for a particular class of transactions. The rule is silent about whether or not a rebate is required or, if so, how it would be accomplished.

One idea is to coordinate third-party service contracts with the time period you use for calculating average charges. For example, if you wish to average courier charges, get a locked-in rate that will not change during the entire time period used to calculate the average price. Then keep the same rate in place during the succeeding time period in which the average charge is used. The consumer will

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pay exactly what is charged.

Prohibition on Average Charges for Costs Based on Loan Amount

You may not use average cost pricing for settlement services whose prices vary based on the amount of the loan or the value of the property. This prohibition is intended to prevent borrowers who borrow less money from having to pay more because the "average" price includes higher fees charged for bigger loan amounts. As a result, average cost pricing cannot be used for charges such as transfer taxes, daily interest charges, loan reserves and escrows, and mortgage, title and hazard insurance. However, recording fees apparently may be averaged, because they do not depend on loan amount or property value. Some industry groups had objected to the averaging of recording fees after the draft rule was published in March 2008.

Required Use

Section 8(a) of RESPA, on referral fees, says that "[n]o person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." Section 8(c) of the law creates an exemption for affiliated business arrangements. The law requires that the affiliation be disclosed to the consumer, and that the use of the affiliated business cannot be mandated (known as the "required use" rule).

The new rule changes long-standing HUD rulings which said that the consumer may be offered a discount as an incentive to use an affiliated business arrangement (AfBA). Also, both HUD and the courts have long said that RESPA does not prohibit volume discounts. The new HUD rule is a significant about-face, which is why the NAHB sued HUD over it. HUD's comment is that the new rule "makes it clear that economic disincentives that are used to improperly influence a consumer's choices are as problematic under RESPA as are incentives that are not true discounts." 73 Fed. Reg. No. 222, p. 68236. This is doctrinaire nonsense, in the opinion of this e-alert's authors.

HUD changed the rule simply by altering the definition of "required use." The new definition says that "required use" means:

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> a situation in which a person's access to some distinct service, property, discount, rebate, or other economic incentive, or the person's ability to avoid an economic disincentive or penalty, is contingent upon the person using or failing to use a referred provider of settlement services.

§ 3500.2(b)

In order to preserve the AfBA exemption under Section 8(c) of RESPA, however, the rule says that a settlement service provider may offer a combination of settlement services at a total price (net of a discount, rebate or other incentive) less than the sum of the market price for those individual services, as long as the use of the bundled services is optional to the consumer and any discount, rebate or other incentive that is part of the bundle "is not made up by higher costs elsewhere in the settlement process."

The rub, for the builders, is simply that they are not providers of a settlement service. Thus, they cannot offer discounts as inducements to use their affiliated businesses, while lenders, title insurers, escrowees and other settlement service providers may. Many homebuilders and developers offer incentives to consumers for using their AfBAs. Although this portion of the rule is suspended until April, HUD's public comments do not suggest that the department intends to modify the language. Thus, it will likely become effective shortly. **Homebuilders and developers should immediately review contract forms, advertisements and other marketing materials to confirm that they will not violate this prohibition should it become effective as we expect it to.**

If you are a settlement service provider and wish to use the exemption described above, review your procedures, contracts and notices to confirm that the consumer is not required to use an affiliated business partner, and that the amount of any incentive offered in connection with the optional use of an affiliated business partner is not recovered through higher costs elsewhere in the settlement process. The disclosure rules about AfBAs are otherwise unchanged.

The new definition creates a form of "bundling" of services that otherwise was not adopted in the rule after much debate. HUD has offered no guidance on how to determine market prices to calculate the sum of the individual services.

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Miscellaneous Technical Changes

The final rule also includes the following three minor technical changes:

- A requirement that lenders, mortgage brokers and dealers must provide a servicing disclosure statement to borrowers indicating whether the party issuing the loan intends to assign, sell or transfer such loan to a third party during the loan's term. Such servicing disclosure statement must be delivered to borrowers within three days of submitting an application for any applicable loan.
- A change that eliminates the phase-in period for aggregate accounting for escrow accounts.
- A clarification that any electronic disclosures permitted by ESIGN are also permissible for disclosures required under RESPA.

Conclusion

As noted above, the RESPA rule leaves many questions unanswered. HUD has been notoriously slow in providing additional guidance after adopting regulations. If you are affected by the new rule, please consult with your Reinhart attorney or other qualified counsel.

These materials provide general information which does not constitute legal or tax advice and should not be relied upon as such. Particular facts or future developments in the law may affect the topic(s) addressed within these materials. Always consult with a lawyer about your particular circumstances before acting on any information presented in these materials because it may not be applicable to you or your situation. Providing these materials to you does not create an attorney/client relationship. You should not provide confidential information to us until Reinhart agrees to represent you.

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