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RESPA

FACING A COMPLIANCE AUDIT

UPDATE 2004

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RESPA COMPLIANCE EXAMINATION

The following chapter deals with a RESPA audit and what can be expected from the examination.

This chapter is drawn from the Comptroller's Handbook and is the directive and guide that the examiner uses in conducting an audit.

EXAMINATION OBJECTIVES

1. To appraise the quality of the bank's compliance management system for the Real Estate Settlement Procedures Act.

2. To determine the reliance that can be placed on the bank's compliance management system, including internal controls and procedures performed by the person(s) responsible for monitoring the bank's compliance review function for the Real Estate Settlement Procedures Act.

3. To determine the bank's compliance with the Real Estate Settlement Procedures Act.

4. To initiate corrective action when policies or internal controls are deficient, or when violations of law or regulation are identified.

EXAMINATION PROCEDURES

1. Obtain from the examiner, who completed the Compliance Management System program, information pertinent to the area of examination (historical examination findings, complaint information, and significant findings from compliance review/audit).

2. Through discussions with management and review of the following documents, determine whether the bank's internal controls are adequate to ensure compliance in the area under review. Identify procedures used daily to detect errors/violations promptly. Also review the procedures used to ensure compliance when changes occur (e.g., changes in service charges, computation methods, and software programs):

- ✓ Organizational charts,
- ✓ Process flowcharts,
- ✓ Policies and procedures,
- ✓ Loan documentation and disclosures,
- ✓ Checklist/worksheets and review documents,
- ✓ Computer programs.

3. Review compliance review/audit work papers and determine whether:

- ✓ The procedures used address all regulatory provisions (see Transactional Testing section).
- ✓ Steps are taken to follow-up on previously identified deficiencies.
- ✓ The procedures used include samples that cover all product types and decision centers.
- ✓ The work performed is accurate (through a review of some transactions).
- ✓ Significant deficiencies, and the root causes of the deficiencies, are included in reports to management/board.
- ✓ Corrective actions are timely and appropriate.
- ✓ The area is reviewed at an appropriate interval.

Transactional Testing

4. Determine the departments or areas of the bank that originate, buy, sell, transfer, or receive federally related mortgage loans.

5. Interview mortgage lending personnel to determine:

- ➢ When the special information booklet is given to the applicant.
- ➢ The timing of the good faith estimate and how estimated fees are determined.
- ➢ Settlement service providers used by the bank.
- ➢ The existence of either affiliate relationships or direct beneficial ownership interests of more than 1 percent in provider(s) of settlement services (controlled business arrangement).
- ➢ If the bank requires borrowers to use particular providers of settlement services.

- If the bank, since the last exam, sold any RE financed by a federally related mortgage loan.

- If the bank refers mortgage borrowers to other lenders or settlement service providers, or has mortgage borrowers referred to the bank. If it does obtain a description of services performed and determine whether:
  The bank collects or pays a fee for the referral (24 CFR 3500.14(b)).

- The bank is in compliance with 24 CFR 3500.14 and the guidance provided in the Appendix on Section 8 Transactions.

- If the bank has transferred or received mortgage loans or mortgage servicing rights.

- Whether escrow arrangements exist on mortgage loans.

- If initial and annual escrow statements are provided to customers.

- The bank's record retention policy for HUD-1 statements (12 CFR 3500.10(e)).

- How borrower inquiries about loan servicing are handled and within what time frame.

- If customers are charged for preparation of RESPA and truth in lending documents.

- If the bank conducts the settlement. If it does, determine whether:

  - ✓ The borrower, upon request, is allowed to inspect the HUD-1 or HUD-1A at least one business day prior to settlement (24 CFR 3500.10(a)).

  - ✓ The HUD-1 or HUD-1A is provided to the borrower and seller at or before settlement (24 CFR 3500.10(b)). – When the right to delivery is waived or the transaction is exempt, the statement is mailed as soon as possible after settlement (24 CFR 3500.10(c);(d)).

6. Assess the overall level of knowledge and understanding of mortgage lending personnel.

7. Through interviews with management and personnel, file reviews, the review of good faith estimates, and HUD-1 and HUD-1A, determine if federally related mortgage loan transactions are referred by the bank, brokers, affiliates, or other parties. Identify those parties and:

- Designate the types of services rendered by the bank, broker, affiliate, or service provider.

- By a review of the bank's general ledger or otherwise, determine if fees were received or paid by the bank.

- Confirm that any fees paid to the bank, broker, affiliate, service provider, or other party meet the requirements of section 3500.14(g) and are for goods or facilities actually furnished or services actually performed. This includes payments to an affiliate or the affiliate's employees.

- When a borrower has paid for a computer loan origination, confirm that its disclosure, as set forth in Appendix E of the regulation, has been provided to the borrower.

8. Select a sample of credit files of loans subject to RESPA. Using the RESPA worksheet, review the files to determine compliance with the various aspects of RESPA. Include in your sample, if applicable, loans:

- Originated and retained by the bank,

- Originated by the bank, but on which the servicing rights were transferred to another entity,

- Not originated by the bank, but on which the servicing rights were transferred to the bank,

- Subject to escrow accounts.

9. Using the bank's RESPA forms, complete the RESPA Forms Review Worksheet.

10. Summarize your findings from the RESPA worksheet.

Conclusions

11. Summarize here *all* violations of law, regulation, or ruling and use when making SMS entries. Refer to EC 263, "SMS Documentation Policy."

	Citation	Department	Violation	Recommendation	Policy Guide	Reference
a.	_____	_____	_____	_____	_____	_____
b.	_____	_____	_____	_____	_____	_____
c.	_____	_____	_____	_____	_____	_____
d.	_____	_____	_____	_____	_____	_____
e.	_____	_____	_____	_____	_____	_____

12. If the violation(s) noted above represent(s) a pattern or practice, determine the root cause by identifying weaknesses in internal controls, compliance review, training, management oversight, or other factors.

Consider whether civil money penalties (CMP), suspicious activity reporting, or an enforcement action should be recommended (see CMP matrix). RESPA enforcement actions are not delegated and must be sent to Washington Enforcement and Compliance for final review.

13. Identify action needed to correct violations and weaknesses in the bank's compliance system, as appropriate. Form a conclusion about the reliability of the compliance system for the area under review and provide conclusions to the examiner performing the Compliance Management System program.

14. Determine, in consultation with the examiner-in-charge, if violations or deficiencies in the compliance system are significant enough to merit bringing them to the board's attention in the report of examination. If so, prepare items for inclusion under the heading Matters Requiring Board Attention and under a Type 75 Follow-up Analysis.

15. Determine whether any items identified during this examination could materialize into a supervisory concern before the next on-site examination (consideration should be given to any planned increase in activity in this area, planned personnel changes, planned policy changes, planned changes to outside auditors or consultants, planned changes in business strategy, etc.). If so, summarize your concerns and assess the potential risk to the institution and discuss with the examiner-in-charge and/or appropriate bank personnel.

16. Discuss findings with bank management and obtain commitment(s) for corrective action.

RESPA Examination Worksheet –Appendix A

The worksheet is designed as a decision tree that will lead the examiner to appropriate conclusions on compliance with the act.

Name of Borrower: Loan #	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
Special Information Booklet										
1.Was the application for a refinancing transaction, a closed-end loan as defined in 12 CFR 226.2(a)(10) in which the lender takes a subordinate lien, a reverse mortgage, or any other federally related mortgage loan whose purpose is not the purchase of a one-to-four family residential										

property (24 CFR 3500.6(a)(3) (i),(ii), (iii),(iv))? If yes, the special information booklet is not required. Go to step 3. If no, go to step 2.										
2. If the bank maintains a record showing when the booklet was provided, was it provided or mailed within three business days of application (24 CFR 3500.6(a)(1))?										
Good Faith Estimate										
3. Was the GFE delivered or mailed within three business days of the application (24 CFR 3500.7(a)?										
4. Does the GFE include: a. The lender's name (Appendix C)? b. The estimate of charges listed in section L of the HUD-1 or HUD-1A (24 CFR 3500.7(c)(1))? c. The estimate of all other charges customary to the locality (24 CFR 3500.7(c)(2))?.										

Name of Borrower: Loan #	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
5. Are amounts on GFE reasonably similar to actual amounts paid and shown on HUD-1 (24 CFR 3500.7 (c) (2)) ?										
6. Was the borrower required to use any particular providers of settlement services? If yes, go to step 7. If no, go to step 8.										
7. Does the GFE disclose: a. The requirement (24 CFR 3500.7(e)(i))? b. The name, address, and telephone number of each required provider (24 CFR 3500.7(e)(ii))? c. The nature of the relationship										

between each provider and the bank (24 CFR 3500.7(e)(iii))? d. The fact that the estimate is based on the charges of the designated provider (24 CFR 3500.7(e)(i))?										
Uniform Settlement Statement (HUD-1 or HUD-1A)										
8. Was a HUD-1 or -1A properly completed for the transaction (24 CFR 3500.8 and Appendix A)? Were: a. Charges itemized properly for both borrower and seller according to the instructions for completion of the HUD-1 or HUD-1A? b. All charges paid to a party other than the lender itemized and the recipient named? c. Charges required by the bank but paid outside of closing, itemized on the settlement statement, marked as paid outside of closing or POC, but not included in totals? d. Is the accounting adjustment on Line 1,000 correct (24 CFR 3500.8(c)(1))?.										

Name of Borrower: Loan #	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
9. Was the transaction exempt from the delivery requirements of 24 CFR 3500.10(b) (24 CFR 3500.10(c) and (d))? if yes, go to 12. If no, go to 10.										
10. Was the HUD statement delivered to the borrower and seller, or lender, as appropriate, at or before settlement (24 CFR 3500.10(b))?										
11. Does the HUD statement reflect any charges paid by the customer to the bank to prepare RESPA or Truth in Lending documents (24 CFR 3500.12)?										

Controlled Business Arrangements If earlier exam steps indicated that no such arrangements exist, go to 15. If such arrangements exist, go to 12.										
12. Was the customer referred to a provider of settlement services with which the bank has a controlled business arrangement? If yes, go to 13. if no, go to 15.										
13. Other than an attorney, credit reporting agency, or appraiser representing the lender, was the use of a provider required (24 CFR 3500.15(b)(2))?										
14. Was the controlled business arrangement disclosure statement given to the customer (24 CFR 3500.15(b)(1) and Appendix D)?										
Servicing Disclosure Statement										
15. Did the applicant receive a properly completed servicing disclosure statement at the time of application or, if the application was not face-to-face, within three business days of the application (24 CFR 3500.21(b) and Appendix MS1)?.										
16. Did the bank obtain a written acknowledgment of the disclosure from the customer (24 CFR 3500.21(c))?										
Name of Borrower: Loan #	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
17. Through a review of late notices or otherwise, were no late fees imposed and no payments treated as late within 60 days following a transfer of servicing (24 CFR 3500.21(d)(5))?										
18. As loan servicer for mortgage loans and re-financings subject to RESPA, does the bank respond to										

borrower inquiries relating to these loans as prescribed in the regulation: a. Provide the notice of receipt of inquiry for qualified written correspondence from borrowers within 20 business days (unless the action requested is taken within that period and the borrower is notified in writing of that action) (24 CFR 3500.21(e)(1))? b. Provide, not later than 60 business days after receipt of the qualified written correspondence from the borrower, written notification of the corrections taken on the account, or statement of the reasons the account is correct or explanation of why the information requested is unavailable (24 CFR 3500.21(e)(3))? c. Does not provide information to any consumer reporting agency on overdue payment when investigating a qualified written request from borrower about disputed payments during this 60-business-day period (24 CFR 3500.21(e)(4))?										
Notice of Transfer of Mortgage Servicing If previous exam steps indicate that the bank has not transferred or received any mortgage servicing rights, go to 32. If the bank has transferred or received mortgage-servicing rights, go to step 21.										
19. Did the bank, as transferor, notify the borrower at least 15 days in advance of transfer with the notice of transfer (24 CFR 3500.21(d)(2))?.										
20. Or as transferee, within 15 days after the effective date of the transfer (24 CFR 3500.21(d)(2))?										

Escrow accounts If previous steps indicate that the bank does not establish escrow accounts in connection with federally related mortgage loans, or if the loan was originated prior to May 24, 1995, go to 27. Otherwise, proceed to step 21.										
21. Did the bank perform an escrow analysis at the creation of the account (24 CFR 3500.17(c)(2) and (7), and 24 CFR 3500.17(d))? Did it contain: a. Amount of monthly mortgage payments? b. Portion of payment going into escrow? c. Charges to be paid from the escrow account during the first 12 months after the account is established? d. Disbursement dates? e. Amount of cushion? f. Trial running balance?										
22. Did the customer receive an initial escrow statement within 45 days after the escrow account was established (24 CFR 3500.17(g))?										
23. Was it accurate?										
24. Does the bank perform an annual analysis of the escrow account (24 CFR 3500.17(c)(3),(7) and 17(d))?.										
25. Did the customer receive a properly completed annual escrow account statement within 30 days of the end of the computation year (24 CFR 3500.17(i))? Did it contain the: a. Amount of current monthly payment and portion of the monthly payment being placed in escrow (24										

CFR 3500.17(i)(1)(i))? b. Amount of the past year's monthly mortgage payment and the portion of the monthly payment that went into the escrow account (24 CFR 3500.17(i)(1)(ii))? c. Total amount paid into escrow for the 12-month period (24 CFR 3500.17(i)(1)(iii))? d. Total amount paid for taxes, insurance, and other charges (24 CFR 3500.17(i)(1)(v))? e. Balance in the escrow account at the end of the period (24 CFR 3500.17(i)(1)(v))? f. An explanation of how any surplus is being handled by the servicer (24 CFR 3500.17(i)(1)(vi))? g. An explanation of how any shortage is to be paid by the borrower (24 CFR 3500.17(i)(1)(vii)? h. If applicable, why the estimated low monthly balance was not reached (24 CFR 3500.17(i)(1)(viii))?										
26. Are the monthly escrow payments following settlement within the limits of 24 CFR 3500.17(c)(1)(ii)?										
27. Did the bank use an acceptable accounting method to determine escrow limits (24 CFR 3500.17(4))?.										
28. Is the escrow cushion no greater than that allowed by 24 CFR 3500.17(c)(5)? If the bank originated the loan, go to 30. If the loan was not originated by the bank, go to 29										
29. As the new servicer of the loan,										

did the bank change the monthly payment amount or the accounting method of the escrow account? If no, go to 31. If yes, go to 30.										

Name of Borrower: Loan #	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
30. Did the bank provide to the customer an initial escrow account statement within 60 days of the transfer of the servicing (24 CFR 3500.17(e))?										
31. Were the payments to be made from the escrow account made promptly by the bank (24 CFR 3500.17(k))? Purchase of Title Insurance If the bank was the titleholder of property sold and the sale was financed by a federally related mortgage loan.										
Purchase of Title Insurance If the bank was the titleholder of property sold and the sale was financed by a federally related mortgage loan										
32. Was the buyer required to purchase title insurance from a particular company (24 CFR 3500.16)?.										

SETTLEMENT PROCEDURES APPENDIX B

RESPA Forms Review Worksheet

Complete this worksheet after file review. Do not complete this worksheet for individual transactions. To complete, review applicable forms and place a check in each applicable box. All no answers indicate a possible violation of law and must be explained fully in the work papers. You also can insert an NA, if the line item is not applicable.

Forms Review Worksheet										
Product Type	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
1. Is the special information booklet used by the bank the most current version published by HUD in the Federal Register (24 CFR 3500.6(b))?										
2. Is the good faith estimate form used by the bank similar to the one in Appendix C of 24 CFR 3500?										
3. Is the HUD-1 or HUD-1A closing statement used by the bank the current form as contained in Appendix A of 24 CFR 3500? Any changes must conform to 24 CFR 3500.9.										
4. Does the mortgage servicing disclosure statement conform to the model disclosure in Appendix MS-1 of 24 CFR 3500 and contain the following information: a. A statement on whether the loan may be assigned or transferred while outstanding (24 CFR3500.21 (b)(3)(i))? b. The percentage of loans made during the past three calendar years that have been assigned or transferred, or in the alternative, the statement that "We have previously assigned, sold, or transferred the servicing of federally related mortgage loans." (24 CFR 3500.21(b)(3)(ii))? c. An estimate of the percentage of loans that will be transferred in the 12-month period following origination (24 CFR 3500.21(b)(3)(iii))? d. A summary of information that will										

be provided at the time a loan is transferred, including information on servicing procedures, transfer practices, and requirements (24 CFR 3500.21(b)(3)(iv))? and e. A summary of the loan servicer's duty to respond to borrower inquiries (24 CFR 3500.21(b)(3)(iv))?										
5. Is the customer acknowledgment form consistent with the format for acknowledgment contained in the model form, at Appendix MS-1 of 24 CFR 3500 (24 CFR 3500.21(b)(3)(v))?										
6. Does the notice of transfer of mortgage servicing used by the bank conform to 24 CFR 3500.21 (d)(3), and does the form disclose: a. Effective date of the transfer (24 CFR 3500.21(d)(3)(i))? b. New servicer's name, address for consumer inquiries, and toll-free or collect call telephone number (24 CFR 3500.21(d)(3)(ii))? c. A toll-free or collect call telephone number of the transferor servicer to answer inquiries relating to the transfer (24 CFR 3500.21(d)(3)(ii))? d. Date on which the present servicer will cease accepting payments and the date the new servicer will begin accepting payments relating to the transferred loan (24 CFR 3500.21(d)(3)(iv))? e. Any information concerning the effect of the transfer on the availability of terms of optional insurance and any action the borrower must take to maintain coverage (24 CFR 3500.21(d)(3)(v))?										

f. A statement that the transfer does not affect the terms or conditions of the mortgage, other than terms directly related to its servicing (24 CFR 3500.21(d)(3)(vi))?										
7. Does the initial escrow statement form used by the bank conform to 24 CFR 3500.17(h) (Appendix G)?										
8. Does the annual escrow statement form used by the bank conform with 24 CFR 3500.17(i)(1) (Appendix I)?.										

RESPA ENFORCEMENT PROCEDURES- APPENDIX C

The following is a memorandum issued to examiners giving some direction as to the enforcement of RESPA.

Memorandum

Date: July 28, 1995

To: District Deputy Comptrollers, District Administrators, District Counsels, District Compliance Directors, and Compliance Managers

From: Daniel P. Stipano, Director, and Enforcement & Compliance Division

As you are aware, significant jurisdictional and interpretive issues currently exist concerning the enforcement of RESPA, especially the anti-kickback provision contained in 12 USC § 2607 and 24 CFR §§ 3500.14 and 3500.15.

We are participating in an interagency work group with HUD and the other financial institution regulatory agencies to attempt to resolve these issues, but in the meantime, it is important that the agency continue to review cases involving RESPA violations for possible referral and enforcement action.

Effective immediately, in order to ensure that the OCC is addressing RESPA violations in consistent fashion, cases involving such violations should be handled on a non-delegated basis. However, as with other non-delegated enforcement matters, the district should continue to take such cases to the district SRCs prior to submitting them to Washington. If the district SRC determines that a substantive violation has occurred, it should refer the case to E&C with a recommendation for appropriate action, including

whether to refer the matter to HUD and whether reimbursement is necessary. E&C will consult with the Compliance Management Division (Compliance) and E&C and Compliance will present the matter to the Washington SRC for a final determination.

These procedures may be revised once the jurisdictional and interpretive issues have been resolved. However, please follow them until you receive further guidance. We will also be sure to keep the districts appraised of the progress of the interagency work group and any other developments in this area.

Because of the lack of definitive guidance with respect to many RESPA-related interpretive issues, the OCC should be cautious about citing violations, except in clear cases. Interpretive questions on substantive RESPA issues should be directed to Compliance and the Community and Consumer Law Division. Please call Beth Knickerbockers or me if you have any questions or comments or wish to discuss these matters further.

SETTLEMENT PROCEDURES APPENDIX D

Section 8 Transactions Under RESPA

Interagency and HUD Letters to IBAA Mortgage; Unofficial Interpretation

Below are excerpts of letters from the U.S. Department of Housing and Urban Development (HUD) to the IBAA Mortgage Corporation (IBAMC) and an interagency letter to the Independent Bankers Association of America (IBAA).

These letters provide important guidance on enforcement of RESPA Section 8 in connection with transactions involving fees paid or received for services performed.

Although the HUD letters are unofficial interpretations and provide no protection under Section 19(b) of RESPA, they do provide the industry with guidance to avoid violations of 24 CFR §3500.14 (prohibition against kickbacks and unearned fees). As described in the interagency letter to the Independent Bankers Association of America, until HUD issues alternative guidance, such as an official interpretation, OCC examiners will use these letters as guidance when examining national banks for compliance with RESPA.

February 14, 1995 Letter to IBAMC, IBAA, and PHH US Mortgage Corporation:

Since November 2, 1992, HUD has had a two-prong system for exercising its regulatory authority under RESPA. See 24 CFR §3500.4. HUD may publish in the Federal Register a ''rule, regulation or interpretation.'' There is no liability under the statute for any acts done in conformity with such ''rule, regulation or interpretation.'' In addition, ''in response to requests for interpretations not adequately covered'' by published rules, HUD may provide ''unofficial interpretations'' at the discretion of staff or counsel. Such unofficial interpretations provide no protection under Section 19(b) of RESPA.

Since the effective date of the November 2, 1992 rule, which withdrew all informal counsel opinions and staff interpretations issued prior to that date, HUD has been inundated with requests to provide RESPA interpretations to guide individual business planning. It has been our policy to concentrate on providing rules, regulations and interpretations, which are of general applicability, rather than unofficial interpretations addressing specific business plans. However, since in excess of 6,000 individual institutions and their customers potentially could be affected by the IBAMC program, we have decided to provide you with this unofficial interpretation.

HUD consistently has interpreted Section 8 of RESPA and Regulation X to provide that the mere taking of an application is not sufficient work to justify a fee under RESPA. Your inquiry seeks a determination of what services are sufficient to justify a fee. This letter sets forth the framework that HUD uses in enforcement to determine when fees for origination services are justified under RESPA.

A determination whether or not sufficient work is performed to justify a fee under Section 8 of RESPA must be based on the specific facts. HUD must look not merely at whether an agreement calls for certain work to be performed in exchange for a fee, but also at whether such work was actually performed, whether those services were necessary for the transaction, and whether they were duplicative of services also performed by others.

Some or all of the following services are normally performed in the origination of a loan:

- Taking information from the borrower and filling out the application;
- Analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;
- Educating the prospective borrower in the home buying and financing process, advising the borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments would vary under each product;
- Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;
- Initiating/ordering VOEs (verifications of employment) and VODs (verifications of deposits);
- Initiating/ordering requests for mortgage and other loan verifications;
- Initiating/ordering appraisals;
- Initiating/ordering inspections or engineering reports;

- Providing disclosures (truth in lending, good faith estimate, others) to the borrower;

- Assisting the borrower in understanding and clearing credit problems;

- Maintaining regular contact with the borrower, realtors, lender, between application and closing to apprise them of the status of the application and to gather any additional information as needed;

- Ordering legal documents;

- Determining whether the property was located in a flood zone or ordering such service;

- Participating in the loan closing. In determining whether or not to bring an enforcement action under RESPA, HUD generally would be satisfied that no RESPA violation had occurred, if it found that:

-
  - ✓ The lender's agent or contractor took the application (item a);
  - ✓ The lender's agent or contractor performed at least five additional items on the list above;
  - ✓ The fee was reasonably related to the market value of the services that were performed.

In addition, HUD has particular concern that a fee for steering a customer to a particular lender, which is prohibited under Section 8 of RESPA, could be disguised as compensation for counseling-type activities. Therefore, if an agent or contractor is relying on taking the application and performing only counseling-type services — b, c, d, j, and k on the above list — to justify its fee,

HUD also will look to see that meaningful counseling — not steering — is provided. In determining whether or not to bring enforcement action under RESPA in these circumstances, HUD would be satisfied that no RESPA violation had occurred, if it found that:

- The counseling gave the borrower the opportunity to consider products from at least three different lenders.

- The agent or contractor performing the counseling would receive the same compensation regardless of which lender's product was ultimately selected.

- Any payment made for the counseling-type services reasonably related to the services performed and not based on the amount of loan business referred to the lender.

I trust this letter will allow you to shape and develop IBAMC programs during the interim as we work to develop an interpretative rule on this and related subjects. In

accordance with the requirements of Regulation X, the matters stated in this letter are unofficial interpretations as identified in Section 3500.4(c) of Regulation X, and any interpretation stated here is subject to change in future rulemaking on this subject.

June 20, 1995 Letter to IBAMC:

In your letter you ask whether it is our view that in order to be compensated under RESPA for purposes of your particular program a lender's agent or contractor must actually fill out the loan application or may perform substantially equivalent activity. You indicate that in your program, member banks obtain the prospective borrower's income and debt information, and this is used in conjunction with an in-file credit report to develop a worksheet showing the loan programs and maximum amounts for which the prospective borrower would qualify. You indicate that you view that as one of the key origination functions. On the other hand, you believe that in your program filling out an application is not a key origination function, and for reasons of efficiency you prefer to have applications filled out in a central location.

Upon review and consideration, we agree that for purposes of my letter of February 14, 1995, the filling out of a borrower's work sheet for the particular program you describe may be substituted for the act of filling out a mortgage loan application. This is consistent with Section 8(c) of RESPA which provides a Section 8 exception for compensation for ''facilities actually furnished or for services actually performed.''

Your second inquiry is whether you are interpreting my February 14, 1995, letter correctly to mean that if your member banks perform only non-counseling services (a, e, f, g, h, i, l, m, n in that letter) or a mix of counseling and non-counseling services (but never rely only on the five counseling services (b, c, d, j, and k) specified in my letter, the concerns I express regarding steering will never be reached, and no further test would be applicable to the IBAMC program. That is the clear meaning of my letter, and I hereby confirm this interpretation.

December 12, 1995 Letter to IBAA:

This letter responds to your letter of July 27, 1995, in which you requested that the financial institutions regulatory agencies provide interagency guidance on how the IBAA Mortgage Company (IBAMC) program will be reviewed for Real Estate Settlement Procedures Act (RESPA) compliance. This response has been prepared jointly by staff of all four financial institutions regulatory agencies and represents the interagency view of RESPA compliance with regard to banks and thrifts participating in the IBAMC program.

As discussed below, the agencies conclude that financial institutions participating in IBAMC's Tier 1 program may lawfully receive compensation for services rendered as long as the institutions actually perform all of the duties required of them under the Tier 1 program. It follows that participating financial institutions may also legally receive compensation for services actually performed under the IBAMC's Tier 2 and Tier 3 programs, which both require institutions to provide more services. Under all programs,

of course, compensation must be reasonably related to the fair market value of the services that are performed.

As you know, HUD has primary interpretive and regulatory authority regarding RESPA. (12 USC §2617(a). See also 24 CFR §3500.4.)

Nicholas P. Retsinas, Assistant Secretary for Housing — Federal Housing Commissioner, on behalf of HUD, responded to two inquiries from the IBAA about the IBAMC mortgage program. See letter from Nicholas P. Retsinas (February 14, 1995) (February letter) and letter from Nicholas P. Retsinas (June 20, 1995) (June letter). In his letters, Mr. Retsinas interpreted RESPA and HUD's Regulation X by setting forth a framework that HUD will use for enforcement purposes in determining when fees for origination services are justified under Section 8 of RESPA. The agencies intend to conform their RESPA Section 8 enforcement to the framework prescribed by HUD in these letters. However, you should be aware that these letters are "unofficial staff interpretations" as described in 24 CFR §3500.4(c), which provide no protection under Section 19(b) of RESPA, and are subject to change. If, in the future, HUD changes its interpretation, the agencies will likely conform to the new interpretation.

You have stated that IBAMC intends to re-institute Tier 1 of its program because IBAMC believes, based on the February and June letters that the program, as described in your letter and the attached checklists, complies with RESPA.

According to the materials you provided, financial institutions participating in the Tier 1 program will perform the following services:

Complete a worksheet detailing a prospective borrower's income and debt and calculate the prospective borrower's pre-qualification ratios in conjunction with pulling an in-file credit report. (The institution should request this type of report from a credit-reporting agency after obtaining written authorization from the customer.)

Educate the prospective borrower on the home buying and financing process, advise the borrower about the different types of loan products available, and demonstrate how closing costs and monthly payments would vary under each product.

Collect financial information and other related documents that are part of the application process, including (a) the fully executed contract of sale for new property on a purchase or copy of deed to property if a refinance; (b) the most recent pay stub or earnings statement; and (c) copies of bank statements for the last two months.

Assist the borrower in understanding and clearing credit problems.

Maintain regular contact with the borrower, real estate agents, and PHH during the processing of the loan to apprise them of the status of their application.

Determine if the property is located in an area requiring flood hazard insurance or order a flood determination. You have identified the first responsibility as an activity that will substitute for taking the borrower's application, the central activity in the February

letter's compliance framework. Mr. Retsinas' June letter states that, for purposes of compliance with Section 8 of RESPA, "filling out a borrower's work sheet for the particular program ... may be substituted for the act of filling out a mortgage loan application. As such, a financial institution may be compensated for this activity because it is a "service actually performed." (12 USC §2607(c).) HUD's February letter states that HUD will generally be satisfied that no RESPA violation has occurred if:

The participating financial institution took the application;

The participating financial institution performed at least five additional items on the list of items in the letter; and the fee was reasonably related to the market value of the services that were performed.

Under IBAMC's Tier 1 program, participating financial institutions perform five items from HUD's list in addition to completing the borrower's work sheet, which HUD's June letter states is equivalent to taking the application. The second through fifth activities in the list of participating bank or thrift responsibilities above are identified as counseling-type activities in the February letter. They correspond with activities c, d, j, and k described in that letter. The final activity is a non-counseling service and corresponds to activity m in HUD's February letter.

HUD's February letter indicated that HUD is concerned that, when an agent or contractor is compensated for only counseling-type activities in addition to taking the application, the compensation may actually be a disguised fee for steering a customer to a particular lender, which is prohibited under Section 8.

If an agent or contractor performs only counseling-type activities in addition to taking the application, then certain other requirements must be met.

HUD's June letter clarifies this concern with regard to the IBAMC programs.

This letter states that if participating financial institutions perform a mix of counseling and non-counseling services, HUD's concerns regarding steering will not arise. The Tier 1 program contains a mix of four counseling-type services and one non-counseling service in addition to filling out the worksheet. In that regard, it meets the minimum requirements of HUD's June letter.

If participating financial institutions actually perform all six activities on the Tier 1 checklist, the institutions may lawfully receive compensation. However, in the past, our examiners have indicated that some participating banks and thrifts do not in fact perform all of the services on the program checklist. If participating financial institutions do not actually perform all six services, examiners may cite a violation of Section 3500.14 of HUD's Regulation X and request that the institution take appropriate corrective action.

You also detailed the activities in the Tier 2 and Tier 3 programs. Because these programs contain additional activities identified in HUD's February letter, they are of less concern to the financial institutions regulatory agencies as regards compliance with

Section 8 of RESPA. Again, however, participating banks and thrifts must actually perform the activities entailed on the program checklists to receive compensation.

Under all three IBAMC programs, we note that it is also a requirement under Section 8 of RESPA that any fee received as compensation must be reasonably related to the market value of the services that were performed

Settlement Procedures Appendix E

Disclosure of Mortgage Broker Fees Under RESPA Below is an excerpt of an August 14, 1992, letter from HUD. While HUD rescinded all informal opinions and staff interpretations November 2, 1992, the information provided below on mortgage broker fees continues to be relevant.

August 14, 1992 Letter
Background: Methods of Loan Origination
Residential mortgage lenders make or acquire residential mortgage loans through retail and wholesale methods. The traditional retail mortgage lenders establish and maintain their own office or offices to originate, process, underwrite, close and fund loans in their own name, using their own employees and facilities. The borrower seeks out the loan officer, or more frequently is found through the loan officer's relationships with various settlement service providers. In the traditional retail lending process, the lender can control the entire process through its employees. In the mid-seventies, when RESPA was being formulated, retail lending was the predominant loan origination practice in the United States.

In the eighties, a number of wholesale mortgage lending programs evolved, which allowed lenders to purchase loans from other lenders or brokers, which had performed some, or all of the front-end loan origination work. In one type of program, a mortgage lender purchases closed loans made by other mortgage lenders, generally known as wholesale buying. These transactions have always been considered secondary market transactions, that is, commercial transactions beyond the general scope of RESPA. (See discussion regarding secondary market exception, below.) A second wholesale method of acquiring loans is through mortgage brokers. In this approach, mortgage lenders accept the assignment of loans which are originated and processed by a mortgage broker and which fit the requirements of the mortgage lender.

There is no uniform generalization regarding the activities, which a mortgage broker must undertake to prepare the loan package. However, it is customary that the mortgage broker in the name of the mortgage lender will arrange the closing of the loan.

A third wholesale method, also used in the FHA program, is correspondent lending. In this arrangement the mortgage broker or correspondent performs the necessary originating functions and closes the loan in the name of the mortgage broker with the expectation that the loan will be sold and assigned to the mortgage lender

immediately after closing. The mortgage broker relies on table funding, a simultaneous advance of loan funds from the lender to the mortgage broker and an assignment of the loan from the mortgage broker to the lender to repay the advance. The essence of the table funding relationship is that the mortgage broker identifies itself as the creditor on the loan documents even though the mortgage broker is not the source of funds.

These various mortgage-lending practices (there are variations of these practices and a single lender may use more than one method) have evolved to respond to a variety of business conditions, and most are related to the burgeoning of the secondary market in residential real estate loans.

Mortgage Broker Fees and Charges

Mortgage brokers are a key element in the functioning of wholesale loan programs. They assist borrowers with information regarding eligible loan programs and assist borrowers through the loan application process. The availability of mortgage brokers allows lenders to expand operations to areas, which they would otherwise not reach because of the substantial costs of opening and maintaining retail offices. The effect of wholesale loan programs is to increase the number of lenders and loan programs available to borrowers in many areas of the country.

Typically, the mortgage broker acts as the borrower's agent and helps the borrower to select a loan program and to negotiate loan terms with the lender on the borrower's behalf and also provides origination type services to the lender. The mortgage broker is usually an independent contractor, unrelated to any lender. The mortgage broker's compensation varies, but is generally between 1 and 2 percent of the loan amount.

RESPA was not intended to be a rate-setting statute (cf. S. Rep. No. 93-866, 93rd Cong., 2nd Sess. p. 1, et seq., 1974). HUD's authority is limited under RESPA to preventing compensated referrals and the payment of fees other than for services "actually performed." The department has neither the mandate nor the intent of limiting mortgage brokers' legitimate fees and charges (HUD, of course, will continue to investigate cases involving fees that may violate Section 8(a), where the payments are for illegal referrals of business, or Section 8(b), where the payments are unearned. See 24 CFR 3500.14(e)).

We do recognize that the market sets fees and the cost of a specific service in Omaha, NE. May bear little resemblance to the cost of a similar service in Los Angeles, CA. However, we also recognize that an effective market is an informed market, as will be discussed below. Under Sections 4 and 5 of RESPA, the department is made responsible for setting forth the procedures for which charges relating to real estate settlement services are disclosed in an open and effective market.

Disclosure under the RESPA statute

Section 4 of RESPA requires the Secretary to create a uniform settlement statement which "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller. ..." Section 4(a) (emphasis added).

Section 2 of RESPA (Findings and Purpose) states:
The Congress finds that significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. ... It is the purpose of this act to effect certain changes in the settlement process for residential real estate that will result (1) in more effective advance disclosure to homebuyers and sellers of settlement costs.

The legislative history of RESPA further stated: "Federal rate controls are warranted only if ... there is no other practical way to deal with the problem." (S. Rep. 93-866, at p. 5.) We read this history to favor a market-based approach to fee setting, particularly since RESPA, *inter alia*, replaced a rate setting authorization in the Emergency Home Finance Act of 1970. There should not be a perceived need for the installation of Federal rate controls, so long as there exists a disclosure practice that makes basic information regarding the cost of service available to all parties to the transaction, particularly the consumer.

Disclosure to the consumer is a *sine qua non* to a free market determination of the reasonable fair market value of any settlement service. The fees of third-party settlement service providers (attorneys, title companies, mortgage insurance companies, hazard insurance companies, appraisers, termite inspectors, and any other provider of settlement services) are routinely disclosed and are most frequently funded at or about the settlement of the loan. (Mortgage broker fees are not one of the listed items on the HUD-1 Settlement statement, 800 series, because mortgage brokers were largely non-existent when the form was devised in the mid-seventies. (A June 1992 NAMB study confirms this.)

Because of the substantial costs in form revisions and software changes for a form used 7-10 million times a year, the Department has concluded that the existing form is sufficiently flexible for use without prescribing changes.)

We see no basis under Section 4 and 5 of RESPA (which require disclosure of amounts paid by or imposed upon borrowers and sellers on the Good Faith Estimate and the HUD-1 Settlement Statement) for exempting any significant class of charges imposed upon borrowers by third-party providers, including mortgage brokers. We read "imposed upon borrowers" to include all charges which the borrower is directly or indirectly funding as a condition of obtaining the mortgage loan. We find no distinction between whether the payment is paid directly or indirectly by the borrower, at closing or outside of closing.

My February 4, 1992 letter stated:

The substantive limitations on referral fees contained in Section 8 of RESPA and the disclosure requirements contained in Section 4 of RESPA were intended to work together to provide borrowers with information about who was receiving compensation in connection with their loan transaction and how much compensation was being received.

I hereby restate my opinion that RESPA requires the disclosure of mortgage broker fees, however denominated, whether paid for directly or indirectly by the borrower or lender. Such fees must be referenced on the Good Faith Estimate and disclosed on the HUD-1 Settlement Statement. Further, the failure to disclose may well raise the inference that a Section 8 violation is being concealed.

We consider mortgage broker transactions commonly called table funding wherein the loan is closed in the mortgage broker's name with a short term advance of a lender's funds to be a covered RESPA transaction and not excepted from RESPA as a secondary market transaction (see secondary market exception discussion below). The lender made the funding decision and put forward the necessary loan funds before the loan was made. The mortgage broker is never responsible for loan funds, either out of its' own capital or from a warehouse line for which it is liable.

Accordingly, the compensation paid to the mortgage broker and the mortgage lender should be set forth on the Good Faith Estimate and the HUD-1 settlement statement. Similarly, other compensation paid by a lender to a mortgage broker, such as service release premiums or yield spread premiums, or any other type of payment or premium tied to the origination of the loan should also be disclosed.

Where mortgage broker compensation is similar to lender points, and thus has tax implications under Revenue Ruling 92-2 and Revenue Procedures 92-11 and 92-12, it should be disclosed on a blank line in the 800 series of the HUD-1 Settlement Statement, and denominated mortgage broker fee, points paid to mortgage broker, discount points paid to mortgage broker, loan origination fee paid to mortgage broker, or similar language. If the amounts are paid from amounts other than from funds disbursed at settlement, including from the loan balances for the life of the loan, they should be identified as Paid Outside of Closing (POC). Examples of filled out. HUD-1s for different funding situations are attached to this letter.

No point loans

It has been suggested that disclosures regarding no point or no cost loans (loans in which the settlement service costs of the loan are paid for out of loan yield rather than out of borrower's funds at closing or withheld from loan proceeds) present problems in characterization for disclosure purposes. In such cases, the mortgage broker fee should be disclosed in the appropriate line on the Good Faith Estimate and on the HUD-1 Settlement Statement and shown as Paid Outside of Closing (POC). Alternatively a narrative statement such as "A mortgage broker fee of is being paid by the lender to [name of company or mortgage broker] for this transaction" can be used on the Good Faith Estimate and on the HUD-1 Settlement Statement and shown as POC.

Secondary market exception

In the past several years, a number of informal opinions have attempted to define what constituted a secondary market transaction (when a loan becomes a commercial commodity) because this has been the point when the coverage of RESPA stopped for most purposes. (Escrow accounts continue to be covered by Section 10 of RESPA, and with the 1990 RESPA amendments, the transfer of mortgage servicing is covered). In devising this line, these opinions determined that a secondary market transaction occurred after the first real funding transaction, that is, after the first real commitment of funds has been made, whether by a lender from its own funds, or in the case of a mortgage broker, from its own funds or from funds for which the broker had liability, normally described as a warehouse line. Transactions occurring after this point have been viewed as secondary market transactions, and the conclusion of these opinions has lead [sic] to what is familiarly known to those in the industry interested in these matters as the RESPA secondary market exception. The term is imprecise, and not, of course, statutorily based, since the rise of the secondary market occurred after the passage of RESPA. The issue is the extent of RESPA coverage, and what is excluded from RESPA coverage, and at a minimum I hold that the disclosure requirements of

Sections 4 and 5 of RESPA cover the costs of the original funding transaction for which the borrower provides most or all of the funding in order to complete the transaction (costs imposed upon the borrower), and these are the costs we deem necessary to be disclosed. While I believe that the coverage line could be drawn elsewhere, such as after the first accrual date, I continue to retain HUD's recognition of a secondary market exemption to RESPA after the first real funding of a covered mortgage loan.

It has been suggested that HUD's interpretations favor mortgage bankers over mortgage brokers. We do not believe that an interpretation, which requires disclosure to the consumer of third party provider fees of mortgage brokers, is discriminatory. Mortgage bankers also disclose their origination fees and discount points. They do not disclose the actual compensation to mortgage loan officers, the salaries and payments to other employees, or overhead costs, but neither do mortgage brokers.

The main distinction between a mortgage broker and a mortgage banker in a disclosure context is that benefits accruing to the mortgage banker in selling its loans into the secondary market are not disclosed. As noted, we view these transactions as beyond the reach of the general provisions of RESPA. Nor are we attempting to limit legitimate compensation to mortgage brokers, so long as it is disclosed.

We recognize that the real estate industry has substantially evolved since the initial attempts by Congress in the mid-seventies to deal with settlement costs. However, we do not see any deviation from the original congressional conclusion that disclosure of costs in the settlement services process is desirable from the point of view of the consumer, and that is the basis for our conclusions here.

EXAMPLES
All examples assume a $100,000 loan, with funds coming from the borrower or the obligation of the borrower. If seller funds some of the fees, the Seller's Funds portion of the HUD-1 should be utilized.

1. Mortgage Broker performs some origination work, orders verifications, appraisals, credit reports, etc. and forwards package to Lender, who completes origination, makes credit decision and closes in its own name.

Borrower pays three points to lender. Lender keeps two points and remits one point to mortgage broker. Lender's fee should be disclosed as origination fee or as loan discount under lines 801 and/or 802. Mortgage broker's fee is disclosed on line 808 as loan origination fee, or other alternative names shown below.

L. Settlement Charges

700. Total Sales/Brokers Commission based on Price $ @ % Division of Commission (Line 700) as follows:	Paid From Borrower's Funds at Settlement	Paid From Seller's Funds At Settlement
701. $ To		
702. $ To		
703. Commission Paid at Settlement		
704.		
800. Items Payable in Connection w/loan		
801. Loan Origination Fee 2% Lender*	$2,000	
802. Loan Discount %		
803. Appraisal Fee To		
804. Credit Report To		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee To		
807. Assumption Fee		
808. Loan Origination Fee** to Mortgage Broker* - 1%	$1,000	
809.		
810.		
811.		

* Or use company name.
** Also may be called mortgage broker fee, points paid to mortgage broker, discount points paid to mortgage broker, or similar language.

2. Mortgage Broker assembles complete application package, forwards to wholesale lender. Lender makes credit decision and closes in own name. Borrower pays three points in origination fees and discount points. Lender pays mortgage broker two points.

L. Settlement Charges

700. Total Sales/Brokers Commission based on Price $ @ % Division of Commission (Line 700) as follows:	Paid From Borrower's Funds at Settlement	Paid From Seller's Funds At Settlement
701. $ To		
702. $ To		
703. Commission Paid at Settlement		
704.		
800. Items Payable in Connection w/loan		
801. Loan Origination Fee 1% Lender*	$1,000	
802. Loan Discount %		
803. Appraisal Fee To		
804. Credit Report To		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee To		
807. Assumption Fee		
808. Loan Origination Fee** to Mortgage Broker* - 2%	$2,000	
809.		
810.		
811.		

* Or use name of company
** Also may be called mortgage broker fee, points paid to mortgage broker, discount points paid to mortgage broker, or similar language.

3. Same as 2, but Mortgage Broker receives a 2-point origination fee plus one half of one percent servicing release premium. Servicing release premium is paid in connection with the origination, and is not the product of a secondary market transaction.

L. Settlement Charges

700. Total Sales/Brokers Commission based on Price $ @ % Division of Commission (Line 700) as follows:	Paid From Borrower's Funds at Settlement	Paid From Seller's Funds At Settlement
701. $ To		
702. $ To		
703. Commission Paid at Settlement		
704.		
800. Items Payable in Connection w/loan		
801. Loan Origination Fee .50% Lender*	$500	
802. Loan Discount %		
803. Appraisal Fee To		

804. Credit Report To		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee To		
807. Assumption Fee		
808. Loan Origination Fee** to Mortgage Broker* - 2%	$2,000	
809. Service Release Premium** to Mortgage Broker*- .50%	$ 500	
810.		
811.		

* Or use name of company.
** Also may be called mortgage broker fee, points paid to mortgage broker, discount points paid to mortgage broker, or similar language.

4. Mortgage Broker closes in its own name, transaction is table funded by Lender and loan immediately assigned to Lender. Lender to whom the loan is assigned is identified on line 808 and Mortgage Broker's compensation is listed on line 801. The lender should be identified on the HUD-1.

L. Settlement Charges

700. Total Sales/Brokers Commission based on Price $ @ % Division of Commission (Line 700) as follows:	Paid From Borrower's Funds at Settlement	Paid From Seller's Funds At Settlement
701. $ To		
702. $ To		
703. Commission Paid at Settlement		
704.		
800. Items Payable in Connection w/loan		
801. Loan Origination Fee 2% Mortgage Broker*	$2,000	
802. Loan Discount %		
803. Appraisal Fee To		
804. Credit Report To		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee To		
807. Assumption Fee		
808. Loan Origination Fee To Lender* - 1%	$1,000	
809.		
810.		
811.		

* Or use name of company.
** Also may be called mortgage broker fee, points paid to mortgage broker, discount points paid to mortgage broker, or similar language.

5. Yield Spread Premium. Mortgage Broker closes in own name, using table funding. Lender takes immediate assignment. Mortgage Broker's compensation is 1 percent yield spread premium (loan is at above market rate) and one half of one percent servicing release premium. Borrower pays one point origination fee.

L. Settlement Charges

700. Total Sales/Brokers Commission based on Price $ @ % Division of Commission (Line 700) as follows:	Paid From Borrower's Funds at Settlement	Paid From Seller's Funds At Settlement
701. $ To		
702. $ To		
703. Commission Paid at Settlement		
704.		
800. Items Payable in Connection w/loan		
801. Loan Origination Fee 1% To Lender*	$1,000	
802. Loan Discount %		
803. Appraisal Fee To		
804. Credit Report To		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee To		
807. Assumption Fee		
808. Yield Spread Premium** to Mortgage Broker* - 1% (POC) $1,000		
809. Servicing release fee** To Mortgage Broker* ½% (POC) $500		
810.		
811.		

* Or use name of company.
** Also may be called mortgage broker fee, points paid to mortgage broker, discount points paid to mortgage broker, or similar language.

6. No point loans. Borrower pays no compensation directly to Lender, but Lender covers costs out of loan yield. Mortgage Broker receives 1½ points from Lender.

L. Settlement Charges

700. Total Sales/Brokers Commission based on Price $ @ % Division of Commission (Line 700) as follows:	Paid From Borrower's Funds at Settlement	Paid From Seller's Funds At Settlement
701. $ To		
702. $ To		
703. Commission Paid at Settlement		
704.		

800. Items Payable in Connection w/loan		
801. Loan Origination Fee		
802. Loan Discount %		
803. Appraisal Fee To		
804. Credit Report To		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee To		
807. Assumption Fee		
808. Loan Origination Fee** to Mortgage Broker* Paid by Lender 1.5% (POC) $1,500		
809.		
810.		
811.		

* Or use name of company.
** Also may be called mortgage broker fee, points paid to mortgage broker, discount points paid to mortgage broker, or similar language.

Glossary

Creditor. In section 103(f) of the Consumer Credit Protection Act (15 USC 1602(f)), RESPA covers any creditor that makes or invests in residential real estate loans aggregating more than $1,000,000 per year.

Dealer. In Regulation X dealer is defined in the context of home improvement loans, a seller, contractor, or supplier of goods or services. For manufactured home loans dealer means one who engages in the business of manufactured home retail sales. Dealer loans are covered by RESPA if the obligations will be assigned, before the first payment is due, to any lender or creditor otherwise subject to the regulation.

Lender. Financial institutions either regulated by, or whose deposits or accounts are insured by any agency of the federal government.

References:
Laws
12 USC 2601, et seq., Real Estate Settlement Procedures Act

Regulations

24 CFR 3500, Real Estate Settlement Procedures Regulation (HUD Regulation X)

OCC Issuances
OCC Bulletin 95-29, RESPA: Availability of Escrow Software
OCC Bulletin 96-23, RESPA: Final Rule
Examining Circular 263, SMS Documentation Policy

RESPA IN SUMMARY

The Real Estate Settlement Procedures Act (RESPA) is a consumer protection statute, first passed in 1974. One of its purposes is to help consumers become better shoppers for settlement services. Another purpose is to eliminate kickbacks and referral fees that increase unnecessarily the costs of certain settlement services.

RESPA requires that borrowers receive disclosures at various times. The disclosures spell out:

- ✓ The costs associated with the settlement,
- ✓ Outline lender servicing and escrow account practices,
- ✓ Describe business relationships between settlement service providers,
- ✓ RESPA also prohibits certain practices that increase the cost of settlement services.

Section 8 of RESPA prohibits:

- ➢ A person from giving or accepting anything of value for referrals of settlement service business related to a federally related mortgage loan,

- ➢ A person from giving or accepting any part of a charge for services that are not performed,

Section 9 of RESPA prohibits:

Home sellers from requiring homebuyers to purchase title insurance from a particular company.

Generally, RESPA covers loans secured with a mortgage placed on a one-to-four family residential property.

These include most purchase loans, assumptions, refinances, property improvement loans, and equity lines of credit.

HUD's Office of Consumer and Regulatory Affairs, Interstate Land Sales/RESPA Division is responsible for enforcing RESPA.

DISCLOSURES:

Disclosures At The Time Of Loan Application

When borrowers apply for a mortgage loan, mortgage brokers and/or lenders must give the borrowers:

- ✓ A Special Information Booklet, which contains consumer information regarding various real estate settlement services. (Required for purchase transactions only).

- ✓ A Good Faith Estimate (GFE) of settlement costs, which lists the charges the buyer is likely to pay at settlement. This is only an estimate and the actual charges may differ. If a lender requires the borrower to use of a particular settlement provider, then the lender must disclose this requirement on the GFE.

- ✓ A Mortgage Servicing Disclosure Statement, which discloses to the borrower whether the lender intends to service the loan or transfer it to another lender.

- ✓ Information about complaint resolution.

If the borrowers don't receive these documents at the time of application the lender must mail them within three business days of receiving the loan application. If the lender turns down the loan within three days, however, then RESPA does not require the lender to provide these documents.

The RESPA statute does not provide an explicit penalty for the failure to provide the Special Information Booklet, Good Faith Estimate or Mortgage Servicing Statement. Bank regulators, however, may impose penalties on lenders who fail to comply with federal law.

Disclosures Before Settlement (Closing) Occurs

A Controlled Business Arrangement (CBA) Disclosure is required whenever a settlement service provider involved in a RESPA covered transaction refers the consumer to a provider with whom the referring party has an ownership or other beneficial interest. The referring party must give the CBA disclosure to the consumer at or prior to the time of referral.

The disclosure must describe the business arrangement that exists between the two providers and give the borrower estimate of the second provider's charges. Except in

cases where a lender refers a borrower to an attorney, credit reporting agency or real estate appraiser to represent the lender's interest in the transaction, the referring party may not require the consumer to use the particular provider being referred.

The HUD-1 Settlement Statement is a standard form that clearly shows all charges imposed on borrowers and sellers in connection with the settlement. RESPA allows the borrower to request to see the HUD-1 Statement one day before the actual settlement. The settlement agent must then provide the borrowers with a completed HUD-1 Settlement Statement based on information known to the agent at that time.

Disclosures at Settlement

The HUD-1 Settlement statement shows the actual settlement costs of the loan transaction. Separate forms may be prepared for the borrower and the seller. If it is not the practice that the borrower and seller attend settlement, the HUD-1 should be mailed or delivered as soon as practicable after settlement.

The Initial Escrow Statement itemizes the estimated taxes, insurance premiums and other charges anticipated to be paid from the escrow account during the first twelve months of the loan. It lists the escrow payment amount and any required cushion. Although the statement is usually given at settlement, the lender has 45 days from settlement to deliver it.

Disclosures After Settlement

Loan servicers must deliver to borrowers an Annual Escrow Statement once a year. The annual escrow account statement summarizes all escrow account payments during the servicer's twelve-month computation year. It also notifies the borrower of any shortages or surpluses in the account and advises the borrower about the course of action being taken.

A Servicing Transfer Statement is required if the loan servicer sells or assigns the servicing rights to a borrower's loan to another loan servicer. Generally, the loan servicer must notify the borrower 15 days before the effective date of the loan transfer. As long the borrower makes a timely payment to the old servicer within 60 days of the loan transfer, the borrower cannot be penalized.

The notice must include the name and address of the new servicer, toll-free telephone numbers, and the date the new servicer will begin accepting payments.

Respa's Consumer Protections And Prohibited Practices

Section 8: Kickbacks, Fee-Splitting, Unearned Fees

Section 8 of RESPA prohibits anyone from giving or accepting a fee, kickback or any thing of value in exchange for referrals of settlement service business involving a federally related mortgage loan. In addition, RESPA prohibits fee splitting and receiving unearned fees for services not actually performed.

Violations of Section 8's anti-kickback, referral fees and unearned fees provisions of RESPA are subject to criminal and civil penalties.

In a criminal case a person who violates Section 8 may be fined up to $10,000 and imprisoned up to one year. In a private law suit a person who violates Section 8 may be liable to the person charged for the settlement service an amount equal to three times the amount of the charge paid for the service.

Section 9: Seller Required Title Insurance

Section 9 of RESPA prohibits a seller from requiring the homebuyer to use a particular title insurance company, either directly or indirectly, as a condition of sale.

Buyers may sue a seller who violates this provision for an amount equal to three times all charges made for the title insurance.

Section 10: Limits on Escrow Accounts

Section 10 of RESPA sets limits on the amounts that a lender may require a borrower to put into an escrow account for purposes of paying taxes, hazard insurance and other charges related to the property.

RESPA does not require lenders to impose an escrow account on borrowers; however, certain government loan programs or lenders may require escrow accounts as a condition of the loan.

At settlement, Section 10 of RESPA prohibits a lender from requiring a borrower to deposit more than the aggregate amount needed to cover escrow account payments for the period since the last charge was paid, up until the due date of the first mortgage installment.

During the course of the loan, RESPA prohibits a lender from charging excessive amounts for the escrow account. Each month the lender may require a borrower to pay into the escrow account no more than 1/12 of the total of all disbursements payable during the year, plus an amount necessary to pay for any shortage in the account. In addition, the lender may require a cushion, not to exceed an amount equal to 1/6 of the total disbursements for the year.

The lender must perform an escrow account analysis once during the year and notify borrowers of any shortage. Any excess of $50 or more must be returned to the borrower.

RESPA ENFORCEMENT

Civil law suits

Individuals have one (1) year to bring a private law suit to enforce violations of Section 8 or 9. A person may bring an action for violations of Section 8 or 9 in any federal district court in the district in which the property is located or where the violation is alleged to have occurred.

HUD, a State Attorney General or State insurance commissioner may bring an injunctive action to enforce violations of Section 8 or 9 of RESPA within three (3) years.

Loan Servicing Complaints

Section 6 provides borrowers with important consumer protections relating to the servicing of their loans. Under Section 6 of RESPA, borrowers who have a problem with the servicing of their loan (including escrow account questions) should contact their loan servicer in writing, outlining the nature of their complaint.

The servicer must acknowledge the complaint in writing within 20 business days of receipt of the complaint. Within 60 business days the servicer must resolve the complaint by correcting the account or giving a statement of the reasons for its position. Until the complaint is resolved, borrowers should continue to make the servicer's required payment.

A borrower may bring a private law suit, or a group of borrowers may bring a class action suit, against a servicer who fails to comply with Section 6's provisions. Borrowers may obtain actual damages, as well as additional damages if there is a pattern of noncompliance.

Other Enforcement Actions

Under Section 10, HUD has authority to impose a civil penalty on loan servicers who do not submit initial or annual escrow account statements to borrowers. Borrowers should contact HUD's Office of Consumer and Regulatory Affairs to report servicers who fail to provide the required escrow account statements.

Filing a RESPA Complaint

Persons who believe a settlement service provider has violated RESPA in an area in which the Department has enforcement authority (primarily sections 8 and 9), may wish to file a complaint. The complaint should outline the violation and identify the violators by name, address and phone number.

Complainants should also provide their own name and phone number for follow up questions from HUD. Requests for confidentiality will be honored. Complaints should be sent to:

Director, Interstate Land Sales/RESPA Division
Office of Consumer and Regulatory Affairs
U.S. Department of Housing and Urban Development
Room 9146
451 7th Street, SW,
Washington, DC 20410

Focus Points

- The Real Estate Settlement Procedures Act (RESPA) was first passed in 1974.
- RESPA is a consumer protection statute designed to help consumers become better shoppers for settlement services and eliminate kickbacks and referral fees.
- RESPA requires that borrowers receive various disclosures at various times.
- RESPA covers loans placed on a one-to-four family residential property.
- HUD's Office of Consumer and Regulatory Affairs, Interstate Land Sales/RESPA Division enforces RESPA.
- When borrowers apply for a loan, lenders must give the borrowers a Special Information Booklet, which contains consumer information regarding various real estate settlement services.
- Lenders also supply borrowers with a Good Faith Estimate, which lists the charges the buyer is likely to pay at settlement.
- In a Mortgage Servicing Disclosure Statement the lender discloses whether it intends to service the loan or transfer it to another lender is provided to the borrower.
- Lenders must supply the Special Information Booklet, the Good Faith Estimate and a Mortgage Servicing Disclosure Statement within three business days of receiving the loan application.

- If the lender turns down the loan within three days the lender is not required the lender to provide these documents.

- A Controlled Business Arrangement (CBA) Disclosure is required whenever a settlement service provider involved in a RESPA covered transaction refers the consumer to a provider with whom the referring party has an ownership or other beneficial interest.

- The referring party must give the CBA disclosure to the consumer at or prior to the time of referral.

- A Controlled Business Arrangement (CBA) Disclosure describes arrangements between the providers and gives the borrower an estimate of the second provider's charges.

- The HUD-1 Settlement Statement is a form that clearly shows all charges imposed on borrowers and sellers in connection with the settlement.

- The Initial Escrow Statement itemizes the estimated taxes, insurance premiums and other charges anticipated to be paid during the first twelve months of the loan.

- Loan servicers must deliver to borrowers an Annual Escrow Statement once a year.

- The annual escrow account statement summarizes escrow account payments during the servicer's twelve-month computation notifies the borrower of any shortages or surpluses in the account and advises the borrower about the course of action being taken.

- Section 8 of RESPA prohibits the giving or accepting of fees, kickbacks or any thing of value in exchange for referrals.

- RESPA prohibits fee splitting and receiving unearned fees for services not actually performed.

- Section 9 of RESPA prohibits a seller from requiring the homebuyer to use a particular title insurance company.

- Section 10 of RESPA sets limits on the amounts a lender may require a borrower to put into an escrow account for purposes of paying charges related to the property.

- Section 10 of RESPA prohibits a lender from requiring a borrower to deposit more than the aggregate amount needed to cover escrow account payments for the period since the last charge was paid, up until the due date of the first mortgage installment.

- Lenders may require a borrower to pay no more than 1/12 of the total of all disbursements payable during the year, plus an amount necessary to pay for any shortage in the account.

- Lender may require a cushion, not to exceed an amount equal to 1/6 of the total disbursements for the year.

- The lender must perform an escrow account analysis once during the year and notify borrowers of any shortage.

- Any excess of $50 or more must be returned to the borrower.

- Individuals have one year to bring a private law suit to enforce violations of Section 8 or 9.

- HUD, a State Attorney General or State insurance commissioner may bring an injunctive action to enforce violations of Section 8 or 9 of RESPA within three (3) years.

- Section 6 of RESPA, if borrowers have a problem with the servicing of their loan, they should contact their loan servicer in writing, outlining the nature of their complaint.

- A servicer must acknowledge any complaint in writing within 20 business days of receipt of the complaint.

- A Servicer must resolve the complaint by correcting the account or giving a statement of the reasons for its position within 60 business days.

HUD PROPOSED MORTGAGE BROKER CONTRACT REQUIREMENT

HUD is proposing a rule to encourage the use of mortgage broker contracts that will clearly establish the:

- Role of the mortgage broker
- Mortgage broker's duties
- Mortgage broker's compensation

This proposed rule strives to protect consumers better by providing them the information they need to be better shoppers and making the information disclosed to them in the mortgage broker contracts binding.

This proposal seeks to discourage practices that give financial incentives to mortgage brokers that offer higher priced loans than what are generally available in the marketplace for the particular mortgage applicant.

This proposed rule is premised on the following facts and policy considerations:

Under current rules, there are reported cases in which exorbitant payments have been made to mortgage brokers by lenders. In these examples, the cost of the loans is significantly more than what the consumers could have obtained from other loan providers in the marketplace, and these additional costs have undoubtedly contributed to foreclosures.

Under the current RESPA rule, consumers are not provided sufficient information about the mortgage broker's role in the transaction. On the other hand, consumers are sometimes overloaded with more information about the home financing process than the consumers can use and receive confusing information about the mortgage brokers' fees.

The borrower would benefit from a useful mortgage broker contract specifying the mortgage broker's functions and compensation so that the borrower is not misled as to the role the mortgage broker plays in the transaction and does not fail to comparison shop.

Borrowers use interest rates, points, and closing costs to shop for mortgage With this information, the borrower can make informed choices about loan services, provided the borrower is also aware of the mortgage broker's function and the extent and sources of its compensation.

The disclosure of mortgage broker fees paid by the lender on the GFE, HUD-1, and HUD-1A without further explanation is frequently confusing to borrowers. In particular, the fact that these fees are listed as "P.O.C." (paid outside of closing) but are paid by the lender, rather than the borrower, is confusing.

Mortgage brokers should agree with borrowers by contract as to how they function, provide appropriate information about their fees, and be required to adhere to the terms of the contract.

The disclosure requirement in the 1992 rule may have caused mortgage brokers to establish warehouse lines of credit simply to avoid the disclosure requirement, thereby incurring unnecessary costs passed on to borrowers.

The industry requires certainty about the permissibility of payment practices.

Fees from lenders to brokers allow the borrower to have an array of choices in trading off interest rate and points, including "no fee, no point" loans. The borrower actually will pay these fees over time as reflected in the interest rate. However, if properly understood by the borrower, this pricing mechanism can expand choice and lessen the closing costs of loans to the homebuyer, making homeownership more affordable and facilitating refinancing to take advantage of lower rates.

Under appropriate circumstances it may be possible to recognize a class of compensation to mortgage brokers presumed to be legal. When establishing a class of compensation presumed legal, it is essential to identify any compensation that should not enjoy such a presumption.

Mortgage brokers reportedly originate approximately half of all mortgages. This volume of activity would not be possible if the majority of loans obtained through mortgage brokers did not have terms competitive with those of mortgages from other lending sources.

A. Department's Overall Approach to a Safe Harbor

This proposal offers a qualified safe harbor that affords limited protection for fees to mortgage brokers. The mortgage broker contracts required to qualify for the safe harbor proposed in this rule tackle two issues that are potentially controversial concerning mortgage broker fees:

How the role of the mortgage broker should be characterized for the consumer/borrower

How the consumer/borrower should be made aware of the total amount of compensation to the mortgage broker. The contracts proposed under this rule require the broker to specify whether or not the broker is acting as a representative of the borrower to shop for a mortgage loan, or whether the broker does not represent the borrower and serves only to arrange loans. If the broker indicates it acts as a representative, the broker must disclose whether or not it is receiving indirect fees from a lender. To qualify under the safe harbor, mortgage brokers must disclose whether the mortgage broker deals with one or more than one lender so that the consumer can understand the extent to which the broker will shop.

The contract requires the broker to disclose the maximum amount of compensation the broker will receive in the loan transaction, distinguishing the fees coming from the borrower and the fees coming from the lender. Mortgage brokers also will continue to be required to disclose their direct fees as well as their indirect fees paid to them by lenders on the GFE, the HUD-1, or HUD-1A in transactions covered by the exemption.

For those transactions in which the proposed mortgage broker contracts are entered into and adhered to, and other requirements of the rule are satisfied, compensation to brokers will be regarded as having been paid within a "qualified safe harbor" within which fees paid to mortgage brokers from lenders will be presumed legal. This presumption of permissibility and legality would not apply, however, if one or more of the requirements for the safe harbor is not met.

Moreover, even if all of the requirements for the safe harbor are met, the presumption may be rebutted if the total compensation does not pass a test to be established by HUD and incorporated in the final rule. When the fees do not pass this test, they are presumed to violate section 8 of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided. By providing that the safe harbor is "qualified" HUD preserves the ability to protect consumers against illegal fees, determined by the test to be established in the final rule following public comment. A qualified safe harbor will ease the difficulty and uncertainty involved in applying section 8(a), 8(b), and 8(c)(2) to total mortgage broker fees. HUD is specifically soliciting comments on the elements of this test.

In order to establish the "qualified safe harbor," HUD is proposing to exercise its exemption authority under section 19(a) of RESPA (12 U.S.C. 2617(a)) to add a new, limited exemption to RESPA's prohibition against kickbacks and unearned fees. In addition, under section 8(c)(5) of RESPA, the Secretary may create regulatory exemptions for "such other payments or classes of payments," after consulting with various Federal agencies (12 U.S.C. 2607(c)(5)). The exemption proposed is limited in that in creates a presumption of legality for compensation that meets the requirements of the exemption.

Regarding lender payments of indirect fees, mortgage brokers and lenders should be aware that, in addition to RESPA, they are also subject to the requirements of the Fair Housing Act and other fair lending laws.

Discretionary pricing of loans is a major fair lending concern of HUD and the Department of Justice because of the possibility of disparate treatment of similarly qualified borrowers. Yield spread premiums or servicing release fees that are consistently higher for a minority population, for example, than they are for a similarly qualified non-minority population could be unlawful under the Fair Housing Act.

While mathematical precision is not required between the premiums and fees associated with borrowers grouped by racial or other categories, the larger the differences, the closer enforcement agencies will look for possible disparate treatment.

Monitoring of such fees by mortgage brokers and lenders can help preclude unlawful conduct under the Fair Housing Act and other fair lending laws. HUD itself will monitor the number and type of fair lending complaints involving such fees and premiums upon implementation of the final RESPA rule regarding payments to mortgage brokers, and will, if necessary, revisit the issue if it appears that consumers are being subjected to discrimination in this area and would benefit from additional disclosures or additional contract terms.

For mortgage brokers meeting the requirements of the qualified safe harbor, volume-based compensation would be presumed legal (subject to application of the test developed for the final rule); outside of the safe harbor, volume-based compensation will be presumed to violate section 8(a) or 8(b) of RESPA. In making the representation regarding the maximum amount of fees from the lender in the mortgage broker contract, the mortgage broker is to state an amount that reflects expected volume-based compensation for the loan.

This rule does not propose to change the secondary market line. HUD concluded that there was little benefit to shifting the line.

B. Elements of the Safe Harbor Provision

In this proposed rule, HUD would amend 24 CFR 3500.14(g)(2) to provide that lender payments to mortgage brokers are presumed legal and permissible under section 8 if the following conditions are met:

1. Mortgage Broker Contracts

The mortgage broker and the prospective borrower(s) execute a mortgage broker contract for each loan transaction.

The form of the mortgage broker contract that would be used would be set forth in Appendix F to part 3500 to facilitate mortgage broker compliance with the safe harbor requirements. The instructions for completing the form would be provided with the form.

HUD is proposing a binding mortgage broker contract rather than a simple disclosure, because a binding contract creates an enforceable remedy for the borrower and ensures that the terms indicated cannot be changed or superseded unilaterally by the mortgage broker.

The mortgage broker contract would provide meaningful terms regarding the broker's functions in the transaction, its duty to the borrower (whether it does or does not represent the borrower), the potential maximum amount of compensation to be received in the transaction including the amounts paid by the borrower and by the lender, and the mortgage broker's State license number, if applicable.

The contract would clarify for the borrower the differing functions of mortgage brokers and the role of the mortgage broker in the particular transaction.

The contract would describe two main types of mortgage brokers:

Those that represent the borrower (including the two different variants of mortgage brokers that represent the borrower--those that do and those that do not receive indirect fees)

Those that do not represent the borrower

Borrowers would be told whether the mortgage broker represents them and will shop for the most favorable mortgage loan that meets the borrower's stated objectives from the lenders the broker does business with, or whether the broker does not represent the borrower and merely arranges loans.

Under the contract, the broker must disclose how many sources the broker will shop from or may use for a borrower's loan.

The mortgage broker is to check the appropriate box regarding how it will function in the particular anticipated transaction. The first box is for use by a mortgage broker that represents the borrower and does not receive a fee from the source of mortgage funds. The second box is for use by a mortgage broker that represents the borrower but may receive a fee from the lender. Both the first and second box are for the type of mortgage broker that, by operation of State law, is a borrower's agent, or that represents itself as a borrower's agent in arranging a mortgage loan in the transaction.

Mortgage brokers that are agents of the borrower would be allowed to represent themselves to the consumer as an entity that is required to obtain the most favorable mortgage loan for the borrower from the sources with which they do business. The disclosure of the mortgage broker's function and whether the mortgage broker is receiving fees from the lender will assist the borrower in assessing whether the mortgage broker works only for the borrower, has competing interests, or may be receiving indirect fees.

The third box is for use by a mortgage broker that does not represent the borrower and does not represent itself as a borrower's agent in arranging a mortgage loan in the transaction.

This type of mortgage broker may deal with one or more than one source of funds and may receive a fee from the source of funds.

This type of mortgage broker would be required under the contract clearly to inform the borrower that it is not the borrower's agent and that it arranges loans from lender(s), and to state the number of lenders with which it brokers loans. Borrowers would not be lulled into paying more than necessary to obtain the loan they want on the assumption that this type of mortgage broker is shopping for the borrower to obtain the best price available. Thus, mortgage brokers that are not the borrowers' agents would not be able to take advantage of borrower confusion over the role of the mortgage broker to obtain a price that exceeds what informed borrowers would pay.

The rule is designed to help ensure that "what the market will bear" is not inflated by the borrower's misimpression as to the service actually being provided.

The contract then describes how brokers are compensated. It also indicates to borrowers that if a borrower would rather pay a lower interest rate, the borrower may pay higher upfront points and/or fees.

The contract specifies the maximum points and other compensation and the maximum total compensation the broker will earn in the transaction for a loan up to a particular amount and at the rate offered by the broker. The contract discloses the source of the compensation--the amount of fees that are to be paid by the borrower and the fees paid by the lender.

Because the compensation may differ under various combinations of rates and points, the contract advises the borrower that the broker has alternative loan arrangements that the broker will display for the borrower. (HUD plans to develop or to facilitate the development of software for use by brokers for this purpose that will be distributed in conjunction with the final rule.)

The contract cautions that the broker's commitment to the amounts disclosed apply only if the borrower qualifies for the loan.

The back of the contract form would include a useful, preprinted summary for the borrower of his or her rights in shopping for a mortgage loan, including rights under RESPA and the mortgage broker contract.

Those mortgage brokers seeking to qualify for the safe harbor in § 3500.14(g)(2) would, at the time a consumer expresses serious interest in obtaining a loan from the broker and prior to application or before receipt of any payment (whichever is earlier), determine which of the categories fits its functions respecting the consumer in the particular transaction. The mortgage broker would, before application or before receipt of any payment, whichever is earlier, complete and execute the mortgage broker contract in Appendix F, deliver a copy to the prospective borrower(s), obtain the borrower's or borrowers' signature(s), and retain a copy of the contract.

Of course, a mortgage broker could check one box on the form for one transaction and a different box in a different transaction, depending upon the mortgage broker's function in the transaction.

However, a mortgage broker would only check one box and complete and execute one form per transaction. For all transactions in which the mortgage broker wishes to qualify for the safe harbor, the mortgage broker would be required to use the form provided and comply with the terms applicable to the box checked. This will ensure consistency in the mortgage broker contracts provided to consumers. If an applicant wants the mortgage broker to shop for more than one type of loan with different rates and fees, then a separate contract would be executed for each possible loan.

Mortgage brokers not wishing to qualify for the safe harbor would not be required to use the form.

2. Performance and Representation Consistent with Contract:
During the course of dealings with the prospective borrower(s), the mortgage broker would have to perform in accordance with the terms of the mortgage broker contract and not make representations inconsistent with such contract.

The terms of the mortgage broker contract could only be changed through mutual written agreement between the mortgage broker and the borrower. A mortgage broker who indicates on the mortgage broker contract that "I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives," is required to get the borrower the most favorable mortgage loan that meets the borrower's stated objectives from among the sources of funds with which the mortgage broker discloses it will shop.

3. Disclosure of Fees
In addition to the disclosures of fees in the contract, the mortgage broker would have to disclose fees on the GFE and the HUD-1 or HUD-1A in a manner consistent with §§ 3500.7 and 3500.8 of the regulations, as do all mortgage brokers whether qualifying for the safe harbor or not.

4. Mortgage Broker Licenses
If the State in which the property for which the mortgage loan is sought has licensing or registration requirements, the mortgage broker must have a valid license or registration and identify the license or registration number on the mortgage broker contract.

Large proportions of States require, or are in the process of requiring, that a State regulatory body license mortgage brokers. This provision would make the borrower aware of State regulations and might assist an aggrieved borrower in pursuing an action under State law against a mortgage broker. All of the members of the Advisory Committee supported including this information on the contract.

C. Effect on State Law
Section 18 of RESPA (12 U.S.C. 2616) preempts State law that is inconsistent with its provisions, unless such law provides greater protection to the consumer.

However, the RESPA regulations in §3500.13 provide, in part, that RESPA and the RESPA regulations do not annul, alter, affect, or exempt any person subject to their provisions

from complying with the laws of any State with respect to settlement practices, except to the extent of the inconsistency.

Therefore, in accordance with § 3500.13, mortgage brokers must comply with relevant State laws regarding disclosure of mortgage broker fees and related issues, except when inconsistent with RESPA or the implementing regulations. HUD, to the extent feasible, will work with interested State regulatory bodies to determine if applicable disclosure terms or requirements may be combined in a single form.

D. Definition of Mortgage Broker
HUD's current definition of "mortgage broker" specifically excludes an "exclusive agent of a lender" from the definition of "mortgage broker." This rule proposes to revise the definition to include an "exclusive agent of a lender" and thereby enable such an entity to qualify for the safe harbor.

A mortgage broker that deals with only one lender may still perform the functions of a mortgage broker, regardless of whether he or she is the lender's exclusive agent.

Such a mortgage broker could take advantage of the safe harbor if all applicable criteria are met. This rule proposes a similar conforming amendment to § 3500.17(b).

E. Questions or Comments HUD invite comment on all aspects of the proposal. In particular, HUD is interested in the public's view regarding the following questions:

1. As proposed, the new safe harbor may be rebutted if the total compensation does not pass a test to be established by HUD. HUD is specifically requesting comments on an appropriate test or tests to determine with certainty what, if any, portion of compensation to a mortgage broker should be impermissible under RESPA. There are numerous possibilities for such a test that could result from this rulemaking. Any test established for the final rule must allow brokers, lenders, and borrowers alike to determine with certainty whether the total compensation to broker is or is not legal. Accordingly, commenters are requested to suggest a quantifiable or otherwise objective test or tests for examining a broker's total compensation.

Suggestions may include, without limitation, defining the outer boundaries of permissible or legal total payments in terms of ranges or amounts such as a specified dollar amount that could vary based on the size of the loan or as a fixed percentage of the loan amount; if compensation exceeds a specified range or amount, the excess could rebut the presumption of legality under section 8. Mortgage brokers and lenders to borrowers of similar credit quality in the broker's area also could base a test on comparing the total compensation for a broker's loan to the total compensation for similar loans. This could be accomplished by establishing a baseline of the average market compensation for comparable loans for an immediately preceding time period. Any compensation for a loan that exceeds the baseline average by more than a specific amount could be used to rebut the presumption of legality.

Additionally, a test could establish the parameters of permissible compensation through plain and straightforward criteria. This could be accomplished, for example, by

providing that a yield spread premium is impermissible unless it is considered owned by, under the control of, and for the benefit of the borrower, or such a premium is impermissible based upon other fixed criteria.

Compensation that does not meet the established criteria would rebut the presumption of legality. In this proposed rule, if the mortgage broker does not enter into the specified contract, any mortgage broker compensation is presumed to violate section 8(a) or 8(b) of RESPA.

This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided. Commenters are urged to provide any other formulations that also would provide a clear line between compensation presumed legal and compensation that would not enjoy such presumption. HUD requests commenters to provide rule language to accompany any suggested test(s).

2. As proposed, the rule offers a qualified safe harbor under which there is a presumption of legality regarding fees to "mortgage brokers" that use the prescribed contract. Is the definition of "mortgage broker" under this proposal adequate to avoid the possibility that settlement service providers or others that do not provide any real services could take advantage of the exemption to charge fees?

Specifically, should this definition be changed, or should the final rule also require that a mortgage broker perform certain core services to qualify for the exemption?

In a letter dated February 14, 1995 from Assistant Secretary Retsinas to the Independent Bankers Association, HUD described certain core services in connection with mortgage lending. To what, if any, extent should the substance of that letter be included in this rule? Those favoring additional requirements should provide their views on what these requirements should be.

3. As proposed, mortgage brokers wishing to qualify for the safe harbor would check a box on a form, depending upon which of the alternatives fits the mortgage broker's function in the particular transaction. HUD seeks comments on alternative approaches or alternative language for the form explaining the broker's function.

Does the language proposed adequately distinguish the various categories of mortgage brokers?

Would the language proposed unduly influence the consumer to prefer one type of mortgage broker over another?

What revisions, if any, should be made to the form?

4. As proposed, mortgage brokers wishing to qualify for the safe harbor must complete and execute the mortgage broker contract "before application or before receipt of any payment."

HUD seeks comments on whether the final rule should maintain this general requirement respecting the timing of the disclosure, or whether the rule should specify a more precise time or occasion when the form should be provided.

HUD also seeks comments on what, if any, requirements should be included in the rule to address a situation in which a broker takes an application over the telephone or by other electronic means, including through the Internet.

HUD believes the contract should be provided to the borrower as early in the process as possible, but recognizes that information that is provided too early can be so imprecise that it is not useful to the consumer.

5. As proposed, the safe harbor would only appear useful to mortgage brokers that are using table funding or that are acting as intermediaries; those brokers that lend their own funds or use a warehouse line of credit would still qualify for the secondary market exemption.

HUD invites comments on whether it should require mortgage brokers that lend their own funds or use a warehouse line of credit to disclose their relationship with the borrower. If so, what would be the basis to impose such a requirement?

Should HUD structure a safe harbor that would encourage mortgage brokers in these other circumstances and other loan providers to enter into mortgage broker contracts with borrowers? If so, how would it be structured and what would be its legal basis?

6. As proposed, mortgage brokers that make available the loan products of only one source of funds must disclose on the mortgage broker contract the name of the one lender with which it does business. Is this a fair burden to impose on such mortgage brokers as a part of qualifying for the safe harbor? Does it put such mortgage brokers at a competitive disadvantage?

7. HUD's intent is that the mortgage broker contract would be binding. HUD seeks views concerning the adequacy of consideration of each party under the contract.

8. As proposed, if the amounts of the compensation change, it is anticipated that the broker and the borrower will execute a new contract or amend the contract. HUD seeks public comments concerning the most practical methods to be incorporated into the final rule for affecting changes to the contract.

HUD also seeks comments concerning what, if any, restrictions there should be on changes under the contract.

9. As proposed, the contract form provides that total compensation can be disclosed as a dollar amount or as a percentage of the loan.

Would it be preferable to require for purposes of comparison that all compensation be disclosed in dollar amounts only? What if any problems would be presented by such a requirement?

10. Should either the contract or regulations address situations in which the borrower chooses not to "lock in" the interest rate and chooses instead to allow the rate to "float" until the borrower locks in?

Should the contract provide that unless the particular loan is applied for by the borrower by a specified date that the broker's commitment to the fees set forth in the contract will expire? Those favoring such provisions should explain what rules, if any, should be added to address these situations. What, if any, rules would be needed to protect borrowers? For example, should the broker be required to provide a new contract detailing the terms of the loan at the lock-in rate? If the contract were to include an expiration date for the fees disclosed, can the borrower be protected from entering into an arrangement too hastily?

11.As proposed, the rule would allow mortgage brokers that represent the borrower and qualify for the safe harbor to collect fees from lenders if such compensation is disclosed and meets the other elements of the safe harbor. Should borrower's-representative mortgage brokers be permitted to receive such compensation, or should such compensation be prohibited? If such compensation were forbidden, how could such mortgage brokers offer "no fee, no point" loans? Does the benefit of allowing the flexibility to fund broker fees from interest rate offsets outweigh the disadvantage of creating a possible conflict of interest to the mortgage broker's fiduciary duty to the borrower?

12. As proposed, the rule obligates the mortgage broker--in those instances in which the broker checks the form to indicate that it represents the borrower--to obtain "the most favorable mortgage loan that meets [the borrower's] stated objectives." The form also provides that the broker will identify how many lenders from which it will shop. Are these statements of the borrower's-representative duty to the borrower appropriate? Should the term "most favorable" include factors other than price, including, for example, quality or processing time of the lender, and should the rule so provide?

Should the rule and the form simply obligate the borrower to obtain the lowest priced loan for the borrower from among the sources it uses?

13. While the market for purchase money loans and most first mortgage refinances is well advertised and highly competitive, this is not necessarily the case for reverse mortgages, as well as home equity, home improvement, high LTV, Alt A, and other less common types of loans. What are the arguments for or against limiting the safe harbor to purchase money and first lien refinancing loans?

Should there be any different requirements for so-called B, C, and D credit?

The Code of Federal Regulations is proposed to be amended as follows:

1. The authority citation shall continue to read as follows:

Authority: 12 U.S.C. 2601 et seq.; 42 U.S.C. 3535(d).

2. In § 3500.2, paragraph (b) is amended by revising the definition of "Mortgage broker" to read as follows:

§ 3500.2 Definitions.

(b) * * *

Mortgage broker means a person (not an employee of a lender) who brings a borrower and lender together to obtain a federally related mortgage loan, and who renders services as described in paragraphs (1) or (2) of the definition of "Settlement service" in paragraph (b) of this section. A loan correspondent meeting the requirements of the Federal Housing Administration under §§202.2(b) or 202.15(a) of this title is a mortgage broker for purposes of this part.

* * * * *

[§ 3500.7 Amended]

3. In § 3500.7, the first sentence of paragraph (b) is revised by removing the phrase "who is not an exclusive agent of the lender".

4. In § 3500.14, paragraphs (g)(2) and (g)(3) are re-designated as paragraphs (g)(3) and (g)(4), respectively; and a new paragraph (g)(2) is added, to read as follows:

§ 3500.14 Prohibition against kickbacks and unearned fees.

* * * * *

(g)(2)(i) A direct payment from a borrower to a mortgage broker or a payment from a lender to a mortgage broker in a particular mortgage loan transaction is presumed to be legal, provided that the following requirements are met:

(A) Prior to the time of mortgage loan application or receipt of any payment, whichever is first, the mortgage broker and the prospective borrower(s) complete and execute a mortgage broker contract, in the form of Appendix F to this part, as appropriate for the particular transaction.

(B) The mortgage broker represents himself or herself to the prospective borrower(s) and acts with regard to such borrower(s) in a manner consistent with the applicable terms of the mortgage broker contract executed by the mortgage broker, and the mortgage broker makes no representations to the prospective borrower(s) that are inconsistent with, and does not act in a manner that is inconsistent with, the terms of the mortgage broker contract. A mortgage broker that indicates on the mortgage broker contract that "I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives" is required to get the borrower the most favorable mortgage loan that meets the borrower's stated objectives from among the sources of funds from which the broker states in the mortgage broker contract that it will shop.

(C) The mortgage broker discloses its maximum total compensation along with the amounts of fees from the borrower and the lender for the transaction in accordance with Appendix A to this part 3500, §§3500.7 and 3500.8, and the mortgage broker contract in the form of Appendix F to this part and the instructions thereto.

(D) If the State in which the property (for which the mortgage loan is to be obtained in the particular transaction) is located licenses or registers mortgage brokers, the mortgage broker has a valid license or registration.

(ii) The terms of the mortgage broker contract referred to in paragraph (g)(2)(i) of this section can only be changed through mutual agreement between the mortgage broker and the borrower(s) executed in writing.

(iii) The presumption established under paragraph (g)(2)(i) of this section may be rebutted if the total compensation does not pass the following test: [Test will be published with final rule].

(iv) If the requirements in paragraphs (g)(2)(i) and (g)(2)(ii) of this section are not satisfied, or if the presumption established under paragraph (g)(2)(i) of this section is rebutted in accordance with paragraph (g)(2)(iii) of this section, payments to a mortgage broker from a lender are presumed to violate section 8(a) or 8(b) of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided.

* * * * *

5. A new Appendix F to part 3500 is added, to read as follows:

Date: September 17, 1997.

Nicolas P. Retsinas

Assistant Secretary for Housing-

Federal Housing Administrator

Content updated November 29, 2001

Focus Points

- HUD is proposing a rule to encourage the use of mortgage broker contracts that will establish the mortgage broker role, duties and compensation.
- This proposal seeks to discourage financial incentives being given to mortgage brokers that offer higher priced loans for the r mortgage applicants.
- Current RESPA rules do not require consumers to be provided sufficient information about the mortgage broker's role in the transaction.
- A broker contract specifying the broker’s function and compensation would be helpful to the borrower.
- Under the contract, the broker must disclose how many sources will be shopped from or may use for a borrower's loan.
- The disclosure requirement in the 1992 rule may have caused mortgage brokers to establish warehouse lines of credit to avoid the disclosure requirement.

- HUD is proposing to exercise its exemption authority under section of RESPA to add a new, limited exemption to RESPA's prohibition against kickbacks and unearned fees.

- The larger the differences, between the premiums and fees associated with borrowers the closer enforcement agencies will look for possible disparate treatment.

- Mortgage brokers wishing to qualify for the safe harbor must complete and execute the mortgage broker contract before application or before receipt of any payment.

- For mortgage brokers meeting the requirements of the qualified safe harbor, volume-based compensation would be presumed legal.

HUD PROPOSED MORTGAGE BROKER CONTRACT REQUIREMENT

HUD is proposing a rule to encourage the use of mortgage broker contracts that will clearly establish the:

- Role of the mortgage broker
- Mortgage broker's duties
- Mortgage broker's compensation

This proposed rule strives to protect consumers better by providing them the information they need to be better shoppers and making the information disclosed to them in the mortgage broker contracts binding.

This proposal seeks to discourage practices that give financial incentives to mortgage brokers that offer higher priced loans than what are generally available in the marketplace for the particular mortgage applicant.

This proposed rule is premised on the following facts and policy considerations:

Under current rules, there are reported cases in which exorbitant payments have been made to mortgage brokers by lenders. In these examples, the cost of the loans is significantly more than what the consumers could have obtained from other loan providers in the marketplace, and these additional costs have undoubtedly contributed to foreclosures.

Under the current RESPA rule, consumers are not provided sufficient information about the mortgage broker's role in the transaction. On the other hand, consumers are sometimes overloaded with more information about the home financing process than the consumers can use and receive confusing information about the mortgage brokers' fees.

The borrower would benefit from a useful mortgage broker contract specifying the mortgage broker's functions and compensation so that the borrower is not misled as to

the role the mortgage broker plays in the transaction and does not fail to comparison shop.

Borrowers use interest rates, points, and closing costs to shop for mortgage With this information, the borrower can make informed choices about loan services, provided the borrower is also aware of the mortgage broker's function and the extent and sources of its compensation.

The disclosure of mortgage broker fees paid by the lender on the GFE, HUD-1, and HUD-1A without further explanation is frequently confusing to borrowers. In particular, the fact that these fees are listed as "P.O.C." (paid outside of closing) but are paid by the lender, rather than the borrower, is confusing.

Mortgage brokers should agree with borrowers by contract as to how they function, provide appropriate information about their fees, and be required to adhere to the terms of the contract.

The disclosure requirement in the 1992 rule may have caused mortgage brokers to establish warehouse lines of credit simply to avoid the disclosure requirement, thereby incurring unnecessary costs passed on to borrowers.

The industry requires certainty about the permissibility of payment practices.

Fees from lenders to brokers allow the borrower to have an array of choices in trading off interest rate and points, including "no fee, no point" loans. The borrower actually will pay these fees over time as reflected in the interest rate. However, if properly understood by the borrower, this pricing mechanism can expand choice and lessen the closing costs of loans to the homebuyer, making homeownership more affordable and facilitating refinancing to take advantage of lower rates.

Under appropriate circumstances it may be possible to recognize a class of compensation to mortgage brokers presumed to be legal. When establishing a class of compensation presumed legal, it is essential to identify any compensation that should not enjoy such a presumption.

Mortgage brokers reportedly originate approximately half of all mortgages. This volume of activity would not be possible if the majority of loans obtained through mortgage brokers did not have terms competitive with those of mortgages from other lending sources.

Department's Overall Approach to a Safe Harbor

This proposal offers a qualified safe harbor that affords limited protection for fees to mortgage brokers. The mortgage broker contracts required to qualify for the safe harbor proposed in this rule tackle two issues that are potentially controversial concerning mortgage broker fees:

How the role of the mortgage broker should be characterized for the consumer/borrower

How the consumer/borrower should be made aware of the total amount of compensation to the mortgage broker. The contracts proposed under this rule require the broker to specify whether or not the broker is acting as a representative of the borrower to shop for a mortgage loan, or whether the broker does not represent the borrower and serves only to arrange loans. I

f the broker indicates it acts as a representative, the broker must disclose whether or not it is receiving indirect fees from a lender. To qualify under the safe harbor, mortgage brokers must disclose whether the mortgage broker deals with one or more than one lender so that the consumer can understand the extent to which the broker will shop.

The contract requires the broker to disclose the maximum amount of compensation the broker will receive in the loan transaction, distinguishing the fees coming from the borrower and the fees coming from the lender. Mortgage brokers also will continue to be required to disclose their direct fees as well as their indirect fees paid to them by lenders on the GFE, the HUD-1, or HUD-1A in transactions covered by the exemption.

For those transactions in which the proposed mortgage broker contracts are entered into and adhered to, and other requirements of the rule are satisfied, compensation to brokers will be regarded as having been paid within a "qualified safe harbor" within which fees paid to mortgage brokers from lenders will be presumed legal. This presumption of permissibility and legality would not apply, however, if one or more of the requirements for the safe harbor were not met.

Moreover, even if all of the requirements for the safe harbor are met, the presumption may be rebutted if the total compensation does not pass a test to be established by HUD and incorporated in the final rule. When the fees do not pass this test, they are presumed to violate section 8 of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided. By providing that the safe harbor is "qualified" HUD preserves the ability to protect consumers against illegal fees, determined by the test to be established in the final rule following public comment. A qualified safe harbor will ease the difficulty and uncertainty involved in applying section 8(a), 8(b), and 8(c)(2) to total mortgage broker fees. HUD is specifically soliciting comments on the elements of this test.

In order to establish the "qualified safe harbor," HUD is proposing to exercise its exemption authority under section 19(a) of RESPA (12 U.S.C. 2617(a)) to add a new, limited exemption to RESPA's prohibition against kickbacks and unearned fees. In addition, under section 8(c)(5) of RESPA, the Secretary may create regulatory exemptions for "such other payments or classes of payments," after consulting with various Federal agencies (12 U.S.C. 2607(c)(5)). The exemption proposed is limited in that in creates a presumption of legality for compensation that meets the requirements of the exemption.

Regarding lender payments of indirect fees, mortgage brokers and lenders should be aware that, in addition to RESPA, they are also subject to the requirements of the Fair Housing Act and other fair lending laws.

Discretionary pricing of loans is a major fair lending concern of HUD and the Department of Justice because of the possibility of disparate treatment of similarly qualified borrowers. Yield spread premiums or servicing release fees that are consistently higher for a minority population, for example, than they are for a similarly qualified non-minority population could be unlawful under the Fair Housing Act.

While mathematical precision is not required between the premiums and fees associated with borrowers grouped by racial or other categories, the larger the differences, the closer enforcement agencies will look for possible disparate treatment.

Monitoring of such fees by mortgage brokers and lenders can help preclude unlawful conduct under the Fair Housing Act and other fair lending laws. HUD itself will monitor the number and type of fair lending complaints involving such fees and premiums upon implementation of the final RESPA rule regarding payments to mortgage brokers, and will, if necessary, revisit the issue if it appears that consumers are being subjected to discrimination in this area and would benefit from additional disclosures or additional contract terms.

For mortgage brokers meeting the requirements of the qualified safe harbor, volume-based compensation would be presumed legal (subject to application of the test developed for the final rule); outside of the safe harbor, volume-based compensation will be presumed to violate section 8(a) or 8(b) of RESPA. In making the representation regarding the maximum amount of fees from the lender in the mortgage broker contract, the mortgage broker is to state an amount that reflects expected volume-based compensation for the loan.

This rule does not propose to change the secondary market line. HUD concluded that there was little benefit to shifting the line.

Elements of the Safe Harbor Provision

In this proposed rule, HUD would amend 24 CFR 3500.14(g)(2) to provide that lender payments to mortgage brokers are presumed legal and permissible under section 8 if the following conditions are met:

1. Mortgage Broker Contracts

The mortgage broker and the prospective borrower(s) execute a mortgage broker contract for each loan transaction.

The form of the mortgage broker contract that would be used would be set forth in Appendix F to part 3500 to facilitate mortgage broker compliance with the safe harbor requirements. The instructions for completing the form would be provided with the form.

HUD is proposing a binding mortgage broker contract rather than a simple disclosure, because a binding contract creates an enforceable remedy for the borrower and ensures that the terms indicated cannot be changed or superseded unilaterally by the mortgage broker.

The mortgage broker contract would provide meaningful terms regarding the broker's functions in the transaction, its duty to the borrower (whether it does or does not represent the borrower), the potential maximum amount of compensation to be received in the transaction including the amounts paid by the borrower and by the lender, and the mortgage broker's State license number, if applicable.

The contract would clarify for the borrower the differing functions of mortgage brokers and the role of the mortgage broker in the particular transaction.

The contract would describe two main types of mortgage brokers:

- Those that represent the borrower (including the two different variants of mortgage brokers that represent the borrower--those that do and those that do not receive indirect fees);

- Those that do not represent the borrower.

Borrowers would be told whether the mortgage broker represents them and will shop for the most favorable mortgage loan that meets the borrower's stated objectives from the lenders the broker does business with, or whether the broker does not represent the borrower and merely arranges loans. Under the contract, the broker must disclose how many sources the broker will shop from or may use for a borrower's loan.

The mortgage broker is to check the appropriate box regarding how it will function in the particular anticipated transaction. The first box is for use by a mortgage broker that represents the borrower and does not receive a fee from the source of mortgage funds. The second box is for use by a mortgage broker that represents the borrower but may receive a fee from the lender. Both the first and second box are for the type of mortgage broker that, by operation of State law, is a borrower's agent, or that represents itself as a borrower's agent in arranging a mortgage loan in the transaction.

Mortgage brokers that are agents of the borrower would be allowed to represent themselves to the consumer as an entity that is required to obtain the most favorable mortgage loan for the borrower from the sources with which they do business. The disclosure of the mortgage broker's function and whether the mortgage broker is receiving fees from the lender will assist the borrower in assessing whether the mortgage broker works only for the borrower, has competing interests, or may be receiving indirect fees.

The third box is for use by a mortgage broker that does not represent the borrower and does not represent itself as a borrower's agent in arranging a mortgage loan in the transaction. This type of mortgage broker may deal with one or more than one source of funds and may receive a fee from the source of funds.

This type of mortgage broker would be required under the contract clearly to inform the borrower that it is not the borrower's agent and that it arranges loans from lender(s), and to state the number of lenders with which it brokers loans. Borrowers would not be lulled into paying more than necessary to obtain the loan they want on the assumption that this type of mortgage broker is shopping for the borrower to obtain the best price available. Thus, mortgage brokers that are not the borrowers' agents would not be able to take advantage of borrower confusion over the role of the mortgage broker to obtain a price that exceeds what informed borrowers would pay.

The rule is designed to help ensure that "what the market will bear" is not inflated by the borrower's misimpression as to the service actually being provided.

The contract then describes how brokers are compensated. It also indicates to borrowers that if a borrower would rather pay a lower interest rate, the borrower may pay higher upfront points and/or fees.

The contract specifies the maximum points and other compensation and the maximum total compensation the broker will earn in the transaction for a loan up to a particular amount and at the rate offered by the broker. The contract discloses the source of the compensation--the amount of fees that are to be paid by the borrower and the fees paid by the lender.

Because the compensation may differ under various combinations of rates and points, the contract advises the borrower that the broker has alternative loan arrangements that the broker will display for the borrower. (HUD plans to develop or to facilitate the development of software for use by brokers for this purpose that will be distributed in conjunction with the final rule.)

The contract cautions that the broker's commitment to the amounts disclosed apply only if the borrower qualifies for the loan.

The back of the contract form would include a useful, preprinted summary for the borrower of his or her rights in shopping for a mortgage loan, including rights under RESPA and the mortgage broker contract.

Those mortgage brokers seeking to qualify for the safe harbor in § 3500.14(g)(2) would, at the time a consumer expresses serious interest in obtaining a loan from the broker and prior to application or before receipt of any payment (whichever is earlier), determine which of the categories fits its functions respecting the consumer in the particular transaction. The mortgage broker would, before application or before receipt of any payment, whichever is earlier, complete and execute the mortgage broker contract in Appendix F, deliver a copy to the prospective borrower(s), obtain the borrower's or borrowers' signature(s), and retain a copy of the contract.

Of course, a mortgage broker could check one box on the form for one transaction and a different box in a different transaction, depending upon the mortgage broker's function in the transaction.

However, a mortgage broker would only check one box and complete and execute one form per transaction. For all transactions in which the mortgage broker wishes to qualify for the safe harbor, the mortgage broker would be required to use the form provided and comply with the terms applicable to the box checked. This will ensure consistency in the mortgage broker contracts provided to consumers. If an applicant wants the mortgage broker to shop for more than one type of loan with different rates and fees, then a separate contract would be executed for each possible loan.

Mortgage brokers not wishing to qualify for the safe harbor would not be required to use the form.

2. Performance and Representation Consistent with Contract

During the course of dealings with the prospective borrower(s), the mortgage broker would have to perform in accordance with the terms of the mortgage broker contract and not make representations inconsistent with such contract.

The terms of the mortgage broker contract could only be changed through mutual written agreement between the mortgage broker and the borrower. A mortgage broker who indicates on the mortgage broker contract that "I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives," is required to get the borrower the most favorable mortgage loan that meets the borrower's stated objectives from among the sources of funds with which the mortgage broker discloses it will shop.

3. Disclosure of Fees

In addition to the disclosures of fees in the contract, the mortgage broker would have to disclose fees on the GFE and the HUD-1 or HUD-1A in a manner consistent with §§ 3500.7 and 3500.8 of the regulations, as do all mortgage brokers whether qualifying for the safe harbor or not.

4. Mortgage Broker Licenses

If the State in which the property for which the mortgage loan is sought has licensing or registration requirements, the mortgage broker must have a valid license or registration and identify the license or registration number on the mortgage broker contract.

Large proportions of States require, or are in the process of requiring, that a State regulatory body license mortgage brokers. This provision would make the borrower aware of State regulations and might assist an aggrieved borrower in pursuing an

action under State law against a mortgage broker. All of the members of the Advisory Committee supported including this information on the contract.

Effect on State Law

Section 18 of RESPA (12 U.S.C. 2616) preempts State law that is inconsistent with its provisions, unless such law provides greater protection to the consumer. However, the RESPA regulations in §3500.13 provide, in part, that RESPA and the RESPA regulations do not annul, alter, affect, or exempt any person subject to their provisions from complying with the laws of any State with respect to settlement practices, except to the extent of the inconsistency.

Therefore, in accordance with § 3500.13, mortgage brokers must comply with relevant State laws regarding disclosure of mortgage broker fees and related issues, except when inconsistent with RESPA or the implementing regulations. HUD, to the extent feasible, will work with interested State regulatory bodies to determine if applicable disclosure terms or requirements may be combined in a single form.

Definition of Mortgage Broker

HUD's current definition of "mortgage broker" specifically excludes an "exclusive agent of a lender" from the definition of "mortgage broker." This rule proposes to revise the definition to include an "exclusive agent of a lender" and thereby enable such an entity to qualify for the safe harbor.

A mortgage broker that deals with only one lender may still perform the functions of a mortgage broker, regardless of whether he or she is the lender's exclusive agent. Such a mortgage broker could take advantage of the safe harbor if all applicable criteria are met. This rule proposes a similar conforming amendment to § 3500.17(b).

Questions or Comments HUD invite comment on all aspects of the proposal. In particular, HUD is interested in the public's view regarding the following questions:

1. As proposed, the new safe harbor may be rebutted if the total compensation does not pass a test to be established by HUD. HUD is specifically requesting comments on an appropriate test or tests to determine with certainty what, if any, portion of compensation to a mortgage broker should be impermissible under RESPA. There are numerous possibilities for such a test that could result from this rulemaking. Any test established for the final rule must allow brokers, lenders, and borrowers alike to determine with certainty whether the total compensation to broker is or is not legal. Accordingly, commentors are requested to suggest a quantifiable or otherwise objective test or tests for examining a broker's total compensation.

Suggestions may include, without limitation, defining the outer boundaries of permissible or legal total payments in terms of ranges or amounts such as a specified dollar amount that could vary based on the size of the loan or as a fixed percentage of the loan amount; if compensation exceeds a specified range or amount, the excess could rebut the presumption of legality under section 8. Mortgage brokers and lenders to borrowers of similar credit quality in the broker's area also could base a test on comparing the total compensation for a broker's loan to the total compensation for similar loans. This

could be accomplished by establishing a baseline of the average market compensation for comparable loans for an immediately preceding time period. Any compensation for a loan that exceeds the baseline average by more than a specific amount could be used to rebut the presumption of legality.

Additionally, a test could establish the parameters of permissible compensation through plain and straightforward criteria. This could be accomplished, for example, by providing that a yield spread premium is impermissible unless it is considered owned by, under the control of, and for the benefit of the borrower, or such a premium is impermissible based upon other fixed criteria.

Compensation that does not meet the established criteria would rebut the presumption of legality. In this proposed rule, if the mortgage broker does not enter into the specified contract, any mortgage broker compensation is presumed to violate section 8(a) or 8(b) of RESPA.

This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided. Commentors are urged to provide any other formulations that also would provide a clear line between compensation presumed legal and compensation that would not enjoy such presumption. HUD requests commentors to provide rule language to accompany any suggested test(s).

2. As proposed, the rule offers a qualified safe harbor under which there is a presumption of legality regarding fees to "mortgage brokers" that use the prescribed contract. Is the definition of "mortgage broker" under this proposal adequate to avoid the possibility that settlement service providers or others that do not provide any real services could take advantage of the exemption to charge fees? Specifically, should this definition be changed, or should the final rule also require that a mortgage broker perform certain core services to qualify for the exemption?

In a letter dated February 14, 1995 from Assistant Secretary Retsinas to the Independent Bankers Association, HUD described certain core services in connection with mortgage lending. To what, if any, extent should the substance of that letter be included in this rule? Those favoring additional requirements should provide their views on what these requirements should be.

3. As proposed, mortgage brokers wishing to qualify for the safe harbor would check a box on a form, depending upon which of the alternatives fits the mortgage broker's function in the particular transaction. HUD seeks comments on alternative approaches or alternative language for the form explaining the broker's function. Does the language proposed adequately distinguish the various categories of mortgage brokers?

Would the language proposed unduly influence the consumer to prefer one type of mortgage broker over another? What revisions, if any, should be made to the form?

4. As proposed, mortgage brokers wishing to qualify for the safe harbor must complete and execute the mortgage broker contract "before application or before receipt of any payment."

HUD seeks comments on whether the final rule should maintain this general requirement respecting the timing of the disclosure, or whether the rule should specify a more precise time or occasion when the form should be provided. HUD also seeks comments on what, if any, requirements should be included in the rule to address a situation in which a broker takes an application over the telephone or by other electronic means, including through the Internet.

HUD believes the contract should be provided to the borrower as early in the process as possible, but recognizes that information that is provided too early can be so imprecise that it is not useful to the consumer.

5. As proposed, the safe harbor would only appear useful to mortgage brokers that are using table funding or that are acting as intermediaries; those brokers that lend their own funds or use a warehouse line of credit would still qualify for the secondary market exemption.

HUD invites comments on whether it should require mortgage brokers that lend their own funds or use a warehouse line of credit to disclose their relationship with the borrower. If so, what would be the basis to impose such a requirement? Should HUD structure a safe harbor that would encourage mortgage brokers in these other circumstances and other loan providers to enter into mortgage broker contracts with borrowers? If so, how would it be structured and what would be its legal basis?

6. As proposed, mortgage brokers that make available the loan products of only one source of funds must disclose on the mortgage broker contract the name of the one lender with which it does business. Is this a fair burden to impose on such mortgage brokers as a part of qualifying for the safe harbor? Does it put such mortgage brokers at a competitive disadvantage?

7. HUD's intent is that the mortgage broker contract would be binding. HUD seeks views concerning the adequacy of consideration of each party under the contract.

8. As proposed, if the amounts of the compensation change, it is anticipated that the broker and the borrower will execute a new contract or amend the contract. HUD seeks public comments concerning the most practical methods to be incorporated into the final rule for affecting changes to the contract. HUD also seeks comments concerning what, if any, restrictions there should be on changes under the contract.

9. As proposed, the contract form provides that total compensation can be disclosed as a dollar amount or as a percentage of the loan.

Would it be preferable to require for purposes of comparison that all compensation be disclosed in dollar amounts only? What if any problems would be presented by such a requirement?

10. Should either the contract or regulations address situations in which the borrower chooses not to "lock in" the interest rate and chooses instead to allow the rate to "float" until the borrower locks in?

Should the contract provide that unless the particular loan is applied for by the borrower by a specified date that the broker's commitment to the fees set forth in the contract will expire? Those favoring such provisions should explain what rules, if any, should be added to address these situations. What, if any, rules would be needed to protect borrowers? For example, should the broker be required to provide a new contract detailing the terms of the loan at the lock-in rate? If the contract were to include an expiration date for the fees disclosed, can the borrower be protected from entering into an arrangement too hastily?

11.As proposed, the rule would allow mortgage brokers that represent the borrower and qualify for the safe harbor to collect fees from lenders if such compensation is disclosed and meets the other elements of the safe harbor. Should borrower's-representative mortgage brokers be permitted to receive such compensation, or should such compensation be prohibited? If such compensation were forbidden, how could such mortgage brokers offer "no fee, no point" loans? Does the benefit of allowing the flexibility to fund broker fees from interest rate offsets outweigh the disadvantage of creating a possible conflict of interest to the mortgage broker's fiduciary duty to the borrower?

12. As proposed, the rule obligates the mortgage broker--in those instances in which the broker checks the form to indicate that it represents the borrower--to obtain "the most favorable mortgage loan that meets [the borrower's] stated objectives." The form also provides that the broker will identify how many lenders from which it will shop. Are these statements of the borrower's-representative duty to the borrower appropriate? Should the term "most favorable" include factors other than price, including, for example, quality or processing time of the lender, and should the rule so provide?

Should the rule and the form simply obligate the borrower to obtain the lowest priced loan for the borrower from among the sources it uses?

13. While the market for purchase money loans and most first mortgage refinances is well advertised and highly competitive, this is not necessarily the case for reverse mortgages, as well as home equity, home improvement, high LTV, Alt A, and other less common types of loans. What are the arguments for or against limiting the safe harbor to purchase money and first lien refinancing loans?

Should there be any different requirements for so-called B, C, and D credit?

The Code of Federal Regulations is proposed to be amended as follows:

1. The authority citation shall continue to read as follows:

Authority: 12 U.S.C. 2601 et seq.; 42 U.S.C. 3535(d).

2. In § 3500.2, paragraph (b) is amended by revising the definition of "Mortgage broker" to read as follows:

§ 3500.2 Definitions

(b) * * *

Mortgage broker means a person (not an employee of a lender) who brings a borrower and lender together to obtain a federally related mortgage loan, and who renders services as described in paragraphs (1) or (2) of the definition of "Settlement service" in paragraph (b) of this section. A loan correspondent meeting the requirements of the Federal Housing Administration under §§202.2(b) or 202.15(a) of this title is a mortgage broker for purposes of this part.

* * * * *

[§ 3500.7 Amended]

3. In § 3500.7, the first sentence of paragraph (b) is revised by removing the phrase "who is not an exclusive agent of the lender".

4. In § 3500.14, paragraphs (g)(2) and (g)(3) are re-designated as paragraphs (g)(3) and (g)(4), respectively; and a new paragraph (g)(2) is added, to read as follows:

§ 3500.14 Prohibition against kickbacks and unearned fees

* * * * *

(g)(2)(i) A direct payment from a borrower to a mortgage broker or a payment from a lender to a mortgage broker in a particular mortgage loan transaction is presumed to be legal, provided that the following requirements are met:

(A) Prior to the time of mortgage loan application or receipt of any payment, whichever is first, the mortgage broker and the prospective borrower(s) complete and execute a mortgage broker contract, in the form of Appendix F to this part, as appropriate for the particular transaction.

(B) The mortgage broker represents himself or herself to the prospective borrower(s) and acts with regard to such borrower(s) in a manner consistent with the applicable terms of the mortgage broker contract executed by the mortgage broker, and the mortgage broker makes no representations to the prospective borrower(s) that are inconsistent with, and does not act in a manner that is inconsistent with, the terms of the mortgage broker contract. A mortgage broker that indicates on the mortgage broker contract that "I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives" is required to get the borrower the most favorable mortgage loan that meets the borrower's stated objectives from among the sources of funds from which the broker states in the mortgage broker contract that it will shop.

(C) The mortgage broker discloses its maximum total compensation along with the amounts of fees from the borrower and the lender for the transaction in accordance with Appendix A to this part 3500, §§3500.7 and 3500.8, and the

mortgage broker contract in the form of Appendix F to this part and the instructions thereto.

(D) If the State in which the property (for which the mortgage loan is to be obtained in the particular transaction) is located licenses or registers mortgage brokers, the mortgage broker has a valid license or registration.

(ii) The terms of the mortgage broker contract referred to in paragraph (g)(2)(i) of this section can only be changed through mutual agreement between the mortgage broker and the borrower(s) executed in writing.

(iii) The presumption established under paragraph (g)(2)(i) of this section may be rebutted if the total compensation does not pass the following test: [Test will be published with final rule].

(iv) If the requirements in paragraphs (g)(2)(i) and (g)(2)(ii) of this section are not satisfied, or if the presumption established under paragraph (g)(2)(i) of this section is rebutted in accordance with paragraph (g)(2)(iii) of this section, payments to a mortgage broker from a lender are presumed to violate section 8(a) or 8(b) of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided.

* * * * *

5. A new Appendix F to part 3500 is added, to read as follows:

Date: September 17, 1997.

Nicolas P. Retsinas

Assistant Secretary for Housing-

Federal Housing Administrator

Content updated November 29, 2001

Focus Points

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- This proposal seeks to discourage financial incentives being given to mortgage brokers that offer higher priced loans for the r mortgage applicants.
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- A broker contract specifying the broker’s function and compensation would be helpful to the borrower.
- Under the contract, the broker must disclose how many sources will be shopped from or may use for a borrower's loan.

- The disclosure requirement in the 1992 rule may have caused mortgage brokers to establish warehouse lines of credit to avoid the disclosure requirement.

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- The larger the differences, between the premiums and fees associated with borrowers the closer enforcement agencies will look for possible disparate treatment.

- Mortgage brokers wishing to qualify for the safe harbor must complete and execute the mortgage broker contract before application or before receipt of any payment.

- For mortgage brokers meeting the requirements of the qualified safe harbor, volume-based compensation would be presumed legal.

HUD PROPOSED MODEL MORTGAGE BROKER CONTRACT

Proposed Model for Mortgage Broker Contract

Notice to Prospective Borrower(s):

Read this contract carefully so that you make an informed choice.

This contract is between:

[Name(s) of borrower(s)] the "Borrower(s)" or "you" and [Name of mortgage broker company] located at [Address of mortgage broker company], who has authorized [Representative of mortgage broker company] to enter into this contract on its behalf. In this contract, the mortgage broker company and the mortgage broker are called "I" and the entity that will provide your mortgage loan funds is called "lender."

Who Do I Represent?

I REPRESENT YOU: Yes No

I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives. I will shop for your loan from among [number] lender(s). For my services, I will charge you a fee, but I will not receive any fee for your mortgage loan from a lender.

I REPRESENT YOU, BUT I MAY RECEIVE A FEE FROM A LENDER Yes No

I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives. I will shop for your loan from among [number] lender(s). For my services, I may charge you a fee and I may also receive an additional fee for your mortgage loan from a lender.

I DO NOT REPRESENT YOU Yes No

I am not your agent. I arrange loans from lender(s). For my services, lenders and borrowers pay me. I make mortgage loans available from

[] One lender: [Name of lender] [or] [ ] [number] lenders.

What Will I Be Paid?

For arranging your loan of up to $ at an interest rate of _____[% rate or reference/attach ARM program] I will receive no greater than points and other compensation of $ _____ so that my total compensation will be no greater than: _____ [total compensation in $ amount and/or % of loan].

My TOTAL COMPENSATION will be made up of--

Fees YOU PAY me of: _____ [$ amount and/or % of loan]

Plus

Fees a LENDER PAYS me of: _____ [$ amount and/or % of loan]

If you would rather pay a lower interest rate, you may pay higher upfront fees; if you pay less up front, you may pay a higher interest rate. Before you sign this contract, I can display alternatives for you.

The amounts disclosed here apply only if you qualify for this loan.

We agree to the terms of this contract. By signing below, the mortgage broker further certifies that the information in this contract is accurate and complies with all provisions of section 8 of the Real Estate Settlement Procedures Act and 24 CFR part 3500.

Borrower(s) Signature and Date

_____

Borrower(s) Signature and Date

_____

Mortgage Broker Signature and Date

_____

Mortgage Broker License No. (Where applicable)

_____

Notice to Borrower(s)

You are entitled to a copy of this contract. Signing this contract does not obligate you to obtain a mortgage loan through this mortgage broker, nor is it mortgage loan approval.

[Back of Form]
BORROWERS - KNOW YOUR RIGHTS!

ATTENTION BORROWER:

This may be the largest and most important loan you get during your lifetime. You should be aware of certain rights before you enter into any loan agreement.

1. You have the RIGHT to shop for the best loan for you and compare the charges of different mortgage brokers and lenders.

2. You have the RIGHT to be informed about the total cost of your loan including the interest rate, points and other fees.

3. You have the RIGHT to ask for a Good Faith Estimate of all loan and settlement charges before you agree to the loan and pay any fees.

4. You have the RIGHT to know what fees are not refundable if you decide to cancel the loan agreement.

5. You have the RIGHT to ask your mortgage broker to explain exactly what the mortgage broker will do for you.

6. You have the RIGHT to know how much the mortgage broker is getting paid by you and the lender for your loan.

7. You have the RIGHT to ask questions about charges and loan terms that you do not understand.

8. You have the RIGHT to a credit decision that is not based on your race, color, religion, national origin, sex, marital status, age, or whether any income is from public assistance.

9. You have the RIGHT to know the reason if your loan was turned down.

10. You have the RIGHT to ask for the HUD settlement costs booklet "Buying Your Home."

"Buying Your Home" and other helpful information is available at HUD's WEB site: http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm For other questions call (800) 569-4287.

[INSTRUCTIONS TO PREPARER: This contract shall be used by a mortgage broker who wishes to claim the qualified safe harbor provided in 24 CFR 3500.14(g)(2). At the top of the contract, insert the name of the prospective borrower(s), the name and address of the mortgage broker's company, and the name of the mortgage broker representative.

Mark the applicable box from among "I REPRESENT YOU," "I REPRESENT YOU, BUT I MAY RECEIVE A FEE FROM A LENDER," or "I DO NOT REPRESENT YOU." If either of the first two

boxes are marked, in the appropriate box, state the number of lenders that will be shopped for the loan. If "I DO NOT REPRESENT YOU" is selected, mark the applicable line corresponding to either: (1) "one lender" (insert the name of the lender), or (2) "_[number]_____ lenders" (insert the number of lenders).

Under "Compensation," fill in: (1) the loan amount (which may be stated in terms of an "up to" amount) and the interest rate for the loan (in the case of ARMs, attach or reference descriptive material for the particular ARM program); (2) the points and other compensation to be received by the broker for the loan; (3) the total compensation to be paid to the mortgage broker for the loan including all points and other compensation which may be paid by the borrower and/or the lender; (4) the applicable dollar amount or percentage of mortgage loan principal amount that represents the prospective borrower(s) direct fee (including points, application and any other origination fees)(if none, put "NONE"); and (5) the maximum indirect fees that may be received from the lender in connection with providing the borrower(s) a mortgage loan (if none, put "NONE").

The prospective borrower(s) and the mortgage broker are to sign and date the contract. The preparer is to fill in the mortgage broker license number where indicated or fill in "State does not license mortgage brokers" if applicable. One copy is to be provided to the prospective borrower(s); another is to be retained in the borrower's mortgage loan file. This contract is to be in clear and conspicuous type. The heading "APPENDIX F TO PART 3500" and these INSTRUCTIONS TO PREPARER should not appear on the contract.]

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