

## **RESPA Reform – One Step Up, Two Steps Back**

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### **Legislative Update: Washington, D.C. Takes on Closing Reform**

On May 7, the House of Representatives passed a bill entitled “The Mortgage Reform and Anti-Predatory Lending Act,” which included a provision ordering the Secretary of Housing and Urban Development (HUD) to suspend implementation of any of the changes made to RESPA, the Good Faith Estimate, and the HUD-1 and 1A forms that were issued by HUD in November 2008. In a surprise move, however, HUD Secretary Shaun Donovan said in a press release on May 12 that he intends to proceed with implementing those changes to RESPA that were originally scheduled to go into effect in January 2010. He also stated that he estimates the RESPA revisions will reduce the average consumer closing cost by \$700 and he thinks RESPA reform is too important to delay. Now we will have to wait and see if the Senate passes a similar measure and the bill gets signed into law. As of May 14, the Senate has not yet introduced a bill requiring HUD to halt implementing RESPA reform, but judging from the speed with which the measure was addressed in the House and the overwhelming support for the measure (the vote was 300-114), one can surmise that the Senate will probably do the same without much delay. The measure to halt all implementing the changes to RESPA was backed by the American Land Title Association, the American Bankers Association, the Mortgage Bankers Association, the Housing Policy Council of the Financial Services Roundtable, and even the Federal Reserve Board. The White House asked all federal agencies to review regulations from the Bush administration that had not yet gone into effect as of January 2009, so it would seem there is a fair amount of pressure on HUD not to proceed with the Final Rule issued by HUD in November. The trade organizations that lobbied Congress to pass the bill halting the implementation of RESPA joined together on May 14 to send Secretary Donovan a letter urging him to please reconsider his decision to proceed with implementing the changes. ALTA and the other groups would like to see joint rulemaking between HUD and the Federal Reserve Board so as to provide consistency to both consumers and settlement service providers.

The day after the House passed the Mortgage Reform Act, the Federal Reserve Board announced its promulgation of final rules to implement the new disclosure obligations under Regulation Z, or Truth in Lending. These changes to mortgage loan disclosures are mandated by the Mortgage Disclosure Improvement Act (MDIA) of 2008, which made substantial revisions to the Truth in Lending Act. The Mortgage Reform Act, if it becomes law, will make significant additional changes to the Truth in Lending Act and to the Truth-in-Lending form, beyond what is being implemented now pursuant to the MDIA. See below for changes to the Truth in Lending Act that will go into effect for loan applications taken on or after July 30, 2009.

*Background on RESPA Reform:* Industry groups and consumer advocates were surprised when HUD announced RESPA reform in November, during the waning days of the Bush administration. RESPA reform had been expected to wait for either the incoming administration or for the opportunity for HUD to coordinate proposed changes to Truth-in-Lending Act as requested by the Federal Reserve Board. This is the main, ongoing concern of ALTA and other industry groups who signed the recent letter to Secy. Donovan. Previous attempts by HUD to promulgate RESPA reform had generated more than ten thousand comments during the public comment period to proposed changes, and hundreds of members of Congress lobbied HUD to not adopt the proposals. HUD made more revisions, solicited more comments from the public and the industry, and then made more changes. The Final Rule issued by HUD in November indicated that HUD has listened to some of the comments – for instance, it dropped the proposed “closing script” that would have been required to be read by the closing attorney/settlement agent at all closings – but had not adopted other requested revisions.

Congress has been attempting to amend the Truth in Lending Act via the Mortgage Reform and Anti-Predatory Lending Act, and already made some changes via the MDIA. Both Congress and the Fed had expected some coordinated efforts with HUD so that the changes to the TILA would be consistent with changes to RESPA. Industry groups are particularly concerned that any new forms adopted as a result of the changes to RESPA and the TILA should be compatible and, preferably, implemented simultaneously. The Final Rule as issued in November was *not* coordinated with proposed changes to the Truth-in-Lending Act, so there was much concern in the closing industry that there would be confusion about how and when to implement the various changes, which in turn would lead to a more difficult, time-consuming, and expensive closing experience for consumers.

In addition to amending the TILA, the Mortgage Reform Act and Anti-Predatory Lending Act would strengthen restrictions on broker and originator compensation based on loan rates and terms; put more liability for fraudulent loans on investors that package securities; require that lenders consider whether borrowers have a reasonable ability to repay their loans before making the loans; and encourage the market to move toward making traditional, fully documented loans. The Mortgage Reform Act also would restrict mandatory arbitration clauses in loans secured by a primary residence to reverse mortgages only; would require

lenders to demonstrate that the loan or refinance has a tangible benefit to consumers, would require a 6-month notice to consumers with “hybrid adjustable rate mortgages” (in other words, consumers who start with a fixed rate for a fixed period of time and then shift into an ARM) before their rate changes; would provide funding for legal assistance for homeowners with foreclosure problems, and also would prohibit “evasions” by lenders seeking to structure residential loans in such a way so as not to be subject to the Act.

### **Revised HUD-1, HUD-1A, and GFE Forms**

The RESPA revisions that are scheduled to go into effect in January 2010 (those with which Secretary Donovan intends to proceed) are the changes to the HUD-1 and 1A, and a new standardized Good Faith Estimate. To view the new forms with notes indicating what is new and different from the existing forms, click on the following links: [HUD-1](#) | [HUD-1A](#) | [Good Faith Estimate](#)

### **Average Charges**

Under the new RESPA provisions, settlement service providers who use a third-party for certain services on behalf of the borrower or seller, e.g., an overnight delivery service, may opt to show an *average* charge for that service on the settlement statement, rather than the exact amount of the charge. This may be beneficial to many settlement service providers, but those providers who opt to use the average-charge method must adhere to strict guidelines in order to comply with RESPA.

There is a prescribed method for determining the threshold issue of how to apply an average charge: “A settlement service provider may define a class of transactions based on the period of time (no less than 30 days nor more than six months), type of loan, and geographic area... Alternatively, a settlement service provider could establish the class of transactions in which it would use a single average charge broadly, i.e., all transactions it engages in for a period of time, regardless of the loan type or location.”

Once the provider has identified the class of transactions for which it would like to charge an average fee, it must then document the formula it uses to establish the average charge and keep all documents determining the accuracy of the pricing method for at least three years. Each individual “average charge” to borrowers or sellers may not exceed the average calculated by the service provider, and the total amounts collected from borrowers or sellers under the average charge method may not exceed the total paid to the third-party provider over the same period of time. For example, the total amount charged for overnight document delivery fees over a six month period of time cannot exceed the amount actually paid to that particular delivery service during that same six month period.

The final caveat for using the average charge option on the HUD-1 or 1A is that the average-charge method may not be used when the charge is based on the loan amount or property value. Therefore, it is not appropriate to calculate and collect an average charge for excise stamps, daily interest charges, escrow reserves, insurance, and the like.

### **“Required Use” of Affiliated Business Arrangements**

The major substantive change to RESPA that was made in the Final Rule, but which has now officially been abandoned by HUD, was the new, more restrictive definition of what constitutes “required use” of an affiliated business arrangement. The new definition of required use generated a firestorm of comments and even a lawsuit filed by the National Association of Homebuilders. Secretary Donovan has announced that HUD will readdress this issue and will arrive at a solution that protects consumers from this ongoing problem.

Affiliated Business Arrangements, or ABAs, are currently regulated by RESPA but there has been very limited enforcement by HUD when ABAs (violate the anti-kickback provisions of RESPA Section 8, and none at all when they force consumers to choose between using them or paying more for non-affiliated services. The RESPA Final Rule issued in November sought to regulate ABAs more closely, by more strictly defining (and therefore prohibiting) what constitutes required use of ABAs. The definition of “required use” is important as an indicator of what HUD might promulgate, even though this particular version has been abandoned. This is how HUD defined required use: “a situation in which a person’s access to some distinct service, property, discount, rebate or other economic incentive, *or the person’s ability to avoid an economic disincentive or penalty*, is contingent upon the person using or failing to use a referred provider of settlement services.” (emphasis added) The lawsuit by National Association of Home Builders alleges that the homebuilders with affiliated businesses will lose a competitive edge, because they will be required to provide incentives to *non*-affiliated businesses, if they want to provide incentives at all, in order to compete with other builders. The most trouble part of the new definition to persons who invested in ABAs is the inclusion of financial disincentives. Incentives offered to get borrowers to use a builder’s ABA obviously put extra money in the builder’s pockets, thus allowing them to at least partially, if

not fully, recoup the offered “incentive” to consumers. The “required use” definition and prohibition included an exemption if the affiliated business were to offer a combination of bona fide settlement services at a discounted price that is lower than the combination of services would be on the open market, if the bundle of services was optional, and if the discount was not made up elsewhere in higher charges to the consumer. The National Association of Homebuilders’ lawsuit asserts that builders have created business models for affiliated companies in reliance on existing RESPA regulations, and should not now be forced to either change their business models or lose the benefits of their investments in affiliated businesses. The existing RESPA regulation of ABAs does not specifically prohibit economic *disincentives*, so there has been leeway in what builders and others who invest in ABAs can get away with in the market. The most common incentive we’ve seen in North Carolina is the builder’s paying for title insurance but only if the builder’s ABA for title insurance is used. When the NAHB lawsuit was filed in January, HUD postponed the implementation of the “required use” prohibition in the RESPA changes until July 16. But on May 12, HUD announced it was keeping its current definition of “required use” in place and would work on developing a new definition. “And after further consultation with the public, stakeholders, and Congress we will propose a clearer and more effective “required use” definition that truly protects borrowers from those who force them to use affiliated businesses,” HUD Secretary Donovan stated.

### **Substantive Changes to the Truth in Lending Act, Effective July 30, 2009**

Currently, the Truth in Lending Act requires consumers who borrow money under a RESPA-regulated loan to buy or construct their primary residence to receive estimated Truth-in-Lending disclosures within three days of submitting their loan application to a loan originator. As of July 30, those disclosures must now be sent to borrowers for *all* loans secured by a primary residence, thus expanding the coverage to refinance loans. Disclosures must also be sent to borrowers before any fees are imposed on consumers, except for a bona fide, reasonable credit report fee. (The Final Rule promulgating RESPA reform passed last November also instituted a similar fee restriction, specifically prohibiting lenders from charging or collecting fees from borrowers until the borrowers had received a Good Faith Estimate.) Borrowers are presumed to receive disclosures on the third business day after they are mailed. The disclosures must be mailed within three business days of the lender’s receipt of the loan application (which is the same as the current timing requirement) and at least seven business days before the loan closes.

If the APR changes from the initially-disclosed rate, the lender must mail a new TIL so that it is received (or presumed received) by the borrower no less than three business days before the loan closing. Other changes that do not render the initial APR inaccurate do require a new TIL, but it need not be received by the borrower three business days before closing. “Business days” will be defined as all calendar days except Sundays and legal public holidays, as specified in 5 USC 6103(a). The initial disclosure and any subsequent corrected disclosure must also contain the following language: “You are not required to complete this agreement merely because you have received these disclosures or signed a loan application.”

Consumers may waive either or both of the waiting periods if the consumer has a personal financial emergency that must be addressed before the end of the waiting periods. However, the waiting periods may not be waived unless and until the borrower receives the required disclosures. Once the borrower has received the mandated disclosures, the borrower may then provide a signed, dated written explanation of the emergency and state that he/she is waiving the waiting period. This waiver must be signed by all persons who will be liable under the terms of the loan.

The MDIA also creates a new category of loans – “higher priced mortgage loans” – that are afforded special protections, effective October 1. A new “average prime rate offer rate” index has been created in order to determine which loans qualify as higher priced. It will be calculated by taking a representative sampling of low-risk mortgage creditors’ average interest rates, points, and other pricing terms. Any first-in-priority loan with an APR that is 1.5% or more above the average prime rate offer rate for comparable loans now will be considered a higher-priced mortgage loan. Loans designed to be a second or third are considered higher priced if the APR is 3.5% or more above the average prime rate offer rate.

Under the new regulations, a lender on a higher-priced mortgage loan cannot make a loan based solely on collateral value and not take into account the borrower’s ability to repay the loan. Stated income may not be used as a basis for the loan application, and any prepayment penalty imposed is limited to two years. All higher priced mortgage loans must include escrows for taxes and insurance. Lenders cannot structure these loans as home equity lines in an attempt to evade these additional protections.

*Future Attorneys Title newsletters will keep readers up-to-date on how Congress, HUD, and the Fed take on RESA reform and ongoing Truth-in-Lending reform.*