

OVERVIEW OF THE FEDERAL REAL ESTATE SETTLEMENT PROCEDURES ACT

MARCH 2009

**Marjorie A. Corwin, Esquire
Gordon, Feinblatt, Rothman,
Hoffberger & Hollander, LLC
233 East Redwood Street
Baltimore, Maryland 21202
410-576-4041
mcorwin@gfrlaw.com**

OVERVIEW OF THE FEDERAL REAL ESTATE SETTLEMENT PROCEDURES ACT

Prepared by
Marjorie A. Corwin
Gordon, Feinblatt, Rothman, Hoffberger & Hollander, LLC
The Garrett Building
233 East Redwood Street
Baltimore, Maryland 21202-3332
(410) 576-4041
mcorwin@gfrlaw.com

March 2009

I. Background

A. Introduction To RESPA

1. Congress first enacted the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. §§ 2601 et seq., in 1974 to reform the residential real estate settlement process.
2. Congress has strengthened and broadened RESPA over the years, and RESPA's referral restrictions have recently received a great amount of attention. Settlement service providers should expect further changes to RESPA.
3. The Department of Housing and Urban Development ("HUD") is charged with issuing regulations for, and overseeing compliance with, RESPA. The regulation that HUD has issued to implement RESPA is known as "Regulation X" and is found at 24 C.F.R. Part 3500.

B. When RESPA Applies

1. *Loans Covered By RESPA.* RESPA applies to "federally related" mortgage loans. Whether a mortgage loan is "federally related" depends on the nature of the security property and on whether the lender, insurer, or eventual purchaser of the loan has certain "federal connections."
 - a. The security property must be residential real property with improvements (either existing or to be constructed using the loan proceeds) that are designed principally for occupancy of from 1 to 4 families (including individual condominium or cooperative units and manufactured homes).

Comment: Except as otherwise noted, RESPA will apply regardless of the lien priority (first mortgage, second mortgage, etc.) and regardless of the type of loan (purchase money, refinance, home equity conversion or "reverse"

mortgage, etc.).

b. The loan must be:

- (i) Made by a lender that is regulated by a federal agency or a financial institution whose deposits are federally-insured;
- (ii) Made, insured, guaranteed, supplemented, or assisted in any way by HUD or any other federal agency;
- (iii) Intended to be sold to Fannie Mae, Ginnie Mae, Freddie Mac, or to a financial institution from which Freddie Mac will purchase the loan;
- (iv) Made by a lender who makes or invests in more than 5 loans totaling over \$1 million per year on residential real estate (including multi-family dwellings); or
- (v) Originated by a mortgage broker and assigned to any lender identified above.

2. *Exemptions.* RESPA does not apply to:

- a. Loans on properties of 25 acres or more;
- b. Loans made primarily for a business, commercial, or agricultural purpose;
- c. Temporary financing, including construction financing for which there is no offer of permanent financing and which has a term of less than two years;
- d. Loans on vacant land where the proceeds of the loan will not be used to improve the property with a 1 to 4 family residence (including a manufactured home);
- e. Assumptions of federally related loans for which the lender does not have the express right to approve the assuming borrower;
- f. Conversions of federally related mortgage loans to different terms consistent with the terms of the original mortgage documents, provided that a new note is not required; and
- g. Transfers of loan obligations in bona fide secondary market transactions.

Comment: The assignment of tablefunded loans from the nominal creditor/mortgage broker to the party providing the settlement funds is not a secondary market transaction.

3. *Tablefunded Transactions.* For RESPA purposes, the "lender" is generally the creditor named in the note and security instrument. In tablefunded transactions, however, where the mortgage broker is the nominal creditor, but the loan is funded by a third party and the loan is assigned to that third party at or after closing, the "lender" is deemed to be the party providing the funds and to whom the loan is initially assigned.

Comment: This means that the HUD Settlement Statement for a tablefunded transaction should identify the funding source as the creditor.

C. RESPA Requirements In General

1. *Disclosure Requirements.* RESPA requires that up to 5 different types of information be provided to borrowers:
 - a. Special Information Booklet;
 - b. Good Faith Estimate, including disclosure of Required Service Providers;
 - c. HUD Settlement Statements;
 - d. Servicing Transfer Disclosures;
 - e. Affiliated Business Arrangement Disclosures.
2. *Referral Fee Prohibitions.* RESPA imposes serious restrictions on the referral of "settlement service business" in return for any thing of value.
3. *Servicing Mortgage Loans and Escrow Accounts.* RESPA obligates persons who service federally related mortgage loans to take certain actions. It also prohibits servicers from other actions. A discussion of loan servicer obligations is beyond the scope of this Outline.
4. *Significant RESPA Terms.* RESPA and Regulation X define many terms. Certain definitions are essential to understanding RESPA.
 - a. A "business day" is any day on which the settlement service provider's offices are open to the public for carrying on substantially all business functions.
 - b. For RESPA purposes, **until January 1, 2010**, an "application" means the submission of an applicant's financial information in anticipation of a credit decision, whether the submission is written or computer generated. **If the submission does not state or identify a specific property, the submission is not considered to be an application for a federally related loan** and instead is considered a request for a pre-qualification not covered by RESPA. When an identified property is added to the

submission, it then becomes an "application" under RESPA (i.e., an application for a federally related mortgage loan) and triggers the RESPA disclosure requirements.

Practice Tip: RESPA applications do not have to be in writing. Thus, for RESPA purposes, an application can be received over the telephone. If both financial and property information are known or obtained by the broker or lender, an application likely has been submitted and RESPA disclosures are required.

Beginning January 1, 2010, for RESPA purposes, an "application" means "the submission of a borrower's financial information in anticipation of a credit decision relating to a federally related mortgage loan, which shall include the borrower's name, the borrower's monthly income, the borrower's social security number to obtain a credit report, the property address, an estimate of the value of the property, the mortgage loan amount sought, and any other information deemed necessary by the loan originator. An application may either be in writing or electronically submitted, including a written record of an oral application."

Practice Tip: This definition is intended to give the lender or broker some control over when an application is received, which triggers the requirement to provide a Good Faith Estimate.

- c. "Settlement service business" includes any service provided in connection with a real estate settlement including, but not limited to: title searches, title examinations, providing of title certificates, title insurance, services rendered by an attorney, preparation of documents, property surveys, rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or mortgage broker, the origination of a federally related mortgage loan (including the taking of loan applications, loan processing, underwriting, and funding of loans), and handling of the processing and closing or settlement functions.
- d. "Settlement service" includes any service provided in connection with a prospective or actual settlement, including, but not limited to, any one or more of the following:
 - (i) Origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of such loans);
 - (ii) Rendering of services by a mortgage broker (including counseling, taking of applications, obtaining verifications and appraisals, and other loan processing and origination services, and communicating with the borrower and lender);

- (iii) Provision of any services related to the origination, processing or funding of a federally related mortgage loan;
 - (iv) Provision of title services, including title searches, title examinations, abstract preparation, insurability determinations, and the issuance of title commitments and title insurance policies;
 - (v) Rendering of services by an attorney;
 - (vi) Preparation of documents, including notarization, delivery, and recordation;
 - (vii) Rendering of credit reports and appraisals;
 - (viii) Rendering of inspections, including inspections required by applicable law or any inspections required by the sales contract or mortgage documents prior to transfer of title;
 - (ix) Conducting of settlement by a settlement agent and any related services;
 - (x) Provision of services involving mortgage insurance;
 - (xi) Provision of services involving hazard, flood, or other casualty insurance or homeowner's warranties;
 - (xii) Provision of services involving mortgage life, disability, or similar insurance designed to pay a mortgage loan upon disability or death of a borrower, but only if such insurance is required by the lender as a condition of the loan;
 - (xiii) Provision of services involving real property taxes or any other assessments or charges on the real property;
 - (xiv) Rendering of services by a real estate agent or real estate broker; and
 - (xv) Provision of any other services for which a settlement service provider requires a borrower or seller to pay.
- e. "Origination service" is a new definition, **effective January 1, 2010**, and means "any service involved in the creation of a mortgage loan, including but not limited to the taking of the loan application, loan processing, and the underwriting and funding of the loan, and the processing and administrative services required to perform these functions."
- f. According to revised Regulation X, **beginning January 16, 2009**, "required use" means "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.” The definition in Regulation X continues to refine this definition as it relates to affiliated business arrangements (see Section IV below).

Practice Tip: Due to a lawsuit filed by the National Association of Homebuilders, which asked for immediate injunctive relieve, HUD has decided to delay the effectiveness of the new definition of “required use” for 90 days.

- g. **Beginning January 1, 2010**, “changed circumstances” means: (1)(i) acts of God, war, disaster, or other emergency; (ii) information particular to the borrower or transaction that was relied on in providing the GFE and that changes or is found to be inaccurate after the GFE has been provided. This may include information about the credit quality of the borrower, the amount of the loan, the estimated value of the property, or any other information that was used in providing the GFE; (iii) new information particular to the borrower or transaction that was not relied on in providing the GFE; or (iv) other circumstances that are particular to the borrower or transaction, including boundary disputes, the need for flood insurance, or environmental problems. (2) “Changed circumstances” do not include: (i) the borrower's name, the borrower's monthly income, the property address, an estimate of the value of the property, the mortgage loan amount sought, and any information contained in any credit report obtained by the loan originator prior to providing the GFE, unless the information changes or is found to be inaccurate after the GFE has been provided; or (ii) market price fluctuations by themselves.

II. Disclosures and Forms

A. Special Information Booklet

1. The Special Information Booklet is a booklet prepared by HUD to help borrowers understand the nature and purpose of the costs relating to real estate settlements.
2. The Special Information Booklet must be hand delivered or mailed within 3 business days after receipt or preparation of a loan application to at least one of the applicants. **However, it is *only required on first mortgage purchase money transactions.***
 - a. The Special Information Booklet need not be provided: if the loan application is denied within 3 business days of application; by the lender if a mortgage broker has provided a copy of the Special Information Booklet; on a home equity line of credit if the borrower is provided with a copy of the brochure "When Your Home is On the Line: What You Should Know About

Home Equity Lines of Credit"; on refinance loans; on secondary mortgage loans; or on home equity conversion or "reverse" mortgages.

B. Good Faith Estimate: Until January 1, 2010

1. The Good Faith Estimate is an estimate of the amount or range of settlement service charges the borrower is likely to incur in connection with the settlement of a mortgage loan. It must include the identification of service providers whose charges the borrower will be required to pay.
2. The Good Faith Estimate must be hand delivered or mailed to all applicants within 3 business days after the receipt or preparation of a loan application.
3. The Good Faith Estimate need not be provided:
 - a. If the loan application is denied within 3 business days of application;
 - b. By the lender if the lender has ascertained that the mortgage broker has delivered a Good Faith Estimate to the borrower;
 - c. On a home equity line of credit where the borrower has been provided with the home equity plan disclosures required under the Truth in Lending Act.
4. Disclosure of Estimated Costs
 - a. The Good Faith Estimate must provide an estimate of the charges that are expected to be listed in Section "L" of the HUD-1 or HUD-1A Settlement Statement. The estimates:
 - (i) May be expressed as a dollar amount or as a cost amount range;
 - (ii) Must be based upon the common practice in the locality of the mortgaged property;
 - (iii) Must be made in good faith.
 - b. All compensation that the mortgage broker or lender will receive as part of the funding transaction must be disclosed on the Good Faith Estimate.
 - (i) This includes mortgage broker fees paid by the borrower, as well as compensation paid by the lender to the broker (commonly referred to as "servicing release premiums" or "yield spread premiums").
 - (ii) Lender-paid broker compensation should be shown as "POC" (Paid Outside Closing).

- c. Any charges that are paid for by the borrower in advance of loan closing, such as credit report and appraisal fees, should be shown as "POC, " and should reflect the actual provider charge for such services.
- d. For "no cost" or "no point" loans, the Good Faith Estimate must disclose any payments to settlement service providers that the lender will make. These items should be shown as "POC."

5. Disclosure of Required Service Providers

- a. If the mortgage broker and/or lender will require that the borrower use a *particular* provider of a settlement service and will require the borrower to pay any portion of the cost of that service, the Good Faith Estimate must include certain information about that "required service provider" as follows:
 - (i) That use of the particular service provider is required;
 - (ii) That the Good Faith Estimate is based on charges of the provider;
 - (iii) The name, address, and telephone number of each required provider; and
 - (iv) A description of the nature of any relationship between each required provider and the mortgage broker or lender.
- b. If the mortgage broker or lender maintains a list of required service providers (5 or more for each distinct settlement service) or relies on a list maintained by others, and at the time of application the mortgage broker or lender has not yet decided which provider will be selected from the list, the mortgage broker or lender may instead:
 - (i) Provide the borrower with a written statement that a particular provider from a lender-controlled or lender-approved list will be required;
 - (ii) Disclose the range of costs for the required provider(s) on the Good Faith Estimate; and
 - (iii) Disclose the name of the actual provider and the actual cost on the HUD-1 or HUD-1A Settlement Statement.
- c. If the mortgage broker or lender has an "affiliated business arrangement" (see Section I below) with a particular provider of a settlement service, the mortgage broker cannot require the use of that provider.

C. Good Faith Estimate: **Beginning January 1, 2010**

1. **Beginning January 1, 2010**, the Good Faith Estimate (“GFE”) means an estimate of settlement charges a borrower is likely to incur, as a dollar amount, and related loan information, based upon common practice and experience in the locality of the mortgaged property, as provided on the form prescribed in Regulation X and prepared in accordance with the Instructions in Regulation X, Appendix C.
2. With some exceptions, discussed below, not later than 3 business days after a lender receives an application, or information sufficient to complete an application, the lender must provide the applicant with a GFE.
 - (i) The lender must provide the GFE to the loan applicant by hand delivery, by placing it in the mail, or, if the applicant agrees, by fax, e-mail, or other electronic means.
 - (ii) The lender is not required to provide the applicant with a GFE if, before the end of the 3 business day period:
 - A. The lender denies the application; or
 - B. The applicant withdraws the application.
 - (iii) The lender is not permitted to charge, as a condition for providing a GFE, any fee for an appraisal, inspection, or other similar settlement service. However, the lender may, at its option, charge a fee limited to the cost of a credit report. The lender may not charge additional fees until after the applicant has received the GFE. If the GFE is mailed to the applicant, the applicant is considered to have received the GFE 3 calendar days after it is mailed, not including Sundays and certain specified legal public holidays.
 - (iv) The lender may at any time collect from the loan applicant any information that it requires in addition to the required application information. However, the lender is not permitted to require, as a condition for providing a GFE, that an applicant submit supplemental documentation to verify the information provided on the application.
3. With some exceptions, discussed below, either the lender or the mortgage broker must provide a GFE not later than 3 business days after a mortgage broker receives either an application or information sufficient to complete an application. The lender is responsible for ascertaining whether the GFE has been provided by the mortgage broker. If the mortgage broker has provided a GFE, the lender is not required to provide an additional GFE.
 - (i) The mortgage broker must provide the GFE by hand delivery, by placing it

in the mail, or, if the applicant agrees, by fax, email, or other electronic means.

- (ii) The mortgage broker is not required to provide the applicant with a GFE if, before the end of the 3 business day period:
 - A. The mortgage broker or lender denies the application; or
 - B. The applicant withdraws the application.
 - (iii) The mortgage broker is not permitted to charge, as a condition for providing a GFE, any fee for an appraisal, inspection, or other similar settlement service. The mortgage broker may, at its option, charge a fee limited to the cost of a credit report. The mortgage broker may not charge additional fees until after the applicant has received the GFE. If the GFE is mailed to the applicant, the applicant is considered to have received the GFE 3 calendar days after it is mailed, not including Sundays and certain specified legal public holidays.
 - (iv) The mortgage broker may at any time collect from the loan applicant any information that it requires in addition to the required application information. However, the mortgage broker is not permitted to require, as a condition for providing a GFE, that an applicant submit supplemental documentation to verify the information provided on the application.
4. Except as provided in this paragraph, the estimate of the charges and terms for all settlement services must be available for at least 10 business days from when the GFE is provided, but it may remain available longer, if the lender or mortgage broker extends the period of availability. The estimate for the following charges are excepted from this requirement: the interest rate, charges and terms dependent upon the interest rate, which includes the charge or credit for the interest rate chosen, the adjusted origination charges, and per diem interest.
5. There is a new GFE form that must be used **beginning January 1, 2010**. The GFE form is set out in Regulation X, Appendix C, which includes instructions for completing the GFE form.
6. **Beginning January 1, 2010**, there are acceptable “tolerances” for the amounts shown on the GFE. “Tolerance” means the maximum amount by which the charge for a category or categories of settlement costs may exceed the amount of the estimate for such category or categories on a GFE.
- (i) Except as provided in paragraph 7 below, there are no tolerances for and the actual charges at settlement may not exceed the amounts included on the GFE for:

- A. The origination charge;
 - B. While the borrower's interest rate is locked, the credit or charge for the interest rate chosen;
 - C. While the borrower's interest rate is locked, the adjusted origination charge; and
 - D. Transfer taxes.
- (ii) Except as provided in paragraph 7 below, there is a tolerance for and the sum of the charges at settlement for the following services may not be greater than 10 percent above the sum of the amounts included on the GFE:
- E. Lender-required settlement services, where the lender selects the third party settlement service provider;
 - F. Lender-required services, title services and required title insurance, and owner's title insurance, when the borrower uses a settlement service provider identified by the loan originator; and
 - G. Government recording charges.
- (iii) There are full tolerances for and the amounts charged for all other settlement services included on the GFE may change at settlement except to the extent that the GFE is "binding" (see paragraph 7 below).
7. The GFE is "binding" and the lender or mortgage broker is bound (within the tolerances provided above) to the settlement charges and terms listed on the GFE provided to the borrower, unless a new GFE is provided prior to settlement as permitted by the regulations. If a lender or mortgage broker provides a revised GFE consistent with the regulations, the lender or mortgage broker must document the reason that a new GFE was provided. Lenders and mortgage brokers must retain documentation of any reasons for providing a new GFE for no less than 3 years after settlement.
- (i) If "changed circumstances" result in increased costs for any settlement services such that the charges at settlement would exceed the tolerances for those charges, the lender or mortgage broker may provide a revised GFE to the borrower. If a revised GFE is to be provided, the lender or mortgage broker must do so within 3 business days of receiving information sufficient to establish changed circumstances. The revised GFE may increase charges for services listed on the GFE only to the extent that the changed circumstances actually resulted in higher charges.
 - (ii) If "changed circumstances" result in a change in the borrower's eligibility

for the specific loan terms identified in the GFE, the lender or mortgage broker may provide a revised GFE to the borrower. If a revised GFE is to be provided, the loan originator must do so within 3 business days of receiving information sufficient to establish changed circumstances.

A. "Changed circumstances" is expressly defined in Regulation X.

- (iii) If a borrower requests changes to the mortgage loan identified in the GFE that change the settlement charges or the terms of the loan, the lender or mortgage broker may provide a revised GFE to the borrower. If a revised GFE is to be provided, the loan originator must do so within 3 business days of the borrower's request.
 - (iv) If a borrower does not express an intent to continue with an application within 10 business days after the GFE is provided, or such longer time specified by the lender or mortgage broker, the GFE is no longer binding.
 - (v) If the interest rate has not been locked by the borrower, or a locked interest rate has expired, the charge or credit for the interest rate chosen, the adjusted origination charges, per diem interest, and loan terms related to the interest rate may change. If the borrower later locks the interest rate, a new GFE must be provided showing the revised interest rate-dependent charges and terms. All other charges and terms must remain the same as on the original GFE, except as otherwise permitted by the regulation.
 - (vi) In transactions involving new home purchases, where settlement is anticipated to occur more than 60 calendar days from the time a GFE is provided, the loan originator may provide the GFE to the borrower with a clear and conspicuous disclosure stating that at any time up until 60 calendar days prior to closing, the lender or mortgage broker may issue a revised GFE. If no such separate disclosure is provided, the loan originator cannot issue a revised GFE, except as otherwise permitted by the regulations.
8. The GFE is not a loan commitment and it does not require a lender to make a loan to a particular borrower. The lender or mortgage broker is not required to provide a GFE if the lender or mortgage broker does not have available a loan for which the borrower is eligible.

D. HUD-1 and HUD-1A Settlement Statements

1. The HUD Settlement Statements provide a summary of the actual amounts paid and received by each party to a loan closing. The HUD-1 is designed for use in purchase transactions, and includes both seller and purchaser/borrower information. The HUD-1 may be used in non-purchase transactions as well. The HUD-1A is designed for use only in non-purchase transactions, and includes only borrower information.
2. Mortgage brokers and lenders are not responsible for providing a settlement statement, and, prior to January 16, 2009, were not responsible for the contents of the settlement statement. Prior to January 16, 2009, the settlement statement was the sole responsibility of the settlement agent. **Beginning January 16, 2009**, revised RESPA regulations impose on the lender and the mortgage broker the responsibility to transmit to the settlement agent all information necessary to complete the HUD-1 or HUD-1A.
3. There are certain things a mortgage broker or lender should know about the HUD Settlement Statements.
 - a. RESPA gives the borrower the right to inspect the HUD Settlement Statement during the business day immediately preceding settlement. If the borrower requests inspection of the HUD Settlement Statement before closing, the settlement agent must complete the HUD-1 or HUD-1A based upon the information known at the time.
 - b. All compensation that the mortgage broker or lender will receive as a part of the funding transaction must be disclosed on the HUD Settlement Statement. This includes compensation paid by either the borrower or the lender.
 - c. In a tablefunding transaction, the HUD Settlement Statement should identify the investor/funding source as the lender for the transaction.
4. **Beginning January 16, 2009**, the lender or mortgage broker must transmit to the settlement agent all information necessary to complete the HUD-1 or HUD-1A.
5. **Beginning January 16, 2009**, there are some changes in how the settlement agent must complete the HUD-1 and HUD-1A.
 - a. Each third party charge paid by the borrower and/or the seller must be separately itemized and shown with the identity of the third party who is receiving the payment.
 - b. Origination services performed by or on behalf of the lender or the mortgage

broker must not be itemized but rather must be grouped together (aggregated) and included in the lender's or broker's own charge.

- c. Administrative and processing services related to title services must be grouped together (aggregated) and included in the title underwriter's or title agent's own charge.
- d. The amount stated on the HUD-1 or HUD-1A for any itemized service cannot exceed the amount actually received by the settlement service provider for that itemized service, unless the charge is an "average charge" (see below)
- e. **Beginning January 16, 2009**, the "average charge" for a settlement service may be shown on the HUD-1 or HUD-1A but subject to certain limitations.
 - (i) The "average charge" shall be no more than the average amount paid for a settlement service by one settlement service provider to another settlement service provider on behalf of borrowers and sellers for a particular class of transactions involving federally related mortgage loans. The total amounts paid by borrowers and sellers for a settlement service based on the use of an average charge may not exceed the total amounts paid to the providers of that service for the particular class of transactions.
 - (ii) The settlement service provider shall define the particular class of transactions for purposes of calculating the average charge as all transactions involving federally related mortgage loans for:
 - A. A period of time as determined by the settlement service provider, but not less than 30 calendar days and not more than 6 months;
 - B. A geographic area as determined by the settlement service provider; and
 - C. A type of loan as determined by the settlement service provider.
 - (iii) A settlement service provider may use an average charge in the same class of transactions for which the charge was calculated. If the settlement service provider uses the average charge for any transaction in the class, the settlement service provider must use the same average charge in every transaction within that class for which a Good Faith Estimate was provided.
 - (iv) The use of an average charge is not permitted for any settlement service if the charge for the service is based on the loan amount or

property value.

- (v) The settlement service provider must retain all documentation used to calculate the average charge for a particular class of transactions for at least 3 years after any settlement for which that average charge was used.
6. Appendix A to Regulation X provides instructions to settlement agents on how to complete the HUD-1 and HUD-1A settlement statements. **Effective January 1, 2010**, Appendix A changes significantly (to coincide with dramatic changes to the HUD-1 and HUD-1A forms and with implementation of the new Good Faith Estimate form).

E. Servicing Disclosures

1. On first mortgage loan transactions, RESPA requires lenders, *including tablefunding mortgage brokers*, to provide borrowers with two distinct disclosures relating to the transfer of loan servicing.
 - a. Mortgage brokers (other than those involved in a tablefunding transaction) are not required to make any disclosures relating to servicing.
 - b. Servicing disclosures are not required on second mortgages or on home equity lines of credit.
2. "Upfront" Servicing Disclosure Statement: **Effective January 16, 2009**.
 - a. This disclosure applicable to first mortgage lenders explains about the potential for a transfer of servicing, and must be hand delivered or mailed to the applicant, or if the applicant agrees by fax, email, or other electronic means, within 3 business days after loan application.
 - (i) The lender does not have to provide a Servicing Disclosure Statement if the loan is denied within 3 business days of application.
 - (ii) If the Servicing Disclosure Statement is mailed, and all co-applicants have the same address, only one copy of the Servicing Disclosure statement need be sent. If co-applicants have different addresses, one copy must be delivered to each of the co-applicants.
 - b. The Servicing Disclosure Statement informs the borrower of the potential for transfer of the servicing of the borrower's loan.
 - c. **Effective January 16, 2009**, a new, simple format for the Servicing Disclosure Statement may be used. It is set forth in Regulation X, at Appendix MS-1. A written acknowledgment is no longer required.

3. Notice of Transfer.

- a. This notice informs the borrower that the servicing of the loan is being transferred. Both the transferor and the transferee must provide Notices of Transfer within certain time periods.
 - (i) The transferor and transferee servicers may send a combined notice, which must be delivered at least 15 days before the effective date of the transfer.
 - (ii) If the loan is to be transferred shortly after closing, either separate Notices of Transfer or a combined Notice of Transfer may instead be delivered to the borrower at closing.

Comment: The borrower in a tablefunding transaction is generally instructed at settlement to send his or her first payment to the funding investor.

- b. The Notice of Transfer must provide the effective date of the transfer, information about both the transferor and transferee servicers (including contact persons, addresses, and toll-free or collect-call phone numbers), the date the borrower should begin sending payments to the new servicer, information about the effect of the transfer on the continued availability of optional insurance coverages, a statement that the transfer of servicing does not affect terms or conditions of the loan other than those relating to servicing, and a statement of the borrower's rights in connection with complaint resolution.

Comment: Maryland also has a law requiring notice of mortgage loan transfers with different requirements. See MD Code Ann., Com. Law § 13-316. It is believed that RESPA preempts this Maryland law but only as to first lien mortgage loans.

III. Referral Fee Prohibitions and Exceptions

A. Referral Fee Prohibitions

1. *RESPA Prohibitions.* The prohibitions against referral fees are found in Section 8 of RESPA. See 12 U.S.C. § 2607. Section 8 provides that:
 - a. No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person; and
 - b. No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate

settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.

2. *Elements of a Section 8(a) Violation.* There are 3 basic elements to a Section 8(a) violation:

- a. There has to be a “payment” of a fee or other thing of value.
 - (i) The payment does not have to be in the form of money. Any type of consideration given to a recipient is covered, such as the free provision of unrelated legal services, the unrestricted use of a fax machine, tickets to sporting events, vacations, computers, interest-free loans, etc.
- b. Payment must be in exchange for the referral of settlement service business.
 - (i) "Settlement services" is broadly defined (see Section C.4.c. above).
 - (ii) The referral must be the reason for the payment. Payments for *bona fide* marketing services that are not related to the volume or value of referrals or will generally not be considered payments for referrals.
 - (iii) It does not matter whether the person paying for a referral passes on that cost by increasing charges to borrowers. The mere fact that the payment is made for a referral is a violation.
 - (iv) The fact that the person receiving the fee actually performs a settlement service may not prevent a violation. If only nominal services are provided, or the fee is disproportionately large in relation to the market value of the goods, facilities, or services provided, the excess may be treated as an unearned fee paid in exchange for a referral.
- c. Payment must be pursuant to an agreement or understanding between the referring party and the settlement service provider.
 - (i) The agreement or understanding does not have to be in writing or to be verbalized. It may be established by a practice, pattern, or course of conduct.
 - (ii) A payment that is made repeatedly and is connected in any way with the volume or value of the business referred to the payor by the recipient is presumed to be pursuant to an agreement or understanding for the referral of business.

3. *Elements of a Section 8(b) Violation.* The elements of a Section 8(b) violation include:

- a. The splitting of a charge or fee made or received for rendering a settlement service.
 - (i) There currently is a divide among the federal circuits as to whether this prohibition against splitting fees requires that there be more than one person receiving a fee for the settlement service performed (mark-ups v. overages). The Third and Eleventh Circuits take the view that there does not have to be more than one person involved for a violation of RESPA Section 8(b). See, e.g., Santiago et al. v. GMAC Mortgage Group, Inc. et al., 417 F. 3d 384 (3d Cir. PA 2005). The Fourth, Seventh, and Eighth Circuits take the view that there needs to be more than one person in order to establish a violation. See, e.g., Boulware v. Crossland Mortgage Corporation, 291 F. 3d 261 (4th Cir. MD 2002).
- b. No services are performed for the split of the charge.

B. Exceptions to Prohibitions

1. *Allowed Payments Under RESPA*. Section 8 does not prohibit:

- a. Payments to a lawyer for services actually rendered.
- b. Payments by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance.
- c. Payments by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan.
- d. Payments, including bona fide salaries and other compensation, to any person for goods or facilities actually furnished or for services actually performed.
- e. Payments pursuant to a cooperative brokerage and referral arrangement or agreement between real estate agents and real estate brokers.

Comment: This refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity. This exemption does not apply to fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.

- f. Normal promotional and educational activities that are not conditioned on the referral of business and that do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or related incidental business.
- g. An employer's payment to its own employees for any referral activities.

- h. An "affiliated business arrangement" that meets the criteria set forth below. See Section IV below.
2. *Broker Fees.* HUD has provided a framework to determine whether fees for mortgage loan origination services violate RESPA Section 8.
- a. It is clear from the HUD guidelines that the mere taking of an application will not justify the payment of a broker fee. What additional services will justify the fee, however, will be based on the specific circumstances involved. In particular, HUD looks at what services were actually performed, whether the services were necessary for the transaction, whether the services were duplicative of services also performed by others, and whether the fee was reasonably related to the market value of the services that were performed.
 - b. On February 26, 1999, HUD issued a revised policy on fees to mortgage brokers. See HUD Statement of Policy 1999-1. On October 18, 2001, HUD issued a second policy statement to clarify its policy on lender payments to mortgage brokers. See HUD Statement of Policy 2001-1.
 - c. These HUD Statements of Policy provide the best roadmap on HUD's position concerning permissible mortgage broker (and other third-party) fees.

C. HUD Enforcement Actions

1. *HUD Enforcement Actions.* In recent years HUD has become more active in enforcing RESPA compliance. Since the beginning of 2004, HUD has brought and settled at least 38 high profile allegations of RESPA Section 8 violations. See <http://www.hud.gov/offices/hsg/sfh/res/resetagr.cfm>.

D. Similar Laws

1. *Similar Maryland Law.* Under Maryland law, persons making payments for the referral of settlement service business can be convicted of a misdemeanor and subject to a fine not to exceed \$1,000, imprisonment for not more than 6 months, or both, for each violation. See MD Code Ann., Real Prop. § 14-127.
- a. This statute does not prevent payment of commissions to licensed insurance agents or the referral of settlement service business from one attorney to another attorney.
 - b. The Maryland Attorney General has opined that this Maryland law is not preempted by RESPA. 78 Opin. Att'y Gen. 86 (January 27, 1993). However, in an informal letter, counsel for the Maryland Attorney General advised that payment of a mortgage broker fee otherwise authorized by Maryland law does not violate this criminal statute. See Letter dated May 4, 1993 to Richard J. Andreano, Jr. from J. Steven Lovejoy. Further, in another

informal letter, counsel for the Maryland Attorney General advised that the opinion did not determine whether any particular practice (e.g., affiliated business arrangements) violates this Maryland law. See Letter dated November 6, 1997 to D. Robert Enten from Jack Schwartz.

2. *Similar FHA Restriction.* The Federal Housing Administration ("FHA") prohibits a mortgagee from paying any fee, kickback, compensation, or thing of value to any person or entity in connection with a HUD-FHA insured mortgage transaction, except for services actually performed and permitted by HUD.

IV. Affiliated Business Arrangements ("AfBAs")

1. A properly created and carefully operated AfBA is an exception to the RESPA referral prohibition. An AfBA exists when:

- a. A person in a position to refer settlement service business, or an associate of that person;

Note: "Associates" include immediate family members, affiliated corporations, and persons with certain other types of relationships with the person in question.

- b. Has an affiliate relationship with, or has a direct or beneficial ownership interest of more than 1 percent in, a settlement service provider; and

Note: "Affiliate relationship" exists only between or among business entities and arises due to common business ownership or control.

- c. The person or the associate directly or indirectly refers settlement service business to the provider or affirmatively influences a borrower's selection of the provider.

2. An AfBA does not violate RESPA's Section 8 referral fee provisions if:

- a. The person making the referral provides a very specific Affiliated Business Arrangement Disclosure to each person whose business is referred.

- (i) The AfBA Disclosure may not be combined with any other disclosure. It must be on a separate piece of paper.

- (ii) If the referring party is the mortgage broker or lender, the AfBA Disclosure must be provided either at the loan application or at the same time that the Good Faith Estimate is provided.

- (iii) If the referring party is any other person, the AfBA Disclosure must be provided at the time of referral.

- (iv) If the referral is by telephone, the written disclosure may be provided within 3 business days after the telephone referral (as long as an abbreviated verbal disclosure of the existence of the arrangement and the fact that the notice will be provided is made over the telephone at the time of the referral).
- b. The person making the referral does not require any person to use any particular provider of settlement services, *except* that the lender may require the borrower to pay for the services of an attorney, consumer reporting agency, or real estate appraiser chosen by the lender; and
 - (i) The definition of “required use” changed **effective January 16, 2009**, to mean: “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. In order to qualify for the affiliated business exemption under [the affiliated business arrangement rule], a settlement service provider may offer a combination of bona fide settlement services at a total price (net of the value of the associated discount, rebate, or other economic incentive) lower than the sum of the market prices of the individual settlement services and will not be found to have required the use of the settlement service providers as long as: (1) The use of any such combination is optional to the purchaser; and (2) the lower price for the combination is not made up by higher costs elsewhere in the settlement process.”

Practice Tip: Due to a lawsuit filed by the National Association of Homebuilders, which asked for immediate injunctive relieve, HUD has decided to delay the effectiveness of the new definition of “required use” for 90 days.

- c. The only thing of value received from the arrangement by the person making the referral, other than payments otherwise permitted under RESPA, is a legitimate return on the person's ownership interest in the affiliated settlement service provider.
 - (i) HUD’s regulations provide that a return on ownership interest does not include payments that vary by the amount of actual, estimated, or anticipated referrals or payments based on ownership shares that have been adjusted on the basis of previous referrals. When assessing whether a payment is a return on ownership interest or a payment for referrals of settlement service business, HUD will consider the following questions:

- 1) Has each owner or participant in the entity made an investment of its own capital, as compared to a "loan" from another entity that receives the benefits of referrals?
 - 2) Have the owners or participants of the entity received an ownership or participant's interest based on a fair value contribution? Or is it based on the expected referrals to be provided by the referring.
 - 3) Are the dividends, partnership distributions, or other payments made in proportion to the ownership interest (proportional to the investment in the entity as a whole)? Or does the payment vary to reflect the amount of business referred to the entity or a unit of the entity?
 - 4) Are the ownership interests in the entity free from tie-ins to referrals of business? Or have there been any adjustments to the ownership interests in the entity based on the amount of business referred?
3. AfBA's have come under significant scrutiny for being "sham arrangements."
- a. HUD issued a policy statement attempting to describe how it would evaluate whether an arrangement is merely a sham established for the purpose of evading RESPA Section 8. See HUD Statement of Policy 1996-2 regarding Sham Controlled Business Arrangements, 61 Federal Register 29258 (June 7, 1996).

Comment: The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended Section 8(c)(4) of the RESPA Act by changing the name "Controlled Business Arrangements" to "Affiliated Business Arrangements." No substantive changes were made to the law by this mere name change.

- b. HUD explained that it will consider the following factors in light of the specific facts in determining whether an entity is a bona fide settlement service provider:
 - (i) Does the entity have sufficient initial capital and net worth, typical in the industry, to conduct the settlement service business for which it was created? Or is it undercapitalized to do the work it purports to provide?
 - (ii) Is the entity staffed with its own employees to perform the services it provides? Or does the entity have "loaned" employees of one of the parent providers?
 - (iii) Does the entity manage its own business affairs? Or is an entity that

helped create the entity running it for the parent provider making the referrals?

- (iv) Does the entity have an office for business which is separate from one of the parent providers? If the entity is located at the same business address as one of the parent providers, does the entity pay a general market value rent for the facilities actually furnished?
- (v) Is the entity providing substantial services, i.e., the essential functions of the real estate settlement service, for which the entity receives a fee? Does it incur the risks and receive the rewards of any comparable enterprise operating in the market place?
- (vi) Does the entity perform all of the substantial services itself? Or does it contract out part of the work? If so, how much of the work is contracted out?
- (vii) If the entity contracts out some of its essential functions, does it contract services from an independent third party? Or are the services contracted from a parent, affiliated provider or an entity that helped create the controlled [affiliated] entity? If the entity contracts out work to a parent, affiliated provider, or an entity that helped create it, does the entity provide any functions that are of value to the settlement process?
- (viii) If the entity contracts out work to another party, is the party performing any contracted services receiving a payment for services or facilities provided that bears a reasonable relationship to the value of the services or goods received? Or is the contractor providing services or goods at a charge such that the entity is receiving a "thing of value" for referring settlement service business to the party performing the service?
- (ix) Is the entity actively competing in the market place for business? Does the entity receive or attempt to obtain business from settlement service providers other than one of the settlement service providers that created the entity?
- (x) Is the entity sending business exclusively to one of the settlement service providers that created it (such as the title application for a title policy to a title insurance underwriter or a loan package to a lender)? Or does the entity send business to a number of entities, which may include one of the providers that created it?

V. Penalties for Violations of RESPA

1. *Failure to provide Special Information Booklet, Good Faith Estimate, or HUD Settlement Statement disclosures.* RESPA does not impose penalties for failure to provide these required disclosures.
 - a. Administrative action (i.e., by regulator) could arise.
 - b. Recently courts have been consistently holding that a borrower has no private right to sue for damages when these RESPA disclosures are not provided.
 - c. State law claims of unfair or deceptive practices might be alleged.
2. *Failure to provide Servicing Disclosures.* RESPA imposes possible penalties for failure to provide servicing disclosures:
 - a. Individuals may bring a private cause of action and recover actual damages plus additional damages up to \$1,000 plus attorney fees.
 - b. Class action is available.
 - c. Correction procedures are available.
3. *Referral Fee Prohibitions.* A person who fails to comply with the referral Section 8 fee provisions of RESPA could be subject to criminal and civil liability:
 - a. **Criminal Penalties.** Each violation of RESPA Section 8 is punishable by imprisonment for up to one year, a fine of \$10,000, or both.
 - b. **Civil Liability.** Borrowers may bring a private action, including class actions, for damages of 3 times the amount of any charge paid for the settlement service involved in the violation. In private actions, the court may award court costs and reasonable attorneys' fees to the prevailing party.
 - c. **Injunctive Relief.** The Secretary of Housing and Urban Development and the State of Maryland are also authorized to bring court actions to enjoin RESPA Section 8 violations, to order restitution to persons charged an illegal fee, and to order the return of all profits made by an illegal activity.
 - d. **Investigations.** HUD is provided with great powers to investigate suspected RESPA Section 8 violations, including authorization to hold hearings, and subpoena attendance and testimony of witnesses and production of documents.