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CLIENT ADVISORY

CERTAIN OF HUD'S REVISED RESPA REGULATIONS WENT INTO EFFECT JANUARY 16, 2009

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Certain provisions of the US Department of Housing and Urban Development's (HUD's) final rule (Final Rule), amending Regulation X implementing the Real Estate Settlement Procedures Act (RESPA), went into effect on January 16, 2009. These provisions allow settlement service providers to use an "average charge" when calculating a service.

The Final Rule, issued November 17, 2008, requires loan originators to provide a new standardized Good Faith Estimate (GFE) and final settlement statement of the loan terms and costs of obtaining a home mortgage. The Final Rule also prohibits certain consumer incentive practices. These more sweeping changes are scheduled to go into effect on January 1, 2010. In addition, a provision expanding the definition of "required use" to include the use of lender economic incentives as violations of Section 8 of RESPA was to become effective January 16, 2009. However, HUD has delayed the enactment of this provision to April 16, 2009 in light of litigation filed by the National Association of Homebuilders (NAHB).

The Final Rule is the culmination of rulemakings by HUD in this area proposed over a period of over six years. The first rulemaking, proposed in 2002, was never finalized in the face of overwhelming opposition by mortgage brokers and lenders. This rulemaking, which also generated an estimated 12,000 responses during the public comment period, was able to be finalized given the subprime mortgage crisis and calls for reforms to be made to the mortgage origination process.

Citing problems in the mortgage industry, HUD did not formally coordinate the GFE disclosures with the credit disclosures of the Truth in Lending Act (TILA). This decision counters over 10 years of congressional and agency policies aimed at harmonizing TILA and RESPA disclosures onto a single required document. In addition to the GFE form, loan originators must also provide borrowers with a TILA disclosure form. These separate forms describe the terms of the same mortgage using different interest rate calculations, different components of the estimated monthly payments, and different descriptions of the loan's payment stream.

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The key provisions of the Final Rule are summarized below:

EFFECTIVE JANUARY 16, 2009:

Permitted Use of "Average Charges"

The Final Rule states that instead of providing the actual charge for a settlement service within individual HUD-1/1A settlement statements, settlement agents may use an average charge. This charge must be calculated from an average of all transactions during a period of not less than 30 days and not more than six months. Average charges may not be used for services with charges based on the loan amount or property value. This limitation excludes transfer taxes, any type of insurance, interest charges, and escrow from being listed as an average charge.

EFFECTIVE APRIL 16, 2009:

Redefinition of "Required Use"

The definition of the term "required use" has been expanded to include the practice of offering incentives to borrowers for selecting a preferred provider of settlement services. A business that is conducting "required use" practices is in violation of Section 8 of RESPA (12 U.S.C. § 2607). The original definition of "required use" was limited to situations in which a business required a consumer to pay for a particular settlement service provider in order to proceed with a transaction. The Final Rule includes, within this definition, economic incentives and disincentives/penalties used to influence a consumer to use a preferred settlement service provider.

The definition of "required use" under the Final Rule also implements an exemption to Section 8 of RESPA for practices under affiliated business agreements. The Final Rule limits this affiliated business exemption to settlement service providers only. In order for the exemption to apply, these businesses must offer a bona fide combination of settlement services that are optional, and lower in total price than the market prices of the services, if offered individually.

On December 22, 2008, the NAHB filed a lawsuit to prevent HUD from enforcing the Final Rule's definition of "required use." The NAHB charged that the regulation impermissibly singled out homebuilders, contradicted RESPA, and arbitrarily reversed past HUD policy. Many homebuilders have business models that use affiliated agreements with mortgage lenders. Under the Final Rule, these affiliated agreements are not exempt from RESPA's anti-kickback provisions because homebuilders are not settlement service providers. In light of the litigation, HUD has postponed the enactment of the definition until April 16, 2009.

EFFECTIVE JANUARY 1, 2010:

The most significant changes required to the settlement process in the Final Rule relate to the GFE form and final settlement statement.

Revised Good Faith Estimate Form Disclosures

The Final Rule still requires that a lender must provide a GFE of the settlement changes for a home loan within three business days of receiving a loan application. However, the GFE is revised to a standard three page form. Furthermore, the only costs that a lender or mortgage broker may charge for this estimate are the fees related to obtaining the applicant's credit report. The lender and mortgage broker may not charge fees for appraisal, inspection, or other similar settlement services until after the applicant has received the GFE.

The new GFE Form is available at: http://www.hud.gov/offices/hsg/sfh/res/gfestimate.pdf.

The first page of the new standardized GFE form contains a summary chart of the components of the estimated loan, including: the initial loan size, the interest rate, and the monthly payment amount. It also requires a summary of the existence of loan characteristics such as an adjustable rate, a prepayment penalty, a balloon payment, and an escrow account requirement. Towards the top of the first page, the Final Rule requires the disclosure of important dates related to the GFE, including the following: the deadline for locking in the estimated rate, the expiration date of the proposed terms, and the date in which settlement must occur after an interest rate is locked. The bottom of the first page of the new GFE contains a block where the total estimated settlement

charge must be set forth. This number is calculated based upon the estimates located on the second page.

The second page of the new GFE requires an individual list of all estimated settlement charges by category along with descriptions designed to educate the consumer of these costs. It includes government assessments, homeowners' and title insurance, as well additional services required by the lender. Unlike the current GFE form, the new GFE requires loan originators to also disclose the "adjusted origination charge" that a mortgage broker receives from the lender for initiating the loan. A chart attempts to break down the yield spread premiums (YSPs) that underlie the term "adjusted origination charge" by defining a higher interest rate in exchange for reduced settlement costs as a "credit." Alternatively, a lower interest rate in exchange for increased settlement costs is defined as a "charge."

The third page of the new GFE seeks to further clarify the YSP disclosure with a tradeoff table. The terms of the estimated GFE loan can be compared to other hypothetical loans with either lower settlement charges or a lower interest rate. The full use of the tradeoff table is optional for lenders, as they are only required to fill out information on the actual GFE loan terms within the first column. Also contained on this page is a shopping guide for comparing GFEs, and understanding what charges can change between the estimate and the final settlement.

Restrictions on Deviating from the GFE

Unlike current practice, the Final Rule makes the settlement charges of the GFE binding. While a lender is not required to make a loan to a particular borrower, the terms of any such loan may only vary from the terms of the GFE within certain tolerances. In particular, the origination charge, the YSP, and the transfer taxes at settlement may not be higher than originally estimated in the GFE. Furthermore, the sum of the charges at settlement for the following services may not be greater than 10 percent of their sum on the GFE: (1) lender-required settlement services where the lender selects the service, (2) lender-required title insurance and services if suggested by the lender, and (3) government recording charges. If any charges at settlement exceed the charges listed on the GFE by more than the permitted tolerances, the loan originator may cure the tolerance violation by reimbursing the borrower the amount by which the tolerance was exceeded, either at settlement or within 30 days.

A lender can provide a new GFE with different settlement costs prior to settlement, but the reason for this new disclosure must be documented. Legitimate reasons for a new GFE include: (1) a change in circumstances resulting in increased costs for any settlement service, (2) a change in the borrower's eligibility for specific loan terms, (3) a borrower's request for changes, or (4) the expiration of the GFE because the borrower did not express an intent to continue with the application within 10 days of the GFE being provided.

Revision of HUD-1/1A Settlement Statement

The Final Rule also revises the HUD-1/1A settlement statement forms to match the format and disclosures of the GFE. The new HUD-1/1A forms will display a comparison chart where the charges of the GFE are directly compared to the actual charges assessed at settlement. If a settlement charge exceeds the restrictions of the GFE, then the lender will be in violation of Section 5 of RESPA (12 U.S.C. § 2604), and will have 30 days to reimburse the borrower of the difference.

The revised HUD-1 Settlement Statement is available at: http://www.hud.gov/content/releases/hud-1.pdf.

CONCLUSIONS

HUD enacted this Final Rule despite pressure from members of Congress, the Federal Reserve, and the housing industry to withdraw the rule. The Federal Reserve as well as 244 members of Congress requested that the Rule be more coordinated with TILA disclosures before being finalized. In addition to thousands of comments, as noted above, the housing industry has responded with litigation to stop enactment of provisions of the Final Rule. HUD may therefore make further changes to this Final Rule as it defends litigation, and potentially implements new policies of the Obama Administration. Also, the Federal Reserve has expressed strong interest in creating a single form that

addresses both RESPA and TILA disclosures. If the Federal Reserve decides to move forward with this effort, then the standardized GFE could be revised or replaced.

If the requirements of the Final Rule go into effect without change, however, loan originators will be required to use the standardized GFE and the revised HUD-1/1A beginning January 1, 2010. During the transition period, the new forms can replace the current GFE and HUD-1/1A forms. However, a loan originator that uses the new GFE before the enactment date is subject to all of the requirements of the Final Rule including the limitations of the tolerance provisions as well as the use of the revised HUD-1/1A settlement statements. Thus, early implementation may be unlikely.

Nevertheless, during the transition period, mortgage businesses should work to conform their practices to the new HUD standards. We would be happy to assist any lender, mortgage broker, or settlement service provider in evaluating how to comply with HUD's new requirements.

We hope that you have found this client advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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