

New RESPA Regulations Take Effect

Information is based on an analysis of regulations provided by the Department of Housing and Urban Development and industry representatives, and is intended to provide assistance to financial institutions.

BACKGROUND

February 3, 2010 — The Real Estate Settlement Procedures Act (RESPA), as implemented by Regulation X, was passed by the U.S. Congress in 1974. The legislation was designed to prohibit the use of kickbacks between lenders and third parties in real estate transactions, which had been inflating the overall cost of those transactions.

After meeting with industry representatives and consumer groups to consider appropriate revisions to RESPA, the U.S. Department of Housing and Urban Development (HUD) proposed revisions on March 14, 2008, issuing the final rules on November 17, 2008. All of the revised final rules became effective by January 1, 2010.

KEY POINTS

Various components of these RESPA amendments will affect banks, other mortgage lenders, and mortgage brokers, including:

- a new definition of “application”
- changes to the Good Faith Estimate (GFE)
- changes to the HUD-1 and HUD-1A settlement statements
- new regulation of charges
- regulations regarding the use of affiliated companies
- revisions to the Servicing Disclosure Statement and new preparation instructions

New definition of “application”

For the first time since 1974, HUD has defined “application” for purposes of determining when required disclosures must be provided. Application is now defined as “the submission of a borrower’s financial information in anticipation of a credit decision relating to a federal related mortgage loan.” The amendments list information that comprises an application, setting a new standard for disclosure timing. According to HUD, banks must provide disclosures within three business days after receiving:

- 1) The borrower’s name;
- 2) The borrower’s monthly income;
- 3) The borrower’s Social Security number (to obtain a credit report);
- 4) The subject property address;
- 5) An estimate of the subject property’s value;
- 6) The requested loan amount; and
- 7) Any other information deemed necessary by the loan originator.

While item seven above allows some latitude regarding when an application is complete for disclosure purposes, lenders should use caution in establishing additional requirements. If a lender has enough information to make a credit decision and meet notification requirements under Regulation B and the Equal Credit Opportunity Act, the lender probably has enough information to trigger RESPA disclosure requirements. HUD has made clear that initial disclosures such as the GFE do not constitute a commitment to lend, but rather are intended to provide applicants with information to make an informed comparison between lenders and the loan products they offer. Consequently, regulators likely will construe the definition in favor of providing the disclosures.

Changes to the Good Faith Estimate

RESPA requires lenders to provide loan applicants with a GFE summarizing the key loan terms and closing costs. The final rule made a number of changes to the GFE, including:

- expanding the GFE to a three-page form;
- limiting fees that could be charged when providing the GFE;
- requiring disclosure of yield spread premiums (YSPs); and
- limiting the amount by which the final settlement fees may differ from the fees disclosed on the GFE (some may not change at all, some may not differ by more than 10 percent). Re-disclosure is necessary in the event of a material fee change.

HUD limited the fees lenders and brokers can charge when providing the GFE, allowing only the fee for obtaining a credit report. Consumer groups argued allowing lenders to impose fees as part of the application process could discourage comparison shopping, and industry groups argued HUD lacked the legal authority to limit fees. HUD, nevertheless, included the fee limitation in the final rule so lenders could obtain a credit report to facilitate a timely decision.

HUD also addressed the issue of YSPs, requiring the premium to be disclosed as a credit to the borrower's origination costs. YSP is the rebate paid by a lender to a mortgage broker for brokering a loan to that lender.

In addition, some of the fees charged at settlement now must match those disclosed on the GFE, and others must be within 10 percent of the fees disclosed on the GFE. While the tolerances may be exceeded under changed circumstances, such as where the borrower's information or transaction either changes or differs from what was known at the time the GFE was provided, this amendment requires re-disclosure under the new terms and likely will require lenders to enter into more rigid contracts with service providers to ensure the disclosed fees don't change prior to the closing of loans.

If the fees charged at settlement are higher than the tolerances allowed, the lender is in violation of Section 5 of RESPA. Currently, HUD can't enforce the tolerances since Section 5 does not provide for penalties. However, HUD indicated it plans to seek the authority from Congress to impose civil monetary penalties, and injunctive and equitable relief for RESPA violations. In the meantime, it is likely banking regulators will enforce the new requirements, and they have included the comparison of fees between the GFE and the settlement statement in their examination procedures.

A new right to cure disclosure errors is available to lenders if they reimburse consumers for any charges that exceed tolerances on settlement service estimates on the GFE. Otherwise,

the overages will be considered a violation of RESPA, and lenders will have 30 days after closing to discover and repay the overages. Closing agents also have 30 days to cure any errors or omissions on the HUD 1/1A. However, lenders cannot cure a failure to properly disclose terms and costs or to make the disclosure timely. Those failures would stand as a violation.

Changes to the settlement statement

HUD's stated goal in revising the settlement statement was to allow borrowers to more easily compare the charges at closing with those listed on the GFE. HUD added a page to the settlement statement that compares the final charges with those listed on the GFE and summarizes the loan terms.

Average charges and negotiated discounts

The average cost pricing methodology uses the average prices for third-party services purchased in volume rather than prices for services purchased individually. Settlement service providers may now use average cost pricing, renamed "average charges."

HUD does not view a third-party servicer discount as a RESPA violation as long as the discount is passed through to the borrower.

Use of affiliates

In revising RESPA, HUD sought to prevent lenders and settlement service providers from forcing borrowers into the use of selected third-party affiliates. Regarding § 3500.15 of RESPA, an affiliate business arrangement doesn't violate Section 8 of RESPA, as long as:

No person making a referral has required (as defined in § 3500.2, "required use") any person to use any particular provider of settlement services or business incident thereto.

The law creates an exception in instances where the lender requires a buyer, borrower or seller to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender to represent the lender's interest in a real estate transaction. Additionally, there is an exception for attorneys or law firms that arrange for the issuance of a title insurance policy for a client. The attorney or law firm must be acting directly as agent or through a separate title insurance agency that may be operated in connection with the law practice of the attorney or law firm when representing their client in a real estate transaction.

Borrowers now have the right to choose their own providers for some services. Banks and lenders may provide borrowers with a list of pre-qualified service providers, but borrowers may still select their own service provider, regardless of whether the provider is on the lender's list, on the condition the provider is qualified (i.e., licensed, insured, etc.).

In its final rule HUD included an exemption to enable a settlement service provider to offer borrowers a combination of settlement services that are priced lower than the total of the individual services. The use of the combination price for services must be optional to the borrower, and the lower combination price must not be offset by higher costs elsewhere in the settlement process.

Revised Servicing Disclosure Statement

Revisions to the up-front Servicing Disclosure Statement (SDS), revised last year and effective January 16, 2009, require a statement whether loan servicing may be assigned, sold or transferred to another person while the loan is outstanding. The revised SDS

eliminates the numerical disclosure of the lender's historical practice of the sale or transfer of servicing rights, and no longer requires the applicant to acknowledge in writing that he or she has read and understands the servicing disclosure statement. Although a model form is provided in the rule, it is not mandatory to use it and the lender may revise it to include more information to clarify or further explain the model language.

TIMELINE FOR COMPLIANCE

As of January 1, 2010, lenders must use the revised GFE and settlement statement. Compliance with the average charge and use of affiliates provisions was optional beginning January 16, 2009, and is now required. However, lenders and settlement service providers will have 30 days from the closing of the transaction to correct errors or violations and repay any overcharges that resulted from those errors or violations. However, failure to disclose affiliate relationships, requirement of service by an affiliated party and other technical violations cannot be cured.

HUD announced it will be lenient in enforcing the new RESPA regulations for the first 120 days following the January 1, 2010, effective date as long as good faith efforts are made to comply. However, the federal banking regulatory agencies are aggressively enforcing compliance with consumer protection laws. In general, compliance requires careful evaluation of the specific facts and circumstances and appropriate reviews by corporate counsel and other stakeholders. To avoid confusion, key stakeholders should be included in this evaluation.

IMPACT TO BUSINESSES

The changes to RESPA are major, and will impact all banks and lenders. The RESPA changes place a significant compliance and operational risk management burden on banks and lenders because of the resources required for training, and forms and systems changes. This burden will be especially high for smaller banks with limited resources to implement the changes.

At the heart of these changes is the concern that the initial transaction outlined in the Good Faith Estimate could change by the time a loan is closed, with unexpected fees showing up on the HUD-1 Settlement Statement. The new rules require the documents to be consistent, and if there are changes, they have to be supported by specific documented changes in the circumstances of the loan. Variances between the GFE and HUD-1 must be effectively monitored.

Lenders should review their pre- and post-closing processes, including a review of the settlement statement against the GFE to ensure final closing costs are within the accuracy tolerances. Lenders also should monitor documents prepared by closing and settlement service providers and develop a process for handling closing cost variances that are outside the tolerances.

Due to the complexities involved with RESPA revisions, banks and lenders should employ responsible compliance and lending personnel who have RESPA training that, at a minimum, covers the:

- new three-page Good Faith Estimate form;
- new prohibition against imposing fees at the time of application;
- new re-disclosure rules for changed circumstances;

- new three-page HUD-1 and the new two-page HUD-1A settlement statement;
- new disclosure tolerances;
- new right to cure disclosure errors;
- new disclosure requirements of credits or charges for the specific interest rate chosen;
- new average cost pricing method of disclosing costs on the HUD-1/1A; and
- revised Servicing Disclosure Statement and new instructions for preparing the form.

In addition, related compliance policies and procedures should be updated to reflect RESPA revisions, and supporting process and systems modifications should be made to accommodate these changes.

HOW JEFFERSON WELLS CAN HELP

Experienced Jefferson Wells professionals have the expertise necessary to help clients identify, mitigate and manage risk across all functions. Our approach to compliance leverages standard frameworks to provide practical internal control design, implementation and evaluation support within a structure that reduces and streamlines controls.

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