

**ANALYSIS OF HUD'S PROPOSED REGULATIONS  
"SIMPLIFYING AND IMPROVING THE PROCESS OF OBTAINING  
MORTGAGES TO REDUCE SETTLEMENT COSTS TO CONSUMERS"  
(67 Fed. Reg. 49134; July 29, 2002)**

**PREPARED FOR THE  
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**ANALYSIS OF HUD'S  
RESPA PROPOSED RULE: "SIMPLIFYING AND IMPROVING  
THE PROCESS OF OBTAINING MORTGAGES TO  
REDUCE SETTLEMENT COSTS TO CONSUMERS"  
(67 Fed. Reg. 49134; July 29, 2002)**

This memorandum provides an initial analysis of the major aspects of HUD's proposed revisions to the RESPA regulations published for public comment in the Federal Register on July 29, 2002. A copy of the proposed regulations, on which comments are due by October 28, 2002, is available at the American Land Title Association (ALTA) website. This memorandum focuses on those aspects of the proposal of particular relevance to title insurance companies, title insurance agents, attorneys, and other members of ALTA, and is not intended to be a comprehensive discussion of all aspects of the proposal as they may affect mortgage lenders or mortgage brokers.<sup>1</sup>

At the outset, several points deserve noting. First, there are a number of ambiguities in the proposal, some of which are expressly identified in the analysis below. In several regards, however, the analysis describes aspects of the HUD proposal in a way that is believed to be a reasonable interpretation of what HUD has proposed, but may nevertheless not be a correct reading of HUD's proposal.

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<sup>1</sup> A significant part of the HUD proposal and accompanying discussion is devoted to issues relating to the compensation of mortgage brokers, and the new disclosure requirements applicable to them.

Second, it should be kept in mind that this is a proposal by HUD, not a final regulation. Accordingly, HUD could well be influenced by concerns brought to HUD's attention during the comment period, and many problems and issues addressed in this analysis (and that will be raised by others) may be remedied in any final regulations that may be promulgated.

Third, Part I provides a short-form summary of the key aspects of the HUD proposal for those readers who are only interested in a general outline of the key aspects of the proposal. For those readers who are seeking a deeper understanding of the proposed regimes and how they may affect the title business, the footnotes in the memorandum provide significant additional information and insights that should be considered along with the text.

Finally, there are substantial questions regarding the statutory authority for certain aspects of the proposal. The RESPA statute has been on the books for almost three decades and HUD's current regulations, including its current regulations relating to the good faith estimates (GFE's) to be provided by lenders, have implemented that statutory language. HUD is proposing very radical changes to its regulations – proposals that would fundamentally change the operation of the market for residential real estate lending and settlement services – without seeking appropriate changes to RESPA that would provide statutory foundation and direction for the new regulatory superstructure HUD is proposing to create. Disclosures and pricing and marketing arrangements that long-standing HUD regulations have expressly authorized or permitted as being consistent with RESPA would become unlawful, because they will no longer be

sanctioned by the only two regimes – a binding GFE regime and a new guaranteed packaging regime – that HUD’s proposed regulations would allow.<sup>2</sup>

While an analysis of the extent to which HUD’s proposals may not be consonant with the regime Congress established in RESPA is beyond the scope of this memorandum, such issues will undoubtedly be discussed in the months to come. In this regard, the views of the United States Court of Appeals for the District of Columbia Circuit, in a very recent opinion striking down certain actions of the Federal Regulatory Energy Commission as exceeding statutory authority, may be appropriate:

As a federal agency, FERC is a ‘creature of statute,’ having no ‘constitutional or common law existence or authority, but *only* those authorities conferred upon it. [Citation omitted; emphasis added.] Thus, if there is no statute conferring authority, FERC has none. [Citation omitted.] In the absence of statutory authorization for its act, an agency’s ‘action is plainly contrary to law and cannot stand.’<sup>3</sup>

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<sup>2</sup> An interesting question is whether, if HUD establishes these two new regimes as the only alternatives for the good faith estimate of closing costs required by RESPA, a lender that wishes to continue to operate under the current GFE regime would be acting in violation of RESPA. One could argue that, absent statutory direction otherwise, this should be an option provided by HUD.

<sup>3</sup> Atlantic City Electric Co. v. F.E.R.C., 2002 WL 1484938 (D.C. Cir. July 12, 2002).

## **I. SUMMARY OF THE MAJOR ASPECTS OF THE PROPOSED REGULATION**

The materials sent by HUD to the Congress and reproduced on the ALTA website consist of several parts and, unfortunately, do not provide a table of contents. The actual proposed regulations and new proposed forms are found in Part VI of the HUD materials, at pp. 49158-70 of the Federal Register notice. The “Supplementary Information” prepared by HUD that provides “Supplementary Information on the proposed regulations” consists of 5 parts:

- Part I (“Introduction,” pp. 49134-37) provides a summary of the proposals.
- Part II (“General Background,” pp. 49137-46) consists of a discussion of:
  - the relevant RESPA provisions (Part II.A.- “Legal Authority,” pp. 49137-38);
  - the history of HUD’s activities on disclosure and mortgage broker issues (Part II.B. – “Background,” pp. 49138-43);
  - the June 1998 HUD-Federal Reserve Board report from which many of the concepts and provisions of the proposed regulation are derived (Part II.C. – “HUD’s Commitment to Mortgage Reform,” pp. 49143-46)
- Part III – (“This Proposed Rule,” pp. 49146-55), discusses in greater detail the proposals regarding:
  - mortgage broker compensation and lender payments to mortgage brokers (Part III.A., pp. 49146-48);
  - the “Significantly Improved Good Faith Estimate (GFE)” (Part III.B., pp. 49148-52); and
  - the proposals for the offering of “Guaranteed Mortgage Packages” (Part III.C., pp. 49152-55).

- Part IV – “Questions for Commenters”(pp. 49155-57), identifies 30 specific questions on which the public is invited to comment in the 90-day rulemaking period. (Comments may, of course, address any issue raised by the proposal.)
- Part V – “Findings and Certifications” (pp. 49157-58), addresses briefly various issues and concerns specified by statute or executive order that must be taken into account by Federal agencies in rulemaking proceedings.

The proposed regulations would (a) create a new approach to the “good faith estimate” (GFE) of settlement costs required to be provided by mortgage lenders to loan applicants within three business days of receiving an application, and (b) encourage the offering of a “Guaranteed Mortgage Package Agreement” (GMPA), which could then be shopped by the consumer, consisting of an offer to provide (i) a loan at a specified interest rate, and (ii) a single guaranteed price for a package of settlement services and charges related to the making and closing of the loan.<sup>4</sup> This package of services and charges – the individual components of which do not have to be identified (with four limited exceptions) – is referred to as a “Guaranteed Mortgage Package” or “GMP.” The obligations that would be incurred by the sponsor of the package are reflected in the GMPA, the language of which is set out in the proposed regulation.

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<sup>4</sup> In addition, the proposal creates a new disclosure regime with regard to the services and compensation of mortgage brokers, which implements the regulatory approach announced by HUD on the issue of mortgage broker compensation in RESPA Policy Statement 2001-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed. Reg. 53052 (Oct. 18, 2001).

In brief, under the revised GFE regime:

- there would be a new GFE form that would disclose information about the loan and “estimated” aggregate costs for seven categories of services and charges, including a category called “Title Services and Title Insurance” intended to cover all of the services and charges normally listed in the 1100 series in the HUD-1 form except for optional owner’s title insurance;
- the estimates for some categories of services (e.g., the categories that involve lender charges or charges for lender-required services where the provider is selected by the lender) may not be exceeded at closing; the estimates for categories where the consumer may shop for the service but ends up selecting a provider recommended by the lender may not be exceeded at closing by more than 10%; the charges for services not required by the lender or for services where the borrower selects a provider not recommended by the lender may exceed the estimate by any amount;
- the GFE would have to be provided by the lender to a consumer within three business days of the time of “application” (which HUD redefines to mean the date on which the consumer furnishes certain limited information – “Social Security number, property address, basic income information, the borrower’s information on the house price or a best estimate on the value of the property, and the mortgage loan needed”)<sup>5</sup> and be held open for at least 30 days to allow the consumer to shop the proposal; and
- the lender may require no payments by the consumer (as an application fee, or to cover the costs of a credit report or appraisal) other than a charge to cover the costs of preparing the GFE.

Under the proposed GMPA regime:

- a packager (most likely a lender) must, within three days of an application, provide an applicant at no charge with a signed Guaranteed Mortgage Package Agreement, in the form specified by HUD, that:

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<sup>5</sup> Definition of “application” in proposed § 3500.2(b), at p. 49158.

- commits the packager to provide a mortgage loan (subject to “acceptable final underwriting and a property appraisal”) at a “guaranteed” interest rate, which, for at least 30 days, can only increase in accordance with interest rate changes based on a verifiable index or other appropriate measure;
  - offers a Guaranteed Mortgage Package of services at a single price that must include:
    - all lender charges (including discount points and origination fees);
    - all third party charges for services required by the lender to make the loan;
    - all title and closing related charges, including a loan title insurance policy (if any), but not optional owner’s title insurance;
    - all charges required to complete the loan (including government recording fees and transfer taxes); and
    - subject to four limited exceptions, provides no specification of the individual services or costs thereof that may be contained in the package;
  - provides an estimate of the additional amount to be paid by the borrower at settlement for *per diem* interest, reserves for taxes and insurance, homeowner’s insurance, and optional title insurance; and
  - advises the borrower if the lender anticipates including a pest inspection, lender’s title insurance, a credit report, and/or an appraisal in the package, and commits to providing the borrower with a copy of any such report that is obtained;
- upon signing the GMPA within the time frame specified by the packager (which can be no less than 30 days from the date of the offer) and payment of an acceptance fee determined by the lender, the GMPA becomes a binding agreement; and

- any payments, discounts, pricing arrangements, exchanges of things of value, or mark-ups involving the GMP or the services included in the GMP are exempted from RESPA § 8 scrutiny.

## **II. HUD’S OBJECTIVES IN PROPOSING THE NEW REGIMES AND HUD’S ESTIMATE OF ANTICIPATED CONSUMER SAVINGS.**

Understanding HUD’s objectives and the consumer savings it believes will be achieved provides critical context to an understanding of HUD’s proposed changes. As part of its proposal, HUD has developed an “Economic Analysis” of which Chapter 5, entitled “Initial Regulatory Flexibility Analysis,” is set out at the end of the Federal Register notice (at pp. 49170-74). Chapter 5 (as well as the discussion in the “Supplementary Information” that accompanies the proposed regulations) indicates that the primary objectives of both the new GFE and GMPA regimes are:

- to encourage and enable borrowers to shop more effectively for mortgage loans by:
  - consolidating the disclosure of estimated costs into a few major categories (which avoids the proliferation of charges and what HUD refers to as “junk” fees);
  - requiring such disclosures to be made early in the application process and before any significant charge (such as an application fee) has to be paid by the consumer;
  - requiring that such estimates either be guaranteed (in the case of the GMPA regime) or be correct – subject to a 10% tolerance for certain costs – in the case of the GFE regime, so as to ensure that borrowers will not be surprised at closing by new charges or by higher charges than disclosed in the GFE or in the GMPA; and
  - requiring that the prices and loan terms in the disclosures be kept open by the lender/packager for at least 30 days so that consumers can shop among other lenders/packagers using the GFE or GMPA provided by the lender as a

benchmark against which to judge the terms offered by other lenders or packagers;

- to enable borrowers to obtain savings in both the costs of the loan and the costs of related settlement services by:
  - placing consumers in a better position to negotiate the terms of a mortgage loan with various lenders by enabling consumers to better compare the ultimate costs, including the interest rates, of loans obtained through mortgage brokers and through direct lenders (mortgage bankers, other lenders);
  - encouraging lenders to negotiate for volume discounts and other reductions in charges by third party settlement service providers, and either requiring that these savings be passed along to the borrower (in the case of the GFE regime) or hoping that competition among mortgage lenders providing GMPAs will result in such discounts being competed away for the benefit of the consumer; and
  - eliminating the charging of new fees at closing or charging more than the fees estimated in the GFE or guaranteed in the GMPA.

The Impact Analysis in Chapter 5 summarizes the benefits to consumers – and the expected revenue losses for the lending and settlement services industries – that HUD anticipates being derived from the implementation of the two regimes. In particular, HUD estimates that the GFE regime will result in savings to borrowers in the form of lower lender and third-party provider fees of \$6.3 billion annually, with this amount derived as follows:

- \$3.75 billion in savings derived from reductions in mortgage broker compensation (as mortgage brokers will be required to pass through as a credit to the borrower any “yield spread premium” or “par premium” payments they may receive from funding lenders);
- \$0.75 billion derived from lower origination fees charged by loan originators; and

- \$1.8 billion derived from lower third-party settlement charges resulting from “increased price pressure as a result of the imposition of tolerances and expanded shopping by originators” (HUD estimates that \$18 billion in third-party charges would be subject to such increased pressures and assumes that prices would fall by 10%).<sup>6</sup>

Of this \$6.3 billion in lost revenue, HUD estimates that the loss of revenues for small businesses will amount to \$3.5 billion.

In addition to lower prices for loans and settlement services, HUD estimates that, as a result of the new GFE regime:

- borrowers will realize \$826 million in savings in time spent shopping for loans and third-party services;
- loan originators will save \$1.28 billion in “time spent with shoppers, in efforts spent seeking out vulnerable borrowers, and from the substitution of more efficient for less efficient originators”; and
- settlement service providers will save \$350 million in time spent with shoppers and “from the substitution of more efficient for less efficient third party settlement service providers.”<sup>7</sup>

With regard to the GMPA regime, the revenue transfers and savings estimated by HUD are even more dramatic – a total of \$10.3 billion annually – derived as follows:

- \$6.7 billion in savings derived from reductions in mortgage broker compensation and from lower origination fees charged by loan originators; and

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<sup>6</sup> Pp. 49170-71.

<sup>7</sup> P. 49171.

- \$3.6 billion derived from lower third-party settlement charges (i.e., 20% of HUD’s estimate of \$18 billion in third-party settlement service charges).<sup>8</sup>

Of this amount, HUD estimates that \$5.9 billion in revenue will be lost by small businesses and transferred to consumer savings in loan costs and fees.

In addition to lower prices for loans and settlement services, HUD estimates that, as a result of the new GMPA regime:

- borrowers will realize \$1.65 billion in savings in time spent shopping for loans and third-party services (twice the amount of savings estimated for the GFE regime); and
- loan originators and settlement service providers will save \$3.41 billion in time spent with shoppers, and from the substitution of more efficient for less efficient providers (approximately twice the amount of savings estimated for the GFE regime).

HUD says that “the final savings to the borrower would depend on how the market settles down between the two methods of loan origination” and, if it is “half and half, borrower gains are slightly over \$8 billion.”<sup>9</sup>

While the estimates can be questioned, what is clear is that HUD believes that its proposal will result in significant lowering of costs to consumers derived primarily from reduced charges by lenders and settlement service providers.

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<sup>8</sup> P. 49172.

<sup>9</sup> Id.

### III. THE NEW GFE REGIME

#### A. HUD's Concerns About the Current GFE Regime.

HUD perceives a number of problems with the current GFE regime that HUD has had in place for almost three decades:

- the current GFE is confusing, because it provides for estimates of an ever-increasing proliferation of separate charges (e.g., lender charges for origination, document preparation, and document review) where the borrower cannot distinguish or understand the purpose or need for the various charges;
- the current GFE is not reliable, because new charges may appear for the first time at closing or the estimates provided in the GFE are frequently significantly lower than the actual charges turn out to be;
- the current GFE fails to include certain information needed to help the consumer shop (e.g., information about the loan (interest rate, APR, prepayment penalties); information about mortgage broker fees and the trade-offs between higher interest rates/lower up front charges, or lower interest rates/higher up front charges; summaries of major categories of charges);
- the consumer may have to complete a full application and pay significant application fees or other up-front charges before receiving the current GFE; as a consequence, borrowers are deterred from shopping once they go through this process; and
- there is no sanction for an incomplete or inaccurate GFE or even outright failure to provide a GFE.<sup>10</sup>

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<sup>10</sup> Because Congress has not provided an express remedy for violations of the GFE requirements, there is little HUD can do through its proposed regulation to create penalties or sanctions that Congress has not authorized.

To provide some “penalty” for a lender’s failure to comply with the new GFE regime, the proposed regulations state that “[i]f the cost at settlement exceeds the estimate reported on the Good Faith Estimate, absent unforeseeable and extraordinary

(footnote continued on the next page)

## **B. The New GFE Regime.**

The proposal would provide for a new and very substantially different format for the GFE, new requirements regarding the estimates provided therein, and requirements for information not previously required in the GFE.

### **1. The new GFE format.**

The new format for the GFE is set out at pp. 49164-65. Rather than simply listing the estimates for individual charges which the consumer is likely to pay in connection with the settlement (using the line items from the HUD-1 form), the new form consists of six parts (on two pages) and an additional Attachment A-1.

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circumstances, the borrower may withdraw the application and receive a full refund of loan-related fees and charges.” See proposed § 3500.7(d)(1), at p. 49159.

Assuming that “cost at settlement” means the aggregate charges at settlement for all items whose costs were estimated in the GFE (some settlement costs will not be covered in the GFE) and that “a full refund of loan-related fees and charges” means a refund of those fees and charges that the consumer will have paid out of pocket prior to the closing, it is unclear (a) how effective such a remedy will be in ensuring the loan originators comply with all of the requirements of the GFE regime (will any or many borrowers really withdraw their applications when they discover at closing that some charges are higher than the estimates?), and (b) what HUD’s authority is for creating such a remedy in the absence of any statutory provision.

In addition, HUD notes that regulators of financial institutions (such as the OCC for national banks) may enforce the GFE obligations with regard to their regulated institutions, although many types of loan originators (mortgage brokers and mortgage bankers) may not be subject to any such regulation.

Finally, HUD indicates (at p. 49151) that, concurrent with the finalization of the proposed regulations, it “will establish procedures for closely scrutinizing loan originators that fail to meet these new GFE requirements for possible Section 8 violations.” It is not clear how a lender potentially violates § 8 if the lender fails to comply with one or more of the new GFE requirements.

- Part I contains prescribed language indicating the role and services of the loan originator, and urging the consumer to compare prices and shop loan originators.
- Part II requires the originator to specify the amount of the loan, interest rate, APR, length of loan term, number of monthly payments, and initial monthly payment for principal, interest, and mortgage insurance (if any). This type of information is not part of the current GFE.
- Part III provides for an estimate of the aggregate charges for each of certain groups or categories of settlement costs.
- Under other provisions of the proposed regulations, absent “unforeseeable and extraordinary circumstances,”<sup>11</sup> the actual charges at settlement for particular categories of charges must either be no higher than the GFE estimate for that category (what the proposal refers to as “0% tolerance”) or, in the case of certain categories, no more than 10% higher (“10% tolerance”), unless the borrower chooses to purchase a more expensive service. The specified categories of charges and the percentage of tolerance between the final charges and the estimates are as follows:
  - lender origination charges (the 800 series charges on the HUD-1 form) (0% tolerance)
  - payments dependent on the interest rate (e.g., discount points or lender payments (YSPs) to the mortgage broker) (0% tolerance);<sup>12</sup>

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<sup>11</sup> Proposed § 3500.2(b) of the Regulations (p. 49159) defines “unforeseeable and extraordinary circumstances” as “acts of God, war, disaster, or any other emergency, making it impossible or impractical to perform.” HUD has invited comments on this definition.

<sup>12</sup> Under the HUD proposal, a mortgage broker would have to inform the prospective borrower of the total compensation that the broker expects to obtain from the transaction from the borrower and the funding lender, treat that total amount as payable by the consumer, and then provide a credit to the consumer for the amount to be paid by the funding lender. In this way, total compensation received by the mortgage broker and paid by the consumer (either directly or in the form of higher interest payments from which the funding lender may pay a YSP to the broker) may be compared by the

(footnote continued on the next page)

- services required by the lender where the lender has selected the provider (800 and 1300 series charges) (0% tolerance);
- “title services and title insurance” (the 1100 series charges) (0% tolerance where the provider is selected by the lender, 10% tolerance where the borrower may shop but elects to use a provider identified by the loan originator, and no limit where the borrower “chooses a more expensive service”);<sup>13</sup>
- other services required by the lender where the borrower may shop for the provider (800 and 1300 series charges) (10% tolerance);
- state and local government charges and taxes (the HUD-1 1200 series) (0% tolerance);<sup>14</sup>
- amounts needed for reserves or escrow (the HUD-1 1000 series) (10% tolerance);
- the total *per diem* interest that will be due on the loan (assuming an estimated settlement date) (no tolerance limit);
- hazard insurance (based on the minimum amount of insurance required by the lender) (no tolerance limit); and
- optional owner’s title insurance (no tolerance limit).

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consumer to mortgage loans offered by mortgage bankers and other lenders that are not acting as a mortgage broker.

<sup>13</sup> This provision is ambiguous and is discussed further below.

<sup>14</sup> HUD assumes that, within the three-day period from the time the consumer submits an “application” for a loan, the loan originator/lender will be able to determine precisely (i.e., at 0% tolerance) the total amount of all government taxes and recording fees that may have to be paid in the transaction. Presumably, this would include any charge for recording the release of the prior mortgage lien.

- The total of all of the costs for the separate categories (Categories III(A) through (J)) must be shown on the bottom of the first page of the GFE form. If the form provided a line to show only the sum of Categories (A) through (F) – thereby excluding reserves for taxes and insurance, *per diem* interest, hazard insurance, and optional owner’s title insurance – that figure would cover all of the services and charges that the single GMP figure covers. In other words, the GFE form, with appropriate changes, would provide loan applicants with the same single figure as the GMP price is intended to provide.<sup>15</sup>
- Part IV provides information and a table to be used to show the consumer the various options she may have to:
  - pay in cash for all or part of the “settlement costs”;
  - borrow additional amounts to pay for all or part of the settlement costs;
  - reduce the amount to be paid for settlement costs at closing by paying a higher interest rate; and
  - lower the interest rate on the loan by paying additional amounts at closing (in the form of “discount points”).
- Part V of the GFE provides information on whether the loan is subject to a prepayment penalty, a balloon payment at the end of the loan term, and, for adjustable rate mortgages, the interest rate and adjustment terms.

Attachment A-1, is a separate form that would go along with the GFE and has two sections to be completed by the loan originator:

- Section A lists those services for which the lender may require the use of a particular provider (including the name of the provider and its estimated charge), and those third party services that are “shoppable” by

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<sup>15</sup> This suggests that there may not be a need for two regimes (with all the complications and potential consumer confusion) if many of the benefits HUD perceives to exist in the proposed GMP regime can be achieved by modifying the proposed GFE regime.

the consumer (i.e., where the lender requires the service but does not require that it be purchased from a particular provider), including an estimate for such charges; and

- Section B requires the loan originator/lender to provide the subtotals for the mortgage broker's origination charges, the lender's origination charges, the title agent's charges, and the title insurance premium.

The disclosures required by Section B of Attachment A-2 are discussed in more detail below.

## **2. The new requirements regarding the GFE.**

The proposed requirements regarding the provision of the new GFE include the following.

- By virtue of HUD's revised definition of what constitutes an "application," the GFE would have to be provided within three business days of the time the consumer provides limited credit information, an estimate of the value of the house, and the type and amount of the requested loan to the loan originator.<sup>16</sup>
- The only charge that can be made at the time of the GFE is one that is not "beyond what is necessary to provide the good faith estimate";<sup>17</sup> no charge in the nature of an application fee, or for an appraisal or credit report, may be made.
- The GFE estimates (which includes the loan rates) would have to be valid for a minimum of 30 days so that the consumer can shop the loan among other lenders.

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<sup>16</sup> Given the fact the new GFE requires precise (or almost precise) "estimates" of virtually all costs to be incurred in connection with the settlement, there is a question whether all lenders will be able to provide and stand behind such estimates. Accordingly, those lenders who may have difficulty ascertaining precisely the costs for particular categories may have to provide high-side estimates so as to be certain that the final charges for that category do not exceed the estimate.

<sup>17</sup> Proposed § 3500.7(a), at p. 49159.

- After full underwriting, the lender may decline to make the loan or offer the consumer a different loan and provide a new GFE.
- If the consumer qualifies for the loan but does not lock in the interest rate, the lender must provide the consumer an amended GFE when the borrower does lock in the rate if charges related to the interest rate have changed.
- In no case may an amended GFE include increases in settlement cost categories that are not dependent on the interest rate. Thus, there can be no increases in the Category III(D) charge.

HUD recognizes that the HUD-1 and 1A forms, which it is reluctant to change, do not report information in the same categories as are required for the revised GFE.

Because of this, consumers may not readily be able to track the final charges on the HUD-1 back to the category estimates in the GFE. HUD has asked for comment on this problem.

**C. Aspects of the GFE Proposal of Particular Interest to the Title Insurance Industry.<sup>18</sup>**

**1. What is included within “Title Services and Title Insurance”?**

The proposed revised GFE form identifies as a separate category (Category III(D)) “Title Services and Title Insurance (1100).” The “1100” refers to the 1100 series of charges on the HUD-1 form. The proposed regulations state that “[l]oan originators shall subtotal all fees or charges for title and settlement agent services and title insurance in

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<sup>18</sup> Many of the problems and concerns noted with regard to the proposed GFE regime are equally relevant to the proposed GMPA regime.

this category of the form.”<sup>19</sup> While the proposed regulations are not entirely clear in this regard, it appears that HUD expects the amount listed for Category III(D) to include not only charges by title insurance companies, title insurance agencies, and other settlement agents (e.g., charges for the title search, abstract, title examination, loan title insurance binder, loan title insurance policy, and settlement or closing fee), but all charges that would otherwise be included in the 1100 series of the HUD-1 form.

Based on the text of the current HUD-1 form and HUD’s current instructions for completing this section of the form,<sup>20</sup> the other charges that might have to be part of the Category III(D) estimate include:

- document preparation fee,
- notary fee,
- attorney’s fee (including any charges to be paid by the borrower for the fees of an attorney representing the lender and the seller, as well as the borrower), and
- fees charged by a private tax service, by a county tax collector for a tax certificate, or a fee to a public registrar for a Torrens certificate.

In addition, charges for wire transfers or express delivery of loan packages or payoffs to lenders may be included in the 1100 series.

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<sup>19</sup> Proposed New Appendix C to the Regulations: “Instructions for Completing Good Faith Estimate; Sample Good Faith Estimates,” Specific Instruction III(D), at p. 49162.

<sup>20</sup> The instructions are found in Appendix A to 24 CFR Pt. 3500.

In short, it appears that the phrase “Title Services and Title Insurance” refers not only to charges made and kept by title agents and insurers, but is really a short-hand reference to all of the charges that are shown in the 1100 series on the HUD-1 form.

In areas of the country where there is a separate charge for the owner’s title insurance premium and the issuance of owner’s title insurance is optional, the estimated charge for the owner’s policy is not included in Category III(D), but is separately estimated in Category III(J). As noted above, there is no tolerance limit for a lender’s estimate of this optional charge. If the owner’s policy is part of a total single premium that covers both the owner’s policy and the loan policy (so that issuance of an owner’s title insurance policy is not optional), it would appear that the total premium should be included in Category III(D), perhaps with some notation that the owner’s policy is included in the estimated total for Category III(D) charge.

**2. How title-related charges are treated under Category III(D) of the GFE.**

The proposed regulations and HUD’s explanation are not entirely clear in this regard.

Category III(D) on the new GFE form contains two lines, one of which must be checked off by the lender, indicating either “(1) \_\_ lender selected” or “(2) \_\_ borrower selected.” A key issue is whether “lender selected” and “borrower selected” means (i) the provider of the services whose charges are included in the Category III(D) total have been selected by the lender (or the borrower), or (ii) the services have been selected by the lender (or the borrower), or (iii) both the services and the provider have been

selected by the lender (or the borrower). Neither the footnotes to the GFE form, nor the proposed regulations, nor the explanation of the proposed regulations give a dispositive answer to this question.

A footnote to the new GFE form states that “the charges listed in . . . D (if selected by the lender) will not vary . . .” and that “the charges listed in D (if selected by the borrower) . . . must not be exceeded at settlement by more than 10% . . . except where a borrower chooses to purchase a more expensive service.” But lenders and consumers do not select “charges,” they select either “services” or “providers” or both.

The instructions for completing the Category III(D) section of the GFE are likewise ambiguous. The second and third sentences of the instruction states that “the loan originator also must indicate whether the services and insurance are loan originator selected or borrower selected,” and that if the services are loan originator selected, there is a 0% tolerance. This language suggests that the “lender box” should be checked off if the service is one chosen by the lender.<sup>21</sup> However, the next sentence in the instructions states that if “title services and/or insurance are shoppable by the borrower,” and the borrower ends up selecting a provider identified by the lender, then there is a 10% tolerance on the estimate. This sentence suggests that whether the lender box or the borrower box should be checked off is a function of who selects the provider. (As

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<sup>21</sup> See p. 49162.

previously noted, if the borrower selects her own provider or a more expensive service, then there is no tolerance limit.)

Assuming the box to be checked and the determination of whether a 0% or 10% tolerance applies is a function of who selects the provider, there appears to be a very significant ambiguity and problem deriving from the fact that, in a transaction involving the sale of property (and not just a mortgage loan), the 1100 series – and hence the single, total figure HUD expects lenders to put down for Category III(D) charges – includes a range of services and charges by providers who may have been selected by different parties, including the lender, the buyer and the seller. HUD's approach appears to assume that all of the charges included in Category III(D) would be provided by a single entity selected by either the lender (0% tolerance), by the borrower based on a recommendation by the lender (10% tolerance), or by the borrower on her own (no tolerance limit). Since the new GFE does not have a separate breakout for each of the 1100 series services, it is not clear what tolerance applies if some providers of services are chosen by the seller and the buyer (e.g., an escrow company), some by the lender, and some by the borrower.

The fact that the lender does not need to disclose what services are or are not included in Category III(D) creates an even greater problem for consumers who seek to shop for Category III(D) services – something HUD very much wants to encourage. For example, having gotten an estimate for Category III(D) services of \$500 from Lender A and an estimate of \$750 from Lender B, the consumer will not know:

- what services have been included in the two estimates so as to be able to make an apples-to-apples comparison;
- whether Lender B may have included in Category III(D) some services or charges that Lender A does not require;
- whether the failure of Lender A to include those services may result in the consumer having to separately purchase those services if she believes they are needed to protect her interests; and
- whether Lender A has listed some charges in other categories that Lender B is including in Category III(D).

In short, getting two different Category III(D) prices from two different lenders – without knowing all of the services and charges included in those prices – does not really help the consumer select the “lowest cost” lender.

### **3. How lenders are likely to establish the estimate for the Category III(D) charge.**

In order to meet the requirement for providing the GFE within three business days of receiving an “application” (as redefined) and to ensure that the tolerance limits for the estimate will be met, the new GFE regime may compel lenders to have firm quotes readily available from one or more title companies for the 1100 series services that the lender anticipates it will need in connection with all of the various mortgage loans it offers.<sup>22</sup>

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<sup>22</sup> See p. 49151 (“HUD recognizes that the new GFE’s tighter requirements on estimated third party charges may cause many loan originators not already doing so to seek to establish pricing arrangements with specific third party settlement service providers in advance, in order both to ensure they are able to meet the tolerances and to ensure lower prices for their customers.”)

Under the GFE regime (as opposed to the GMPA regime) a lender cannot require the use of an affiliated title company because of the continued applicability of RESPA § 8 and the safe harbor requirement for an affiliated business arrangement (AfBA) that there be no required use of the affiliated provider. Accordingly, lenders would appear to have three alternatives:

- they may require the use of a non-affiliated title company, in which case there is a 0% tolerance for the Category III(D) estimate used by the lender on the basis of that title company's charges;
- they may base their Category III(D) estimate on the charges made by a non-affiliated title company, permit the borrower to use any other title company, and, if the borrower ultimately elects to use the title company recommended by the lender, there is a 10% tolerance; or
- they may base their Category III(D) estimate on the charges made by an affiliated title company, permit the borrower to use any other title company, and, if the borrower ultimately elects to use the affiliated title company, there is a 10% tolerance.

Lenders may seek from their favored title companies a price quote that includes all of the possible series 1100 charges (including the charges by other providers), or a quote that includes only those services to be provided by the title company (with the lender obtaining the quotes for the other services on its own). In either event, title companies will have to ensure that the quotes they provide include all possible costs because the lender is limited by the estimate for the Category III(D) services (with either a 0% or 10% tolerance) in how much it can charge the consumer. Accordingly, to the extent the title company underestimates the aggregated Category III(D) charges, it may have to “eat the difference.”

This raises further questions regarding the proper treatment of certain charges, such as courier charges or government charges for recording lien releases. For example, is a courier charge for delivery of loan documents a Category III(D) charge, or a charge properly included in Category III(C) (“Lender Required and Selected Third Party Service”) or III(E)(“Shoppable Lender Required Third Party Service”)? Presumably, the charge for recordation of the release of the seller’s mortgage lien is a Category III(F) charge (“Government Charges – Taxes, State and Local”), but will all lenders in fact include an estimate for that charge in their Category III(F) estimate or will they assume that the title company will include that charge in its Category III(D) estimate?<sup>23</sup>

While HUD wants to avoid having the GFE provide more detailed information on the nature or amount of the particular services included by a particular lender in its Category III(D) estimate, in transactions involving a sale of property more information may have to be provided to the borrower so that (a) the borrower (and her real estate agent and/or attorney) can determine whether the services the lender contemplates will be needed to meet the lender’s needs for the loan transaction are sufficient to meet the buyer’s needs in the sale/purchase transaction, and (b) to avoid confusion and problems at

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<sup>23</sup> Since RESPA § 8 continues to apply in the GFE regime, the fact that anticipated charges for courier fees or recordation of lien releases are included in the estimates would not, in HUD’s current view of RESPA § 8(b), permit the lender or the title company to charge an amount for either item that exceeds the actual cost incurred in the transaction for that item. Such a charge would likely be viewed by HUD as a mark-up impermissible under § 8(b).

settlement if, as may well be the case, the buyer/borrower ultimately agrees to purchase other series 1100 services beyond those that may be included in the lender's estimate.<sup>24</sup>

**4. The offering of discounts by title companies and other settlement service providers.**

While a significant objective of the GMPA regime is to encourage lenders and other packagers to negotiate discounts in charges from third party settlement service providers, HUD also hopes to achieve that objective under its revised GFE regime. In this regard, HUD proposes that discounts offered by settlement service providers on services whose prices may be included in the lender's GFE would not be subject to RESPA § 8 analysis "provided that the entire discounted price is charged to the borrower and reported as part of the total charge within Sections III(C) through (J) as appropriate."<sup>25</sup> Another provision of the proposed regulation dealing with the GFE states that "[l]oan originators must include all charges correctly within their prescribed category on the Good Faith Estimate and not include any 'mark-ups' or 'up charges' in their estimates for such categories III(C) through (J)."<sup>26</sup> This direction would apply to all prices quoted by the third party provider whose charges are used by the lender to

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<sup>24</sup> As noted above, the new GFE form contemplates that the only "optional" service that a borrower (buyer) may elect to purchase beyond the services included in the lender's Category III(D) total is owner's title insurance.

<sup>25</sup> Proposed § 3500.14(g)(1)(viii), at p. 49160.

<sup>26</sup> Proposed § 3500.7(d)(6), at p. 49160.

determine the GFE estimate for the Category involved, whether or not that price was discounted by the third party provider.

The fact that in the GFE regime lenders must pass through to the consumer any discounts they are able to negotiate with settlement service providers, whereas (as will be discussed below) they can realize all or a portion of the benefit of such discounts in the GMPA regime, could be a determinative factor in a lender's decision as to which regime it should operate under.

What state law (or other) limitations may exist on the ability of title insurance companies or title insurance agents to offer "discounts" on particular charges in particular states as an inducement to be included in the GFE estimate of a particular lender is beyond the scope of this memorandum. But this is certainly an issue that need to be taken into account. This is not just a question of whether such a discounted rate may or may not be consistent with a filed, approved or promulgated rate, but whether a discount given to borrowers from lenders or loan originators with significant market clout but not to borrowers from smaller lenders or loan originators can be justified under state law requirements that insurance rates not be discriminatory.

**5. The treatment of title insurance agent charges and the title insurance premium in Attachment A-1 to the GFE.**

In an effort to keep the GFE to a two-page document, HUD is proposing an Attachment A-1 to the GFE (see p. 49166) that will disclose some additional information that HUD believes is relevant to consumer shopping or required by existing RESPA provisions. Section B of Attachment A-1 would require certain subtotals for the amount

of the origination charges imposed by the mortgage broker (if there is one in the transaction) and the origination charges of the funding lender. HUD is requiring this disclosure “so that borrowers can better understand the respective lender and broker charges, and where possible even negotiate lower costs.”<sup>27</sup>

In addition, Section B of Attachment A-1 proposes to require the lender to disclose “the subtotals of all the charges for title and settlement agent services, including any commissions for title insurance; and the subtotal for the title insurance premium.”<sup>28</sup> The Instructions for Attachment A-1 (at p. 89) add little to this language, stating only that “in reporting subtotals for mortgage broker/lender and title agent/title insurance, the loan originator must indicate the names of the service providers and the subtotals of all their charges and fees.”<sup>29</sup> The Supplementary Information contains the following explanation:

In a similar vein, Attachment A-1 also breaks out title agent services and title insurance into separate subtotals for the actual title insurance versus compensation to the title agent. Title agents routinely receive direct payments from borrowers for their services as well as commissions from the insurance premium for the sale of insurance. The title agent subtotal will add up these costs so that the borrower can compare, and possibly negotiate, these charges.<sup>30</sup>

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<sup>27</sup> P. 49149.

<sup>28</sup> Attachment A-1, at 49166 (emphasis added).

<sup>29</sup> In fact, there is no space on the proposed Attachment A-1 form for the names of the title insurance agent or insurance company.

<sup>30</sup> P. 49149.

The proposal that the title insurance agent disclose the commission it receives for the issuance of the title insurance policy has its roots in an earlier HUD opinion expressed in a February 25, 2000 letter to the Massachusetts Bankers Association in which HUD stated that, in its view, the current instructions for the completion of the HUD-1 form requires that title insurance commissions received by settlement agents and closing attorneys be separately shown on the form.<sup>31</sup>

A number of questions are raised by the direction in Attachment A-1 that the amount of the agent's commission be included in the subtotal for "Title Agent Charges."

These include:

- whether a legitimate RESPA objective is served by including the amount of the commission in the subtotal for Total Agent Charges;
- whether HUD has authority to require a lender to obtain and disclose this information;
- whether and how HUD can require title insurance agencies or underwriters to disclose such confidential business information;
- whether the amount of the commission that would have to be included in the disclosure of the "Title Agent Charges" includes the commission only in connection with the issuance of the loan policy or the commission realized in connection with the owner's policy as well (which might or might not be issued in the transaction); and
- whether the amount of the title insurance premium that would be reported should reflect the total premium (in which case, the amount of the agent's commission would be double counted in the two subtotals) or only the net premium remitted to the insurer.

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<sup>31</sup> The HUD letter, and an ALTA letter in response, may be obtained at the ALTA website ([www.alta.org/govt](http://www.alta.org/govt)) by clicking on the Archive Period April – June 2000.

#### **IV. THE NEW GUARANTEED MORTGAGE PACKAGE AGREEMENT REGIME.<sup>32</sup>**

As a clearly favored alternative to the GFE regime, HUD is also proposing the “creation” of a regime of “guaranteed packages of settlement services and mortgages.”<sup>33</sup> While mortgage lenders can elect to operate under either or both regimes, it is likely that the majority of lenders, particularly the large lenders, will opt for the GMPA regime. Because of a lack of statutory authority for the creation of such a regime, all of the requirements, directions, and limitations that HUD proposes to establish are grounded on one “hook” – the proposed exemption from RESPA § 8 (what HUD refers to as a “safe harbor”) that lenders, packagers, and settlement service providers would obtain if they comply with all of the requirements, directions, and limitations that HUD is creating. In essence, the GMPA regime is a regulatory regime created on the basis of a suspect § 8 exemption, rather than a regime created on the basis of statutory authorization.

##### **A. Who May Offer a GMPA?**

The American Land Title Association and other groups have urged that, if HUD or the Congress were to propose a “packaging” regime, anyone – and not just mortgage lenders – should be allowed to offer packages to consumers. While HUD’s proposal

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<sup>32</sup> The GMPA includes both the guaranteed loan and the guaranteed package of settlement services, which is referred to as the Guaranteed Mortgage Package, or GMP. Because the loan itself is a key aspect of the GMPA, referring to the regime as a GMP regime is not really correct because the GMP does not include the loan itself. Accordingly, the more comprehensive reference is to the “GMPA regime,” since the GMPA includes both the settlement package (the GMP) and the loan.

<sup>33</sup> P. 49152.

appears to allow anyone to offer a GMPA, because the GMPA must include a loan at a guaranteed interest rate it is questionable – if not unlikely – that anyone other than lenders will be in a position effectively to offer a GMPA to consumers. While lenders may turn to third parties, such as title companies, to help put together some or many of the services the lender requires for the package, because the GMP must also include all of the charges the lender may be seeking in connection with the origination of the loan, a non-lender packager cannot establish the single charge for the package without knowing the origination charges for a particular lender. Moreover, even where a lender may team up with a title company or other non-lender party to offer GMPAs on a joint basis, it is possible that the final price of the GMP offered to applicants will be determined by the lender and any profit on the GMP realized by the lender.

HUD’s explanation of the GMPA proposal states that “entities other than lenders may qualify as packagers for a safe harbor, as long as their packages include a mortgage or otherwise satisfy the requirements for the safer harbor.”<sup>34</sup> If an entity other than a lender decides to offer a GMPA, then both the non-lender entity and the lender must sign the GMP. While HUD’s explanation suggests that the non-lender packager would have a lender sign the GMPA after the borrower has accepted the GMPA,<sup>35</sup> the proposed

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<sup>34</sup> P, 49152.

<sup>35</sup> Id.

regulations contemplate that the lender can sign on to a package developed by a non-lender either before or after the applicant accepts the GMPA.<sup>36</sup>

As a practical matter, it is difficult to see how a non-lender entity could offer, or would run the risk of offering, a GMPA to a borrower – and thereby become obligated to provide both the loan and the GMP at the guaranteed prices – without having gotten the commitment from a lender to provide the loan portion of the GMPA. Moreover, the information that has to be completed on page 2 of the GMPA (see p. 49169) with regard to the terms of the loan and the alternative options regarding the payment of up-front settlement costs and interest rates may be impossible for a non-lender to complete.

#### **B. What Must Be Offered in the GMPA?**

To qualify for the § 8 exemption, lenders and other packagers must offer to applicants a “Guaranteed Mortgage Package Agreement” the form and content of which is set out in proposed Appendix F to the HUD regulations (at pp. 49168-70). The GMPA can be provided in lieu of a GFE and the GMPA is deemed to satisfy the requirements of §§ 4 and 5 of RESPA with regard to the requirements for the disclosure by lenders of estimated settlement costs. The GMPA must be offered at no charge to mortgage applicants within three business days of the application. The GMPA must be signed by the party offering the package, and be held open as an offer that the applicant can accept

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<sup>36</sup> Proposed § 3500.16(c)(3)(vi), at p. 49161.

at any time within a period of not less than 30 days by paying a “minimal fee.”<sup>37</sup> By accepting the GMPA, the applicant makes it a binding legal contract on the lender and the packager (if different from the lender).

### **1. The “Interest Rate Guarantee.”**

Section I of the GMPA provides that the lender or other packager “guarantee[s]” to provide the applicant a specified interest rate, on a mortgage loan of a specified amount, for a loan term of specified years, and a monthly payment of a specified amount. The disclosure must also indicate the APR.<sup>38</sup> The applicant and the lender have the following options under the GMPA:

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<sup>37</sup> The requirement that the fee be “minimal” is only mentioned in the instructions for completing the GMPA in new Appendix F to the HUD regulations. See p. 49167. Neither the proposed regulations nor Appendix F provides guidance on what is a “minimal fee.”

<sup>38</sup> The calculation of the “finance charge” and APR (annual percentage rate) under the Truth-in-Lending Act is problematic under the GMPA proposal – particularly for non-lender packagers. The finance charge and APR on a mortgage loan can only be determined by knowing the amount of certain lender-retained charges (such as points and origination fees). While a packager does not have to itemize the separate costs of individual settlement services contained in the single price GMP, the packager will have to know what portion of that price is attributable to those lender charges in order to determine the “finance charge” and APR. Indeed, the calculation of the “finance charge” and APR may require that any profit on the GMP price (i.e., the difference between the GMP price and the charges/prices for the individual services) that is realized by the lender be included in the calculation of these figures.

A similar problem exists with regard to determining when a loan may be subject to the additional disclosure and other requirements of the Home Ownership Equity Protection Act (HOEPA). The proposed regulations indicate the § 8 safe harbor is not available to a loan subject to HOEPA. A mortgage loan is subject to that Act if the “points and fees” as defined in HOEPA exceed certain amounts or percentages of the

(footnote continued on the next page)

- the specified interest rate is guaranteed through settlement if the applicant accepts the agreement “now”<sup>39</sup> and locks-in the loan rate by a date specified in the GMPA;
- if the applicant does not accept and lock in the rate as specified above, the lender is obligated to guarantee that, if the applicant accepts and locks in the rate by a date specified by the lender that must be no less than 30 days after the date of the GMPA offer, the interest rate will vary from the stated interest rate “only to reflect changes in market interest rates based on movement in a observable and verifiable index or other appropriate measure”;<sup>40</sup> and
- the making of the loan, however, is not “guaranteed” since the issuance of the loan is still subject to “acceptable final underwriting and property appraisal.”<sup>41</sup> Such underwriting would include “verification of credit rating.”<sup>42</sup>

Since the GMPA must be issued within three days of the loan application as that term is redefined in new § 3500.2(b)<sup>43</sup> and before the applicant can be asked to pay any

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loan. In the absence of information on the specific charges for particular items, it is impossible for a borrower or her counsel to determine if a loan exceeds the HOEPA thresholds. As in the case of the “finance charge” and the APR under the Truth-in-Lending Act, there is a question as to whether the profit realized by the lender on the GMP should be included in the calculation of “points and fees” to determine whether the loan exceeds the HOEPA threshold.

<sup>39</sup> It is not clear what “now” means.

<sup>40</sup> Proposed § 3500.16(c)(2), at p. 49160.

<sup>41</sup> Proposed § 3500.16(c)(3)(viii), at p. 49161.

<sup>42</sup> See GMPA form, introductory paragraph, at p. 49168.

<sup>43</sup> The proposed regulations indicate that the GMPA must be offered within three days of application “or such time as may be reasonable in special cases but prior to the borrower paying any fee . . . .” Proposed §3500.16(c), at p. 49160. There is no indication of what circumstances might be viewed as “special cases.”

charge (such as an application fee or a charge for a credit report), in light of the interest rate commitment given in the GMPA there is a question regarding how lenders will decide whether, and in what circumstances, they are prepared to offer applicants a GMPA. While the making of the loan is subject to “acceptable final underwriting,” some lenders may decide to undertake a short-form loan underwriting at their own expense prior to issuing the GMPA in order to be reasonably certain that they would be prepared to follow through on the GMPA commitment if it were accepted by the applicant.

Finally, because mortgage interest rates change in accordance with a lender’s perception of changes in bond and other long-term interest rates, lenders may conclude that they are unable or unwilling to guarantee that interest rates will only change in accordance with a verifiable index.

## **2. The Contents and Price of the GMP.**

Section II of the proposed GMPA requires the packager to offer a guaranteed, single price for a package of all services and charges required to complete the loan. The proposed form appears to exclude from the GMP only (a) three specific charges that are required by the lender (*per diem* interest, amounts to be placed in reserve/escrow for taxes and insurance, and hazard insurance), which are separately itemized in Section III of the GMPA, and (b) “optional owner’s title insurance” (the estimated cost of which is identified in Section IV of the GMPA). Other than these charges, it appears that the guaranteed GMP price must include all other charges for settlement services or governmental charges that the borrower can be asked to pay at settlement, including, without apparent limitation, all discount points, loan origination charges of any kind, and

any other 800 series charge, all 1100 series charges, all transfer taxes, recording or release fees and other 1200 series charges, and any other 1300 series charges.<sup>44</sup>

It is not clear whether and how the GMP price is to include charges that the borrower/buyer may have agreed to pay that are not related to the loan (e.g., the borrower's attorney's fee) or that the buyer has agreed to pay (or split with the seller) in the contract for the purchase of the property. For example, if, in areas of the country that use an escrow closing system and where the buyer and seller may have agreed in the sales contract to share the cost of escrow at a particular escrow company, would such cost have to be included in the GMP price?

### **3. Disclosure of the services contained in the package.**

“The proposal does not require packagers to itemize the services included in the GMPA.”<sup>45</sup> HUD does not explain why the services contained in the package do not have to be disclosed, although, in a footnote, it refers to the considerations on this issue that were discussed in the 1998 HUD/Federal Reserve Board report, which concluded that

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<sup>44</sup> The total amount to be paid by the buyer at settlement (indicated in line 303 of the HUD-1 form) also reflects payments that the buyer has to make to the seller for local property taxes and assessments that the seller may have prepaid (see lines 106-108). Although this can be a significant cash item that the borrower has to pay at settlement (and which may come as a surprise to the buyer at closing), it does not appear that the reimbursement of seller paid taxes has to be included in the GMP.

<sup>45</sup> P. 49153.

such disclosure was not necessary.<sup>46</sup> However, in completing the HUD-1 form in transactions involving a GMPA, all the services of third party providers included in the package must be noted as included in the GMP price to be listed as the origination fee on line 801, but no separate price is to be shown for any of those particular charges. As a consequence, lenders and other packagers will have to inform the party that is responsible for producing the HUD-1 form of all of the services and government charges that have been included in the GMP, even though the amounts for each of those charges will not be separately identified on the HUD-1 form.

The HUD proposal also calls for an Attachment A-1 to the GMPA on which the lender is to indicate whether it anticipates that certain specified services will be included in the guaranteed package.<sup>47</sup> The specified services are: pest inspection, lender's title insurance, property appraisal, and credit report. There appear to be two reasons why HUD is requiring lenders to identify whether the GMP is expected to include these four services.

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<sup>46</sup> See p. 49144, n.30, which indicates that there was a concern that itemization might lead some packagers to create longer lists that could confuse borrowers and hinder their shopping, and that lenders had pointed out that "services are performed in large measure to protect their security and when the initial disclosure is provided they may not know what is needed in each case." An alternative explanation may be that disclosure of what services are and are not included in the package could enable consumers or others to determine how much profit is being made on the package.

<sup>47</sup> P. 49170.

First, HUD indicates that it is useful for the borrower to have this information because these services are of “specific interest and value to the borrower,” and “some lenders may choose to forego some or all of these services.”<sup>48</sup> Presumably, if the borrower is told that the lender is not obtaining a pest inspection or appraisal, the borrower may decide to purchase these services herself, particularly in a purchase/sale transaction. With regard to loan title insurance, HUD suggests that whether or not the lender is obtaining such insurance “may affect the cost of owner’s title insurance.”<sup>49</sup>

Second, Attachment A-1 also specifies that, upon request, the borrower is “entitled to receive a copy of the reports generated . . . .” Accordingly, a second HUD rationale for the Attachment A-1 list appears to be to ensure that if the GMP price to be paid by the borrower includes any of these four services – all of which result in a written report or document – the borrower will get a copy of what she has paid for.

As was discussed with regard to the lack of itemization in the “Title Services and Title Insurance” category of the proposed GFE, there are good reasons why the borrower

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<sup>48</sup> See p. 57.

<sup>49</sup> Id. In general, HUD appears to be misunderstanding how loan and owner’s title insurance policy charges are determined in transactions in many parts of the country where both a loan and owner’s policy are issued. HUD appears to believe that the basic price is determined by the loan policy and that the cost of an additional owner’s policy is essentially an add-on to the price of the loan policy. While that may be true in the eastern United States, simultaneous issue rates that are available in many other parts of the country provide that the basic price for title insurance is determined by the charge for the owner’s title insurance policy, with the cost of the loan policy, when issued simultaneously with the owner’s policy, being quite low and generally a fixed dollar amount.

should be informed about other services that may be included in the package so that the borrower (a) can determine if her interests will be protected by the type of services the lender has decided should be included or not included in the package, or (b) can avoid charges being included in the GMP that she has independently arranged to purchase or that the seller has agreed to pay for.

**C. The “Carrots” Offered By HUD to Encourage the Offering of GMPAs.**

To induce lenders and others to offer GMPAs, HUD offers two carrots: (1) an exemption from RESPA § 8 for payments and prices relating to the package and to the services included in the package, and (2) elimination of the need for the need to disclose what services are being offered or included in the package.

**1. The exemption from § 8 for GMPs.**

A number of points are worth noting regarding HUD’s decision to provide a “safe harbor” from § 8 for payments and prices involved in the GMP and services offered in the package.

First, the package price offered for the bundle of the services in the GMP may be higher – indeed significantly higher – than the total costs of the individual services and charges in the package without this “mark-up” being subject to § 8 scrutiny.<sup>50</sup> Similarly, a lender who requires a provider to pay a kickback in order to be included in that lender’s package – or who seeks the same economic result by requiring the provider to reduce its

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<sup>50</sup> HUD’s current view is that, absent such an exemption, a party that an unearned mark-up of the charge of another provider violates RESPA § 8(b).

normal charges in order to be included in the package<sup>51</sup> – would not be subject to § 8 sanctions. HUD believes that the possible application of § 8 to packager mark-ups is the primary regulatory barrier to packaging that had to be removed in order to encourage the market to move in this direction.

Second, at the time of the 1998 HUD/Federal Reserve Board report, the fear that any profits derived from a package could be viewed as an unlawful mark-up appears to have been the chief concern among lenders about moving to a packaging regime. That concern should be substantially lessened as a result of the recent decisions of the United States Courts of Appeal for the Fourth and Seventh Judicial Circuits that RESPA § 8(b) does not prohibit mark-ups.<sup>52</sup> However, lenders operating in states outside those two Circuits may still be concerned that HUD's view regarding unearned mark-ups could be applied by federal courts in those other states.

Third, a recent article by Ken Harney indicates that ABN Amro Mortgage Group, the fifth largest home mortgage originator in the country, is currently providing the kind of guaranteed packages contained in the HUD proposal without a RESPA § 8

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<sup>51</sup> If the market determines the price at which a particular lender will offer a GMP, then there appears to be no economic difference between the situation where, in order to be included in a particular lender's package, a service provider (a) charges its customary fee and then pays that lender a kickback in order to be included in that lender's GMP, or (b) offers to reduce its charges by the amount of the kickback it would otherwise be willing to pay.

<sup>52</sup> Boulware v. Crossland Mtge. Corp., 291 F.3d 361 (4<sup>th</sup> Cir. 2002); Echevarria v. Chicago Title & Trust Co., 256 F.3d 623 (7<sup>th</sup> Cir. 2001).

exemption.<sup>53</sup> This further suggests that a RESPA § 8 exemption for packaging may not be needed in order for the market to move in that direction.

Fourth, a lender may use an affiliated business entity to provide any (or all) of the services in its package even though such “required use” would otherwise violate the safe harbor provision for the AfBA exemption from § 8. Whether it would be in the economic interest of a lender to use an affiliated provider if the same service could be obtained at a lower cost from an independent provider is an issue that would obviously have to be considered by lenders with affiliated settlement service providers.

Fifth, the financial arrangements under which service providers are included in a package may still be subject to state kickback and referral fee prohibitions, and state insurance law provisions prohibiting rebates and discrimination in insurance pricing. In

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<sup>53</sup> See Ken Harney, “Upfront Settlement Fees: Lender Gets Positive Response from Buyers on HUD Proposal,” Washington Post, at H3 (July 13, 2002). The article is available at << <http://www.washingtonpost.com/wp-dyn/articles/A61694-2002Jul12.html>>>.

The ABN Amro Mortgage website (<<<http://www.mortgage.com/C3/application.bus>>>) indicates that the company makes loans in all 50 states and offers a “OneFee<sup>SM</sup> Closing” price that includes: discount points, appraisal fee, lender’s title insurance and related title services, lender’s attorney’s fee (if required), survey (if required), flood certification, credit reports, tax service fees, underwriting and processing fees, and recording fees. The single fee expressly excludes: prepaid interest, transfer taxes, PMI (if applicable), homeowner’s/hazard insurance, and monies required to fund any escrow or impound account. The amount of the fee depends on the amount of the mortgage and the state and county in which the property is located.

this regard, one of the issues on which HUD has invited comment is what kinds of state laws are inconsistent with the new GFE and GMPA proposals and should be preempted.<sup>54</sup>

Sixth, while the § 8 exemption is the primary carrot offered by HUD to get mortgage lenders and others to offer GMPAs, HUD also makes clear that the safe harbor from § 8 is only available if the conditions set forth in new § 3500.16 are met.<sup>55</sup>

Accordingly, if the lender/packager fails to comply with any of the new requirements regarding the GMPA, the lender/packager and any company that has provided services in the package at a price that might otherwise be deemed to be a violation of § 8 (e.g., a reduced price intended to induce the lender to include the provider in the lender's package) would lose the benefit of the § 8 safe harbor and may be exposed to § 8 consumer suits and class actions.

Finally, HUD has explained the reason why it is not concerned about "legalizing" kickbacks when paid and received in a packaging context:

HUD has examined this concern and concluded that guaranteed packaging arrangements should be permitted in a carefully circumscribed safe harbor. Deregulation, transparency and a free market will wring out kickbacks, referral fees, and other excesses more effectively than the

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<sup>54</sup> There may be a serious question as to the legal authority and/or appropriateness of any action by HUD to preempt state laws in this regard in order to encourage a GFE or GMPA regime that HUD believes is desirable but which has not been expressly authorized by Congress.

<sup>55</sup> Proposed § 3500.16(b), at p. 49160.

current restrictions and, for this reason, the establishment of a safe harbor is warranted.<sup>56</sup>

Whether HUD is correct in this regard is far from clear.

**2. No need to disclose the services contained in the package.**

Not having to disclose in the GMPA what services are included in the package and the costs incurred by the packager in obtaining those services may be an important carrot for lenders and other packagers. If such disclosure were required, borrowers might tend to focus on the amount of profit realized by the packager.

The failure to require the disclosure of information about the title-related services contained (or, more importantly, not contained) in the package and the amount of the package price attributable to those services is an important issue with significant potential impact on consumers in purchase/sale transactions. In proposing its GMPA regime (and, as discussed above, in proposing the new GFE regime as well), HUD appears to be of the view that title and closing services are primarily provided for the benefit of the lender and that borrowers elect to purchase optional owner's title insurance as an add-on service provided by the title insurance industry. While this may be true in refinance and second mortgage transactions and in sale transactions in the eastern United States,<sup>57</sup> it is not the

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<sup>56</sup> Page 5.

<sup>57</sup> HUD's understanding of how the real estate settlement process operates is influenced by the fact that HUD officials and staff are personally more familiar with real estate settlement practices in the D.C., Maryland and Virginia area, than they are with practices in other parts of the country.

case in sale transactions in many other parts of the country, where the closing of the mortgage loan transaction (and the issuance of the loan title insurance policy) is the “add-on” to the primary objective of the title and closing-related services – to facilitate the sale and purchase of the property for which the mortgage loan is security.

Accordingly, the failure to require the disclosure of what title/closing services are included in the GMP and the component of the GMP price represented by those services may create problems for consumers that HUD has not considered. For example:

- if a lender were to decide that its interests were met through the use of a non-traditional form of title protection that did not require the kind of title search and examination customarily undertaken in a sale transaction, the buyer and seller would need to know that so as to make other arrangements for title-related services that meet their needs;
- in many transactions, before the buyer has begun to shop for a lender; the buyer and the seller may have agreed on the selection of a party to handle the closing (or, in the western U.S., the escrow) and/or the title-related services, and how they will split that party’s fee;
  - in those situations, inclusion of a charge for closing or title-related services in the GMP may result in the buyer (and seller) paying twice for the same service;
  - accordingly, the packager should be required to provide a credit towards the GMP price if the borrower and seller elect not to use the provider of closing or title services who is part of the GMP;
- by custom or contract, sellers in many parts of the country pay for all or a portion of certain title/closing services; how such practices (which benefit buyers by reducing some of the settlement charges they might

otherwise pay) might be affected by the proposed GMPA regime is unclear, but the issue needs to be considered.<sup>58</sup>

**D. Particular Concerns of the Title Insurance Industry Regarding the Proposed GMPA Regime.**

While a more complete assessment of the potential impact of the proposed GMPA regime on the title insurance industry can only be developed after the industry has had a chance to review and discuss the HUD proposal, as an initial matter the following concerns and problems appear likely.

1. The use of GMPAs by lenders could become the predominant regime for loan originations, and other parties (such as real estate brokers or title companies) may not be able to offer packages effectively without the participation of lenders.
2. As a consequence:
  - being included in the GMPs developed by lenders may be the only effective means by which providers of title/closing services can obtain any significant amount of business in residential mortgage loan transactions;
  - to the extent that a mortgage lender can realize greater profits on the GMP price by negotiating for lower prices from the providers of the services in the package, providers of title/closing services are likely to face significant pressure to offer cut-rate prices or cut-rate

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<sup>58</sup> Because it is not customary in the eastern United States, as it is in other parts of the country, for the seller to pay for a portion of the title or closing-related costs, HUD frequently fails to take such “seller-pay” practices into account and tends to assume that the buyer/borrower pays for all title and closing-related costs throughout the United States.

services in order to be selected for inclusion in lender-created GMPs.<sup>59</sup>

3. While HUD believes that such loss of revenues for the title/closing industry is desirable if consumers reap the benefits of such revenue transfers:
  - there is no comprehensive study – indeed, no responsible study at all – that supports the conclusion that the loss of such revenues (a) will simply eliminate “fat” or unnecessary services, or (b) will not adversely affect the ability of the industry to continue to provide needed services, or to retain and attract capital; and
  - the GMPA regime may end up simply transferring revenues from settlement service providers to lenders.
  
4. To increase profits from the package price, some lenders may be willing to accept non-traditional forms of title/lien protection if secondary market purchasers of mortgages would be willing to accept such coverage in lieu of a loan title insurance policy. Such a development, if widespread, could have adverse effects on buyers and sellers of real estate because:
  - it would change the pricing structure for the issuance of owner’s title insurance;

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<sup>59</sup> The Robinson-Patman Act, 15 U.S.C. § 13, which applies to the sale of goods, but not services, was enacted because of the concern about abuse of buying power by large purchasers of goods who, by virtue of such clout, could secure lower prices from sellers than could their smaller competitors. In this regard, it should be noted that, in the last five years, the market share of the top 10 originators of residential mortgages has doubled from 25% of the market to “control of upward of 50%.” See “Consortium Approach Gains in Home Loans,” American Banker, July 12, 2002, at 1, 10.

While HUD appears to believe that allowing large lenders to use their clout to arrange for the purchase of settlement services at discounted prices is a good thing, an examination of the policy concerns underlying the Robinson-Patman Act would likely provide valuable insights as to why it is not sound regulatory or economic policy for HUD to be encouraging (through an exemption from RESPA § 8) the offering of discounts induced by the market leverage of major lenders, without whose business many settlement service providers could not survive.

- it could affect consumer decisions on purchasing title insurance for their protection.
5. Lenders may seek to have title companies that provide significant services for the GMP assume the risk of cost overruns if the ultimate charges for the settlement exceed the guaranteed price (e.g., because a government charge included in the GMP price turned out to be too low).
  6. To the extent that large national and regional lenders find it more efficient to deal with fewer and bigger providers of settlement services to be included in the GMP, smaller title companies may be particularly adversely impacted by widespread adoption of the GMPA regime.

### **CONCLUSION**

The proposed regulations represent a bold – some might say audacious – effort to restructure the way in which residential mortgage loans and settlement services are offered and priced throughout the United States. In the absence of express statutory authorization and guidance, HUD has endeavored to shoe-horn two new disclosure/payment regimes into the existing statutory framework. While the new regimes may make some sense with regard to those charges that are imposed by lenders or are for services that only benefit the lender, as the discussion in this memorandum indicates, there are a host of difficult questions – many of which do not appear to have been considered by HUD – in trying to include in these proposals title and closing services that are provided for the benefit of the buyer and the seller.