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## The Revamping of RESPA May Increase Litigation

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In the wake of the housing crisis and global credit crunch, the Department of Housing and Urban Development (HUD) issued a Final Rule amending the Real Estate Settlement Procedures Act (RESPA) on November 17, 2008. The revised rule allows for average charges. It also creates a new Good Faith Estimate (GFE) and Settlement Statement (HUD-1/1A), along with new instructions and definitions for completion. While the average charge provision was implemented on January 16, 2009, the new GFE and HUD-1/1A will be required on January 1, 2010. As a practical matter, if the lender elects to use the new GFE prior to January 1, 2010, then the new HUD-1/1A must also be used and all provisions of the new rule must be implemented.

The goal of the new rule is to "Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs." (24 C.F.R. § 3500, 73 F.R. 68204). Specifically, HUD believes that the new GFE will be more "user-friendly," enabling consumers to better understand the terms of their loan and to search more effectively for the lowest cost loan by comparing loans from different lenders and the fees quoted on the GFE with the actual fees on the HUD-1/1A. HUD estimates its new GFE will save consumers approximately \$700 in closing costs per transaction.

With the revised rule comes a host of questions as well as a potential for increased liabilities for lenders. This article seeks to address some of those questions and expose some of the pitfalls of the revised rule from a legal perspective, while providing an overview of the changes to the GFE and the HUD settlement statement.

### The New GFE

The new GFE is now three pages in length. Similar to the original form, the first page contains general information regarding the lender and borrower, along with important dates for when the rate lock and fee estimates expire. In response to concerns that borrowers did not completely understand the impact that an adjustable interest rate could have on monthly mortgage payments, HUD added the following three new fields to the "Summary of Your Loan" section located in the center of the first page: 1) Initial monthly payment for principal, interest and private mortgage insurance (PMI); 2) "Yes" or "no" boxes for the lender to check to indicate whether the loan's interest rate is adjustable (and if "yes," the lender must provide the maximum rate to which that interest can adjust); and 3) If the rate is adjustable, the full dollar amount to which a monthly payment of principal, interest and PMI can rise, along with the first interest rate adjustment dollar amount.

Another key change is evident in the field entitled "Required services that you can shop for" on the second page of the new GFE. By requiring the lender to list all of the settlement charges that the borrower may "shop around" for in this field, HUD hopes to increase consumer awareness of the fact that some services can be obtained from settlement service providers other than those selected by the bank.

The quoted settlement charges on the second page of the new GFE are subject to the following three "tolerances" set forth at the top of the third page: 1) Charges that cannot increase at settlement, which generally are lender required costs; 2) Charges that can increase up to 10 percent at settlement, which are generally charges suggested by lender; and 3) Charges that can change at settlement, which are generally borrower selected costs. Fees such as transfer taxes, a loan originator's own charges and the interest rate after it is locked will be subject to a zero-tolerance requirement and, therefore, must not change before closing. Other charges, such as charges required by the lender, government recording charges and certain third-party charges, may individually increase. However, the collective sum of their increases at closing may not exceed 10 percent of the amount disclosed on the GFE.

The new rule permits a revised GFE to be provided when "changed circumstances" result in increased loan terms or charges in excess of the tolerances. "Changed circumstances" include: 1) Acts of God, war, disaster or other emergency; 2) Information that was relied on in providing the GFE and that later changes or is found to be inaccurate; 3) New information that was not relied on in providing the GFE; or 4) Other circumstances that are particular to the borrower or transaction, including boundary disputes, the need for flood insurance or environmental problems.

The third page of the new GFE also contains the "tradeoff table," a worksheet-type chart to compare different loans and terms. The loan originator must complete the left-hand column of the "tradeoff table" with the information pertaining to the loan as shown on the first page of the GFE. The loan originator has the option of also completing the remaining sections in the "tradeoff table" with the same information showing an alternate loan with the same loan amount but one with a higher interest rate and one with a lower interest rate, if the loan originator has those loans available and would issue a GFE based on the same information provided by the applicant.

Finally, the third page provides a "shopping cart" chart that allows the borrower to enter in the terms of other GFEs from different lenders. Again, HUD hopes this will encourage consumers to shop around for the best loan package.

### The New HUD-1/1A

The first page of the new HUD settlement statement is essentially unchanged. The second page, however, contains additional information to make the form more closely align with the new GFE. HUD has added a new third page to the HUD-1 in order to establish a direct correlation between the estimated closing costs of the GFE and the actual closing costs shown in the HUD-1. The original proposed HUD rule change called for the settlement agent to read from a closing script. This third page eradicates the need for a closing script as it contains a complete comparison of the GFE charges and those set forth in the HUD-1, as well as a final statement of the key loan terms. While the new HUD-1 is utilized when the transaction involves a buyer and a seller, HUD is utilizing the HUD-1A for those transactions without sellers. The HUD-1A is two pages in length, and essentially mirrors the second and third pages of the new HUD-

### Average Charge Pricing

Settlement service providers are allowed to use average charge for certain services obtained from third parties, such as FedEx courier fees or recording costs. This is not allowed for any service based upon the value of the property or loan such as hazard insurance. The settlement agent must properly retain all closing documents for a period of three years, and the total average charge over the utilized time period must not exceed the total paid for those services to third parties.

### Revised Rule Compliance and Potential Pitfalls

Not only does the revised rule charge the lender with providing the new GFE, it also places a greater burden on the lender to clarify and disclose certain costs and terms associated with loans and to provide extremely accurate estimates on the GFE. This could prove daunting (not to mention quite costly) for lenders, especially early in the application process and will likely force them to alter their business practices. For example, lenders will likely look to coordinate with third-party settlement providers to ensure compliance with the tolerances.

In the event of a disclosure error or tolerance violation, the lender is "on the hook" to cure the violation with an amended HUD or to repay to the borrower any overcharges within 30 calendar days of the closing. The settlement agent would be required to issue a revised HUD-1/1A within the 30-day period to reflect the adjusted charges. Although HUD recommends that the lender cure the potential tolerance violation at closing, it does not require the settlement agent to stop the closing if a tolerance would be violated. Rather, the 30-day right-to-cure period would apply.

A lender's failure to repay the borrower any overages within the prescribed 30-day period is considered a violation of Section 5 of RESPA. A closing agent would violate Section 4 of RESPA if there is an inadvertent or technical error on the HUD-1/1A and a revised HUD-1/1A is not provided to all parties within 30 calendar days after settlement.

HUD has set forth guidelines for complying with the new RESPA rule. However, before and now, RESPA does not provide penalties for violations of Sections 4 and 5 of RESPA. HUD has expressed concern over such lack of enforcement mechanisms for violations of these two critical sections of RESPA. With that being said, legislative changes providing for civil money penalties and additional injunctive and equitable relief for violations of Sections 4 and 5 of RESPA are likely on the horizon.

Despite the current absence of any specific penalties under RESPA for lenders who have provided an incorrect estimate on the GFE or failed to provide the new GFE altogether, increased litigation on things other than the RESPA statute is certainly foreseeable. Expect borrowers to bring suits (individual suits and possibly even class actions) against lenders under state consumer practices or unfair credit practices statutes. Such suits could subject lenders to monetary damages and perhaps even liability for payment of plaintiffs' attorneys' fees.

Another potential RESPA violation (Section 8(a)) would arise under the new rule if a lender pressures a settlement agent to reduce their charges or otherwise "cover the difference" to bring the actual costs into compliance with the tolerance as a condition of receiving future business referrals. Such a violation could subject the lender to civil and/or criminal penalties. Specifically, the lender could be fined up to \$10,000 and imprisoned for up to one year. In a private lawsuit, the lender may be liable to the person charged for the settlement service an amount equal to three times the amount paid for the service.

Another concern is litigation under the generic theory of "the disclosures were confusing to the borrower." One thing we do know from more than 40 years of experience with TILA, is that "confusing disclosure" claims have been very profitable for the plaintiff's bar. The plaintiff's bar will scrutinize the GFE, the HUD and the TILA disclosure for discrepancies, and if there is even the slightest discrepancy, you can be certain that lawsuits will be filed against the lender. Another unintended consequence could be fewer lenders offering ARM products as this regulation and other Obama Administration proposals make the offering of "non-vanilla" loan products too risky.

With this in mind, lenders must immediately begin preparation for implementing the requirements set forth by the revised rule so as to avoid the stiff consequences of non-compliance. As for the success of the revised rule, only time will tell if it will live up to HUD's aspirations.