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Office of Thrift Supervision **August 5, 2002**

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Transmittal

TR-289

Federal Register, Vol. 67, No. 145, pp. 49134 - 49174 **Number TR-289**

The attached proposed rule regarding Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages To Reduce Settlement Costs to Consumers was published in the Federal Register on July 29, 2002.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR–4727–P–01]

RIN 2502–AH85

Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages To Reduce Settlement Costs to Consumers

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: The Department of Housing and Urban Development is issuing this proposed rule under the Real Estate Settlement Procedures Act (RESPA), to simplify and improve the process of obtaining home mortgages and reduce settlement costs for consumers. The current disclosure requirements under RESPA have not been substantially revised in decades. The current disclosures were comprehensively reviewed as recently as 1998 by HUD and the Board of Governors of the Federal Reserve System, but the problems identified then remain. Nevertheless, since 1998, there have been continuing changes in the marketplace, new products, and greater accessibility of mortgage information via the Internet, all of which are reducing settlement costs and, if properly addressed by Government, could result in greater price reductions for consumers. First, to simplify and improve the mortgage loan process, this proposal would address the issue of loan originator compensation, specifically the problem of lender payments to mortgage brokers, by fundamentally changing the way in which these payments in brokered mortgage transactions are recorded and reported to consumers. Second, it would significantly improve HUD's Good Faith Estimate (GFE) settlement cost disclosure and HUD's related RESPA regulations to make the GFE firmer and more usable, to facilitate shopping for mortgages, to make mortgage transactions more transparent, and to prevent unexpected charges to consumers at settlement. Finally, the rule would promote competition by removing regulatory barriers to allow guaranteed packages of settlement services and mortgages to be made available to consumers, to simplify shopping by consumers and further reduce settlement costs. The proposed rule also includes proposed, revised forms and solicits comments on additional changes including changes to HUD's settlement disclosure form and disclosure requirements.

DATES: Comment Due Date: Deadline for comments on this proposed rule, including comments on the proposed information collection requirements: October 28, 2002.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–0500. Communications should refer to the above docket number and title. Facsimile (FAX) comments are not acceptable. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

HUD also invites interested persons to submit comments on the proposed information collection requirements of this proposed rule. Comments should refer to the above docket number and title, and should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for HUD, Washington, DC 20503.

FOR FURTHER INFORMATION CONTACT: Ivy Jackson, Acting Director, Interstate Land Sales and RESPA Division, Room 9146, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410; telephone (202) 708–0502 (this is not a toll-free number) or for legal questions Kenneth A. Markison, Assistant General Counsel for GSE/RESPA, or Steven J. Sacks or Teresa L. Baker (Senior RESPA Attorneys); Room 9262, telephone (202) 708–3137. Persons with hearing or speech impairments may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877–8339. The address for the above listed persons is: Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410.

SUPPLEMENTARY INFORMATION:

I. Introduction

The American mortgage finance system is justifiably the envy of the world. It has offered unparalleled financing opportunities under virtually all economic conditions to a very wide range of borrowers that, in no small part, have led to the highest homeownership rate in the Nation's history. At the same time, however, the process of financing or refinancing a home, which is regulated under RESPA, 12 U.S.C. 2601 *et seq.*, remains too complicated, too costly, and too opaque for many borrowers. The monies needed to close on a home are a significant impediment to homeownership, and settlement costs are a significant component of these costs. In light of the Administration's commitment to reach even higher levels of homeownership, the RESPA regulatory scheme deserves particular scrutiny and necessary reform.

The current disclosure requirements under RESPA have not been substantively revised in decades. Although the RESPA disclosures were comprehensively reviewed as recently as 1998 by both HUD and the Board of Governors of the Federal Reserve System, the problems identified in that review remain largely unaddressed.

Recent judicial developments regarding lender [1] payments to mortgage brokers [2] (yield spread premiums and other named payments based on borrowers' transactions) have heightened the importance of increasing borrower awareness regarding how mortgage brokers are paid and how borrowers can benefit from payments made by lenders based on mortgages exceeding par interest rate.[3] Some borrowers [4] understand, agree to, and properly use higher interest rates to lower up front settlement costs. Others report, however, that they paid substantial origination costs in up front fees for mortgages and then learned that they were charged interest rates higher than those they qualified for merely to support an additional payment to their mortgage broker.

Under the current rules, many borrowers are provided estimated settlement cost information on a GFE only after paying a significant fee required by a loan originator,[5] which prevents the borrower from shopping among additional originators using the

[1] The term ''lender'' is used throughout this document to mean any person who is the ''real source of funds'' for a federally related mortgage loan.

[2] Except as specifically described in footnote 17, the term ''mortgage broker'' is used throughout the document to mean a person (not an employee of a lender) who table funds or acts an intermediary in a federally related mortgage loan. Mortgage brokers that are the ''real source of funds'' for a federally related loan are not regarded as brokers in such transactions.

[3] The term ''par interest rate'' is used throughout this document to mean the interest rate at which there is not payment made by the lender to the borrower or from the borrower to the lender.

[4] The terms ''consumer'' and ''borrower'' are used interchangeably throughout the document.

[5] The term ''loan originator'' is used throughout this document to refer to lenders and mortgage brokers.

GFE. Also, when borrowers receive estimated settlement cost information after applying for a mortgage, the estimates are often unreliable and prove too low. Final charges at settlement often include additional surprise ''junk fees,''[6] which increase the original estimates. HUD's current rules provide little guidance on the standards that originators should be held to in providing good faith settlement cost estimates.

By requiring a long listing on the GFE of each estimated settlement charge, the current disclosure fails to highlight the major costs and seems to lead only to a proliferation of charges without any actual increase in the work performed or enhanced borrower understanding to assist in shopping for services and guard against unnecessary charges. The current requirements allow an individual such as a loan originator, to charge several fees for origination, document preparation, and document review. It is difficult for borrowers to distinguish or understand the precise purpose of these various itemized services provided by the same originator. Excessive itemization thus enables originators to charge more than if the borrower could review and shop the total origination charges. The same holds true for title and other third party services. The types of fees charged by loan originators, title agents and other service providers have multiplied in recent years making it steadily more difficult for borrowers to compare settlement costs.

Industry advocacy groups have indicated that they support better disclosure of mortgage broker compensation specifically and loan origination charges in general. Consumer groups have called for protections against yield spread premiums that were not bargained for, more shoppable settlement cost disclosures, and much firmer interest rates and settlement service costs.

Settlement cost disclosures need to be improved so that the information they provide is simpler, clearer, more reliable, and reasonably available to facilitate shopping, increase competition, and lower settlement costs. Although HUD has called for better disclosures in policy statements and opinions, its regulations need to be updated to establish requirements that are more useful to consumers.

While technology and market forces have played a significant role in lowering costs in the settlement process, it is not clear that under existing rules these benefits are passed on to the borrower in the form of lower settlement prices. HUD's rules implementing Section 8 of RESPA require originators to pass through third party costs without ''mark-ups'' or ''upcharges,'' and generally prohibits volume discount arrangements. Many industry and consumer advocates assert, however, that these regulatory restrictions prevent activities and innovations which would lower prices to borrowers. Many mortgage industry providers also report that while they follow the rules, they are competitively disadvantaged by those who do not because of the lack of adequate enforcement by HUD.

Specifically, some assert that HUD's RESPA rules impede arrangements for the packaging of settlement services, which would allow packagers to draw on their knowledge of the market and familiarity with the products offered by providers of specific services to develop lower settlement cost packages for borrowers. They assert that such packages would increase competition and enhance borrower shopping, lowering costs more effectively than restrictions against referral fees or unearned fees. In the joint HUD and the Board of Governors of the Federal Reserve System, Joint Report to the Congress Concerning Reform of the Truth in Lending Act and the Real Estate Settlement Procedures Act, (July 1998), (hereafter HUD-Federal Reserve Report) both agencies agreed that an exemption should be established to facilitate the provision of settlement services and to improve consumers' ability to shop effectively for a mortgage loan and thereby allow competitive forces to reduce the cost of financing a home. HUD-Federal Reserve Report at 33. At that time, some settlement service providers claimed that such an exemption would legalize kickbacks and referral fees. 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 current restrictions and, for this reason, the establishment of a safe harbor is warranted. Under this proposal, settlement service providers may choose either to operate using an improved GFE disclosure, or to participate in packages qualifying for the safe harbor. Accordingly, this dual approach will provide industry and borrowers alike with an opportunity to test both methods where they should be tested, in the marketplace, to determine which is more effective in lowering settlement costs.

Late last year, in Statement of Policy 2001–1, Clarification of Statement of Policy 1999–1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 FR 53052 (October 18, 2001), the Secretary announced his intention to make full use of his regulatory authority to provide clear requirements and guidance regarding the disclosure of mortgage broker fees, and more broadly, to improve the mortgage settlement process to better serve borrowers. The Secretary has established the following principles to guide HUD's RESPA reform and enforcement efforts:

1. Borrowers should receive settlement cost information early enough in the process to allow them to shop for the mortgage product and settlement services that best meet their needs;

2. Disclosures should be as firm as possible to avoid surprise costs at settlement;

3. Regulatory amendments should be utilized to remove unintended barriers to marketing new products, competition, and technological innovations that could lower settlement costs;

4. Many of the current system's problems derive from the complexity of the process; with simplification of disclosures and better borrower education, the loan origination process can be improved; and

5. RESPA should be vigorously enforced to protect borrowers and ensure that honest industry providers have a level, competitive playing field.

In accordance with these principles, this proposed rule would first fundamentally change the way in which mortgage broker compensation is reported by requiring, in all loans originated by mortgage brokers, that any payments from a lender based on a borrower's transaction, other than the payment for the par value[7] of the loan, including payments based upon an above par interest rate on the loan (payments commonly denominated ''yield spread premiums''), be reported on the Good Faith Estimate (and the HUD–1/1A Settlement Statement) as a lender payment to the borrower. Additionally, in brokered loans, any borrower payments to reduce the interest rate (''discount points'') must

[6] ''Junk fee'' is a term used throughout this document to mean any fee charged for a service to a borrower that has little or no value in relation to the charge, and/or may be duplicative, to increase a loan originator's profits.

[7] The term ''par value'' of the loan is used throughout this document to mean the principal amount of the loan.

equal the discount in the price of the loan paid by the lender, and be reported on the GFE (and HUD–1/1A) as borrower payments to the lender. These changes would require mortgage brokers to disclose, at the outset, the maximum amount of compensation they could receive from a transaction, and include the amount in the ''origination fees'' block of the GFE and separately on the GFE Attachment A–1. They would then disclose the amount of the lender payment to the borrower that would be received at the interest rate quoted, if any. Mortgage brokers would be unable to increase their compensation without the borrower's knowledge, either by placing the borrower in an above par loan, and receiving a payment from the lender (yield spread premiums), or by retaining any part of any borrower payment intended to reduce the loan rate (discount points).

Through these changes in reporting requirements, HUD believes that virtually all disputes regarding broker compensation in table funded transactions and intermediary transactions involving yield spread premiums would be resolved. Maximum broker compensation would be clear and brokers would have no incentive to seek out lenders paying the largest yield spread. They would instead be motivated to find the best loan product they can for the borrower. At the same time, HUD believes that since these new disclosure requirements will allow borrowers to focus on the total origination costs for shopping purposes, they will not disadvantage brokers in competition with lenders.

Second, the proposed rule would improve the existing RESPA disclosure scheme by establishing a new required format for the Good Faith Estimate providing greater accuracy and usefulness for borrowers, which would: (1) Inform the borrower that mortgage brokers and other loan originators do not offer loans from all funding sources and cannot guarantee the lowest price or best terms available in the market; (2) explain to the borrower the option of paying his or her settlement costs through the use of lender payments based on higher interest rates, or reducing the interest rate by paying the lender additional amounts at settlement; (3) disclose the loan originators' fees, including the mortgage broker's and lender's total charges to borrowers; and (4) require, in transactions originated by mortgage brokers, that all payments from a lender other than for the par value for the loan (including ''yield spread premiums,'' servicing release premiums, and all other payments from lenders), be reported on the GFE and the HUD–1 Settlement Statement as a lender payment to the borrower and any discount points charged to the borrower must equal the discount in the price of the loan paid by the lender and be reported on the GFE and the HUD–1 Settlement Statement as borrower payments to the lender. These changes will ensure that borrowers receive the full benefit of any payments from or to lenders in brokered transactions, either by reducing their up front settlement costs in exchange for accepting a loan with a higher rate, or by reducing their interest rate and monthly payments by paying additional amounts to the lender at settlement.

The new GFE would also better inform borrowers of the costs of obtaining a mortgage loan from a mortgage broker, as well as from mortgage bankers, lenders or other loan originators, and would better protect borrowers from unnecessary surprise charges at settlement. It would:

(1) Include an interest rate quote in the form of the mortgage loan's note rate and APR, and notification of any prepayment penalties, to assist the borrower in shopping among mortgages;

(2) Disclose subtotals of major categories of settlement costs (including, for example, loan origination costs and title services) to borrowers to eliminate the proliferation of fees by individual settlement service providers, and to allow borrowers to focus on and compare major fees; and

(3) Provide additional shopping information for borrowers that would provide a breakdown of lender and broker origination charges, title insurance and title agent charges, and inform the borrower of lender required and selected services and those third party services that can be shopped for by the borrower.

The proposed rule would further improve the existing disclosure scheme, by amending Regulation X to establish new rules for the provision of the GFE which would: (1) Clarify the basic information needed in an ''application'' to obtain a GFE; (2) limit fees paid by borrowers for the GFE, if any, to the amounts necessary to provide the GFE itself and exclude amounts used to defray later appraisal or underwriting charges, in order to facilitate shopping with GFEs; (3) require that loan originators not exceed the amounts reported on the GFE regarding their total compensation, lender required and selected third party services, and government charges through settlement (absent unforeseeable and extraordinary circumstances); (4) require that loan originators comply with upper limits or ''tolerances'' for specified major settlement charge categories so they do not exceed those stated on the GFE by more than 10%; and (5) clarify that loan originators can make arrangements with third party settlement service providers to lower prices for their customers, provided that these prices and any charges are reflected accurately on the GFE and are not ''marked up'' or ''up charged.''

Third, the proposed rule would remove regulatory barriers to allow packages of settlement services and mortgage loans to be made available to borrowers. These transactions would be even simpler and more transparent for borrowers, and would allow market forces, borrower shopping, and competition to further reduce the costs of settlement services to better achieve the purposes of the statute.

To accomplish this objective, HUD would establish a carefully circumscribed safe harbor under RESPA for ''Guaranteed Mortgage Package'' (GMP) transactions. Any entity (a lender, broker, other settlement service provider, or other entity), hereinafter a ''packager,'' may qualify for the safe harbor as long as it offers a GMP. The packager must offer the GMP to a borrower following his or her submission of application information, but before the borrower's payment of any fee to the packager. The GMP must include: (1) A guaranteed package price for a comprehensive package of loan origination and virtually all other settlement services required by the lender to close the mortgage (including without limitation, all application, origination and underwriting services, the appraisal, pest inspection, flood review, title services and insurance, and any other lender required services except hazard insurance, *per diem* interest, and escrow deposits); (2) a mortgage loan with an interest rate guarantee, whether when the ''Guaranteed Mortgage Package Agreement'' (GMPA) is given or subject to change (prior to borrower lock-in) only pursuant to market changes evident from an observable and verifiable index or other appropriate data or means; and (3) a contract offer in the form of a GMPA to guarantee the price for settlement services and the mortgage interest rate through settlement, if the offer is accepted by the borrower. Additionally, in order to ensure that the borrower receives the settlement package of services and the mortgage loan, the proposed rule would require that the packager sign the GMPA agreeing to provide the Guaranteed Mortgage Package at the Guaranteed Mortgage Package price and that non-lender packagers have a lender sign the

GMPA after borrower acceptance agreeing to provide the loan included in the Guaranteed Mortgage Package.

The GMPA would describe the package as ''including all services required by the lender to close the mortgage'' but would not itemize the specific services to be provided. The packager would, however, be required to inform the borrower if certain items of interest to the borrower are anticipated to be excluded from the package, specifically lender's title insurance, pest inspections, and a property appraisal. Additionally, where the packager anticipates obtaining a pest inspection, appraisal, or credit report, the packager must disclose that information on Attachment A–1 and make such documents available at the borrower's request. The HUD–1 would list the services ultimately provided, but not the charges for specific services. HUD is requesting comments on whether this approach satisfies, or whether alternative approaches should be developed, to ensure that consumers' rights under TILA and HOEPA are protected while facilitating packaging.

The Secretary is exercising the exemption authority under Section 8(c)(5) and Section 19 of RESPA to establish this Guaranteed Mortgage Packaging safe harbor for those Guaranteed Mortgage Package transactions that meet the requirements set forth in this rule. The Secretary has determined that the establishment of this carefully circumscribed safe harbor is necessary to allow this class of transactions to be available to consumers and to achieve the purposes of the Act. The Secretary has concluded that the availability of these packages to consumers at single guaranteed prices with an interest rate guarantee will simplify consumers' shopping for mortgages and allow them to gain the benefit of an active competitive marketplace in which market forces produce lower settlement costs. For the same reasons, the Secretary has determined that payments among packagers and participating settlement service providers and the earnings of packager in Guaranteed Mortgage Packages, as set forth in this rule, shall not be construed as prohibited under Section 8 of RESPA as long as the requirements in this rule are satisfied. Pursuant to Section 8(c)(5) the Secretary has undertaken the necessary consultation with other agency heads as required prior to promulgating this exemption.

The safe harbor from Section 8 will permit the packager to charge for services within the package and will permit payments to, or exchanges of other things of value between entities participating in the package. Section 8 would, however, continue to prohibit any payments for the referral of business, kickbacks, splits of fees and unearned fees between the packager and any of the entities participating in the package on the one hand and entities outside of the package on the other. Under the safe harbor, packagers would provide the GMPA in lieu of a GFE. HUD regards such provision of a GMPA as fully, indeed more than, satisfying the requirements of Section 5 of RESPA that borrowers receive a Good Faith Estimate of the amount of charges for settlement services the borrower is likely to incur. HUD believes that the GMPA, by providing a Guaranteed Mortgage Package price encompassing virtually all settlement charges, along with a limited number of itemized charges, including owner's title insurance, also more than satisfies the requirements of Section 4 of RESPA. Nevertheless, as long as the requirements of the safe harbor are satisfied, HUD is also prepared to exercise the exemption authority under Section 19 to create a safe harbor for packagers from the requirements of Sections 4 and 5 of RESPA, if it deems such an exemption necessary.

The safe harbor is proposed to be available only where the transaction does not result in a high cost loan as that term is defined in the Home Ownership Equity Protection Act, 15 U.S.C.1601(Supp II 1996). The safe harbor also may not be available to mortgages that exceed other limits, or include other features identified through this rulemaking, resulting in unreasonable settlement charges or loan terms inimical to the purposes of RESPA.

The proposed rule's new regulatory requirements will apply to first and second lien transactions, purchase money loans, and refinances. Home equity transactions are addressed in § 3500.7(f), under current RESPA regulation. At Question 26 the Department invites comments on this issue.

The Department also is inviting comments specifically on whether, and to what extent modification of the existing HUD–1/1A Settlement Statement and Instructions, found at 24 CFR part 3500, Appendix A, is necessary to make it comparable to the new GFE. HUD also announces that it plans to revise the Special Information Booklet concerning settlement costs consistent with the final rule, and to develop new booklets for refinance and junior lien transactions.

In this proposed rule at Appendix C and F, the Department is publishing for comment new proposed required formats for the Good Faith Estimate (GFE) and new GMPA. HUD believes that the content of the material in these proposed forms gives the consumer the information needed to shop for loan products and to assist them during the settlement process. HUD recognizes that in order for these forms to be useful shopping tools, they must be consumer friendly. The Department seeks public comment on these proposed forms In addition, the Department will arrange focus groups during the comment period to elicit comments on how to make the material in the new proposed forms as consumer friendly as possible including considering, among other things, how the new proposed forms are best compared by consumers to the HUD–1 and what revisions, if any, to the HUD–1 would be most helpful.

In addition, the Department will facilitate the provision of web based information to consumers on settlement costs and pursue other efforts to ensure that RESPA regulation encourages technological advances to facilitate competition, and lower costs and prices to consumers. Beyond this rulemaking, the Department is examining possible changes to its rules to facilitate electronic mortgage transactions consistent with the Electronic Signatures in Global and National Commerce Act, Public Law 106–229. The Department will also undertake efforts with Federal and State regulators and others to better address technological changes to lower costs.

Additionally, the Department plans to finalize the 1997 Section 6 transfer of servicing proposed rule; however, in the meantime the Section 6 language in the statute may be provided in conjunction with the GFE. Separate from this rulemaking, the Secretary is increasing the resources dedicated to enforcing and regulating RESPA.

Following the background materials, this proposal includes a description of today's proposed rule, specific questions for public comment, and proposed rule language. Public comment on this proposal will be important to formulating a final rule that is consistent with RESPA's purpose, workable in the marketplace, and best serves the financing needs of America's families.

II. General Background

A. Legal Authority

The Department is proposing this rule in accordance with 5 U.S.C. 552, Sections 19 and 8(c)(5) of the Real Estate

Settlement Procedures Act of 1974 (12 U.S.C. 2617).

RESPA Overview

In 1974, Congress enacted the Real Estate Settlement Procedures Act (Pub. L. 93–533, 88 Stat. 1724, 12 U.S.C. 2601 *et seq.*) after finding that ''significant reforms in the real estate settlement process are needed to ensure that borrowers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from the unnecessarily high settlement charges that have developed in some areas of the country.'' *Id.* RESPA's stated purpose is to ''effect certain changes in the settlement process for residential real estate that will result:

(1) In more effective advance disclosure to home buyers and sellers of settlement costs;

(2) In the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;

(3) In a reduction in the amounts home buyers are required to place in escrow accounts established to ensure the payment of real estate taxes and insurance; and

(4) In significant reform and modernization of the local record keeping of land title information.'' Id.

RESPA's requirements apply to transactions involving ''settlement services'' for ''federally related mortgage loans.'' Under the statute the term ''settlement services'' includes any service provided in connection with a real estate settlement.[8] The term ''federally related mortgage loan'' is broadly defined to encompass virtually all purchase money and refinance mortgages.[9] Section 4(a) of RESPA requires the Secretary to develop and prescribe ''a standard form for the statement of settlement costs which shall be used * * * as the standard real estate settlement form in all transactions in the United States which involve federally related mortgage loans.'' The rule further requires that the form ''conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement. * * *'' Section 5 requires the Secretary to prescribe a Special Information Booklet for borrowers. Section 5(c) requires that a Good Faith Estimate (GFE) be provided at or within 3 days of loan application, authorizes the Secretary to prescribe the contents of the GFE, and requires that the GFE state ''the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary.'' Notice of transfer of servicing language was added to RESPA at Section 6 in 1990 and amended most recently in 1996, and requires notification to borrowers at the time of application for the mortgage, and during the life of the loan, of whether the servicing of the loan may be or has been assigned, sold, or transferred.

Section 8(a) prohibits any person from giving and any person from accepting ''any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise,'' that real estate settlement service business shall be referred to any person. 12 U.S.C. 2607(a). Section 8(b) prohibits anyone from giving or accepting ''any portion, split, or percentage of any charge made or received'' for the rendering of a real estate settlement service ''other than for services actually performed.'' 12 U.S.C. 2607(b). Section 8(c) of RESPA provides, in part, that ''[n]othing in [Section 8] shall be construed as prohibiting * * * (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.'' * * * or ''(5) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board,[10] the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System and the Secretary of Agriculture.'' 12 U.S.C. 2607(c)(2).

Section 9 forbids any seller of property from requiring buyers to purchase title insurance covering the property from any particular title company as a condition of sale. Section 10 limits the amounts that lenders or servicers may require borrowers to deposit in escrow accounts, and requires that borrowers be provided with both initial and annual escrow account statements. Section 12 prohibits lenders and loan servicers from imposing any fee or charge on any other person for the preparation and submission of the Settlement Statement, the escrow account statements required under Section 10(c), or any disclosures required by the Truth in Lending Act.

Section 19 of RESPA specifically authorizes the Secretary ''to prescribe such rules and regulations, * * * and to grant such reasonable exemptions for classes of transactions * * *, as may be necessary to achieve the purposes of [RESPA].''

B. Background

HUD's RESPA Rules

In 1975, HUD promulgated its first set of RESPA rules including limited disclosure requirements. Real Estate Settlement Procedures and Cost, 40 F.R. 22448 (1975). These rules included a requirement that the HUD–1 form be given to borrowers within seven days of a loan commitment, with the provision that estimates were permitted for those items the lender could not accurately provide cost information for at the time of loan commitment. Congress amended the RESPA statute in 1976 and included a requirement that borrowers be provided with a Good Faith Estimate along with the special information booklet at, or within 3 days of a loan application. Following these amendments, HUD promulgated rules in 1977 that included a suggested format for the GFE and requirements for its provision to borrowers at or within 3 days of application, as well as a Uniform Settlement Statement, designated as the HUD–1, to itemize settlement charges to borrowers in every settlement involving a federally related mortgage loan where there is a borrower

[8] These services include, but are not limited to, ''title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans), and the handling of the processing, and closing of settlement.'' 12 U.S.C. 2602(3).

[9] Specifically, the term covers mortgages ''secured by a first or subordinate lien on residential real property (including individual units of condominium and cooperatives) designed principally for the occupancy of one to four families''; mortgages made ''in whole or in part by any lender the deposits or accounts of which are insured by the Federal Government or is made in whole or in part by any lender which is regulated by any agency of the Federal Government'' or ''insured, guaranteed, supplemented or assisted in any way by HUD or any officer or agency of the Federal Government,'' intended to be sold to Fannie Mae, Ginnie Mae, Freddie Mac or an institution from which it will be purchased by Freddie Mac, or is made in whole or in part by any loan originator, among other things, ''who makes or invests in residential real estate loans aggregating more than $1,000,000.00 per year.'' 12 U.S.C. 2602(3).

[10] The Federal Home Loan Bank Board (FHLBB) was abolished Effective October 8, 1989, by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, (Pub. L. 101–73). Its successor agency, the Office of Thrift Supervision, Department of the Treasury, assumed the FHLBB's regulatory functions.

and a seller, along with instructions and requirements for its use.

On November 2, 1992, HUD amended its rules to implement the 1984 amendments to RESPA establishing a ''controlled business exemption'' (now known as an ''affiliated business exemption''), a controlled (now known as an ''affiliated'') business disclosure to be provided at the time of a referral, and a disclosure of required providers to accompany the GFE. 57 FR 49600. The 1992 amendments also made other significant additions and changes, including defining the term mortgage broker,[11] and applying disclosure requirements to mortgage brokers, as more fully discussed below. In 1994, at 59 FR 6506, HUD amended its rules to conform with the 1992 amendments to the law covering refinancings and junior lien transactions. At that time, HUD promulgated a new disclosure form, the HUD–1A, for use in refinancing and subordinate loan transactions where there is no seller. While the 1992 and 1994 amendments necessitated additional disclosures, the formats of the GFE and HUD–1, and the disclosure requirements, have remained substantially unchanged since they were originally established in 1977.

Contents of Good Faith Estimate and the HUD–1

HUD's RESPA rules require that lenders and mortgage brokers who are not exclusive agents of lenders provide a GFE to all applicants for federally related mortgage loans, and contain a suggested format in Appendix C to 24 CFR part 3500. The suggested GFE format lists twenty common settlement services and provides spaces for the charges for such services. The instructions indicate that any other possible services and charges should also be listed.[12] The GFE provides a place for the ''amount of or range'' of each charge that the borrower is likely to incur in connection with the settlement. Between the name and amount of each charge is a reference to where the same charge will be disclosed on the HUD–1 or HUD 1–A at settlement. If the lender requires the use of particular settlement service provider(s) and requires the borrower to pay for any portion of such provider's services, the rules require that the GFE state: that the use of the provider is required and that the estimate is based on the selected provider's price; the provider's name, address and telephone, and the nature of any relationship between the provider and the lender.[13] The current GFE does not identify the particular items that the borrower may shop for after he has selected a lender or broker, such as a title or settlement agent, title insurance, and a pest inspector.

The HUD–1, described in detail in Appendix A of HUD's RESPA rules, discloses the charges at settlement in major groupings or series. The left hand column on the front of the HUD–1 summarizes the borrower's transaction, listing the cash due at settlement from the borrower, as a result of the gross amounts due less any amounts paid by or on behalf of the borrower prior to settlement. This part of the HUD–1 lists credits to the borrower as well as the total settlement charges due from line 1400 on the back of the form. The right hand column on the front of the HUD–1 summarizes the seller's transaction, listing the total amount due to the seller as the gross amount due to the seller adjusted for items such as settlement charges to the seller and the payoff(s) of any mortgages, and any other items due from seller (such as taxes), to arrive at a total amount due seller.

The 700 series of the HUD–1 lists real estate broker commissions; the 800 series lists origination fees and certain third party settlement services payable in connection with the loan; the 900 series lists items required by the lender to be paid in advance; the 1000 series lists reserves deposited with lender; the 1100 series lists all title related charges; the 1200 series lists government charges; the 1300 series lists any additional settlement charges; and line 1400 discloses the total settlement charges.

The current GFE and HUD–1/1A forms require a listing of the settlement charge for each service, which appears to have led to an increasing proliferation of enumerated services by individual settlement service providers (e.g., loan originators, title agents, etc.) and an artificial separation and inflation of the total charges of certain settlement service providers resulting in higher total costs to borrowers than a more consolidated list would provide. For example, the current requirements encourage loan originators to charge for several separate ''services''—origination, document preparation, document review. Similarly, title service providers are required to separate their charges into ''abstract,'' ''document preparation,'' ''attorney's fees,'' and other charges. Moreover, neither the GFE nor the HUD–1 specify the total amount of fees that each major recipient receives and retains, including the lender, the broker, and the title agent. It is reported that some originators charge ''junk'' fees for ''services'' to increase profits by filling in as many blank lines on the form as possible. It also has been reported that some originators compete on rate and points when giving quotes and then charge a variety of additional fees to increase their profits.

Provision of the Good Faith Estimate

The RESPA rules require that the loan originator must provide the GFE either by delivering it or placing it in the mail to the borrower not later than three business days after a loan application[14] is received or prepared. In practice, loan originators frequently insist on the borrower's completion of a full application form and payment of a significant fee to cover the costs of an appraisal and credit check before a GFE is provided. Therefore, by the time that the borrower receives a GFE he or she has typically already selected a particular loan originator, and paid substantial fees, and is highly unlikely to shop further for another loan originator. In addition, because the GFE is not generally provided until the borrower applies for a loan, the form does not provide borrowers with sufficient opportunity to focus on and compare the full costs of the originator and other major recipients of fees, nor does it indicate clearly other individual settlement services including title services that the borrower may shop for. Borrowers must shop on their own without the aid of a GFE.

Current Definition of ''Good Faith''

HUD's RESPA rules currently require that a GFE must be made in good faith, bear a ''reasonable relationship'' to the charge the borrower is likely to be

[11] HUD's RESPA rules, found at 24 CFR part 3500 (Regulation X), currently define a ''mortgage broker'' to be ''a person (not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally-related mortgage loan, and who renders services'' as described in the rule (24 CFR 3500.2(b)).

[12] Specifically, the GFE format lists the loan origination fee, loan discount fee, appraisal fee, credit report, inspection fee, mortgage broker fee, CLO access fee, tax related service fee, interest at ''dollars'' per day, mortgage insurance premium, hazard insurance premium, reserves, settlement fee, abstract or title search, document preparation fees, attorney's fee, title insurance, recording fees, city/county tax stamps, state tax, survey, pest inspection and the form provides space for additional fees that may be added.

[13] 24 CFR 3500.7(e)(3). Except for a provider that is the lender's chosen attorney, credit reporting agency, or appraiser, if the lender is in an affiliated business relationship with the provider (see § 3500.15), the lender may not require the use of that provider.

[14] The rules define an ''application'' as the submission of a borrower's financial information in anticipation of a credit decision involving a federally related loan on a specific property. 24 CFR 3500.2(b).

required to pay at settlement, and ''be based upon experience in the locality of the mortgaged property.'' 24 CFR 3500.7(c)(2). The rules, however, do not establish any bright lines or tolerances to assure that there is, in fact, a reasonable relationship between these estimates and final costs at settlement. Although the rules do require additional disclosure where the lender requires the use of a particular provider, stating that the lender must ''make its estimate based upon the lender's knowledge of the amounts charged by the provider,'' the rules do not establish any bright lines for the loan originator with respect to their estimates of these or other third party charges, or even with respect to their own charges. Id.[15] Under HUD's rules, charges on the Good Faith Estimate are to be disclosed as ''a dollar amount or range of each charge'' which will be listed in section L of the HUD–1 or HUD–1A. Frequently, borrowers report to HUD that brokers' or lenders' own charges at settlement include one or more additional fees that were not disclosed on the GFE, or that the charges for particular services rendered by or for the loan originator substantially exceed the estimated amounts. RESPA contains no sanctions for inaccurate or incomplete GFEs, or even for outright failure to provide a GFE. Bank and other regulators do enforce these requirements with respect to regulated institutions, although other originators are not subject to such enforcement.

Use and Provision of the HUD–1, HUD–1A

Settlement agents are required to use the HUD–1 in every settlement transaction involving a federally related mortgage loan in which there is a borrower and a seller.[16] The settlement agent is required to complete the HUD–1 in accordance with the instructions at Appendix A to HUD's RESPA rules and to deliver a completed HUD–1 (or HUD–1A where applicable) at or before the settlement to the borrower, the seller (if applicable), and the lender (if the lender is not the settlement agent) or their agents. 24 CFR 3500.8(a). RESPA and HUD's RESPA rules permit the borrower to inspect, a day before settlement, the HUD–1 or HUD–1A containing those items that are known to the settlement agent at the time of the inspection. 24 CFR 3500.10.

Mortgage Brokers[17]

At the time RESPA was enacted, single-family mortgages were mainly originated and held by savings and loans, commercial banks, and mortgage bankers. During the 1980's and 1990's, the rise of secondary mortgage market financing resulted in the emergence of new retail entities, notably mortgage brokers, to compete with traditional mortgage originators, lending institutions, and mortgage bankers. Today, mortgage brokers are estimated to originate more than 60% of the nation's mortgages.

Mortgage brokers essentially provide retail lending services, including counseling borrowers on loan products, collecting application information, ordering required reports and documents, and otherwise gathering data required to complete the loan package and mortgage transaction. As retailers, brokers also provide the borrower and lender with goods and facilities such as reports, equipment, and office space to carry out retail functions.[18] The amount of work mortgage brokers provide in particular transactions depends, in part, on the level of difficulty involved in qualifying applicants for particular loan programs. Differences in credit ratings, employment status, levels of debt, assets, and experience frequently translate into varying degrees of effort required to originate a loan. Also, mortgage brokers may be required to perform different components of origination services (i.e., underwriting) pursuant to specific agreements with individual wholesale lenders.[19]

Mortgage brokers have various means of obtaining funding for the loans they originate. Some mortgage brokers close mortgage loans in their own name but, at the time of settlement, transfer the loan to a lender that simultaneously advances funds for the loan. Immediately after the loan is consummated, the mortgage broker delivers the loan package to that lender, including the promissory note, mortgage, evidence of insurance, and all rights in the loan that the mortgage broker held. This type of transaction is known in the lending industry, and defined in HUD's regulations, as ''table funding.''

Some mortgage brokers function purely as intermediaries between borrowers and lending sources. They originate loans by providing loan processing and arranging for the provision of funds by lenders. Loans which they originate are closed in the names of the funding lenders.

Other mortgage brokers originate loans that are closed in the mortgage brokers' names, fund the loans temporarily using their own funds or a warehouse line of credit, and sell the loans after settlement. These transactions by mortgage brokers are treated similarly to loans made by mortgage bankers, and other lenders, and hence any compensation received by the mortgage broker, as a result of the bona fide transfer of a loan obligation in the secondary market, is not subject to Section 8 of RESPA due to the ''secondary market transaction'' exemption. 24 CFR 3500.5(b)(7).

Mortgage Broker Functions and Compensation

Since the advent of mortgage brokers in the mid-1980s, there has been confusion among borrowers concerning the mortgage broker's functions and fees,—i.e., whether brokers do or do not shop on the borrower's behalf, as well as how they are paid and how much they are paid, and by whom.

Some mortgage brokers indicate to borrowers that they will, in essence, act as their agent to shop for the best mortgage loan for them.[20] Other brokers state that they work with a number of funding sources to provide loans, and

[15] While the current rules need improvement, they are not entirely without standards. They do require estimates to be in good faith and tell the borrower what charges he or she is likely to incur at settlement based on the originator's experience. For example, on July 5, 2002, HUD issued a letter to the State of Washington that indicated that a range of charges of 0–$15,000 on a GFE for points did not meet these requirements.

[16] 16 Under current rules, where there is a borrower and no seller, such as in a refinance or a subordinate lien loan, the HUD–1 may be utilized using the borrower's side of the HUD–1 statement, or the HUD–1A may be used as an alternative.

[17] In the discussion of mortgage brokers in the background section of this preamble, the term is being used in a broader sense than the proposed amended HUD definition, and the way the term is used throughout the rest of the proposed rule. In this section when referring to mortgage brokers the term also includes those individuals who are the real source of funds through a warehouse line of credit or otherwise.

[18] HUD Statement of Policy-1999–1 Regarding Lender Payments to Mortgage Brokers provided a list of compensable loan origination services originally developed by HUD in a response to an inquiry from the Independent Bankers Association of America (IBAA), which HUD considers relevant in evaluating mortgage broker services. In analyzing each transaction to determine if services are performed by mortgage brokers, HUD stated that it believes the 1999 Statement of Policy should be used as a guide. As stated there, the IBAA list is not exhaustive, and while technology is changing the process of performing settlement services, HUD believes that the list is still a generally accurate description of settlement services.

[19] The terms ''wholesale lender'' or ''funding lender'' are used throughout the document to mean a lender who does not originate the mortgage loan but provides funds for the loan and may purchase the loan.

[20] In some states, for example North Carolina, mortgage brokers may be held to have an agency relationship or a legal responsibility to the borrower.

will arrange a favorable loan with one of them for their borrower. Whether brokers serve as the borrower's agent as a strict legal matter, the fact is that many brokers are perceived by borrowers as shopping on their behalf for the best loan to meet the borrower's needs. This perception frequently deters borrowers from shopping themselves for the loan originator and mortgage product that best meets their needs.

Mortgage brokers receive compensation for their services by various methods. A broker may be paid directly by the borrower, indirectly by the lender or wholesale lender who purchases the mortgage loan, or through a combination of both. Brokers may charge borrowers directly at or before settlement for loan origination as well as for other services including the application, document preparation and document review. In some cases, broker origination charges may be denominated as an origination fee and sometimes as an ''origination point'' (one point equals 1% of the loan amount), while other fees for named services (e.g., application fees, document preparation fees, processing fee, etc.) are charged as separate cost items on the GFE.[21] Some brokers receive both percentage based fees and fees for named services.

Where brokers receive a payment for compensation from someone other than the borrower, most commonly the lender, it is called indirect compensation. Such indirect compensation from lenders is ordinarily based upon an above market interest rate on the loan entered into by the broker with the borrower. This type of compensation is often referred to as a ''yield spread premium,'' (YSP) though it sometimes shows up under a different label, e.g. servicing release premium.

The use of a YSP can reduce up front settlement costs to a borrower by building these costs into the borrower's interest rate and monthly payments over the life of the borrower's loan. In issuing RESPA Policy Statement 2001–1, discussed in greater detail below, HUD stated that borrowers should continue to have the choice of paying their total settlement costs up-front or using the yield spread premium payment as a credit to pay all or part of these costs. Consumer advocates assert, however, that all too frequently brokers place the borrower in an above par rate loan without the borrower's knowledge, provide the borrower with little or no benefit in the form of reduced up front costs, and use the YSP payment solely or primarily as a means of increasing their total compensation.

Current Broker Disclosure Requirements

Under HUD's current rules, where mortgage brokers originate and table fund loans or act as intermediaries, they are required to disclose their direct charges and any indirect payments to be made to them on the GFE, and deliver or mail it to the borrower no later than 3 days after loan application. 24 CFR 3500.7(a)–(c). Such disclosure must also be provided to borrowers, as a final figure, at settlement on the HUD–1 and HUD–1A settlement statement. 24 CFR 3500.8. In table funded and intermediary transactions, direct broker fees are treated like the fees of other settlement service providers, such as title agents, attorneys, appraisers, etc, whose fees are disbursed at or before settlement. However, HUD's current rules require that on the GFE and HUD–1, lender-paid (indirect) mortgage broker fees are to be shown as ''Paid Outside of Closing'' (P.O.C.), listed outside the columns, and excluded from the computation of borrower's total settlement costs. 24 CFR 3500.7(a)(2). This approach does not assure that YSPs are understood and credited to the borrower to reduce up front settlement costs.

Disclosure of Fees by Lenders

Lenders are also compensated by borrowers through various methods. When lenders originate mortgage loans, they may charge borrowers directly at or before settlement for loan origination as well as for other services including the application, document preparation and document review. In some cases, lender origination charges may be denominated as an origination fee and sometimes as an ''origination point'' (one point equals 1% of the loan amount), while other fees for named services (e.g., application fees, document preparation fees, processing fee, etc.) are charged as separate cost items on the GFE.[22]

Lenders may also require ''discount points'' from the borrower for the stated purpose of lowering the interest rate of the loan. It is unclear to what extent discount points represent the present value of the difference between the par mortgage interest rate and the rate on the loan on one hand, or provide additional compensation to lenders on the other.

The functional equivalent of a yield spread premium may also be present in loans originated by lenders. Lenders routinely offer loans with low or no up front costs required at settlement. They can do so just like brokers do by charging higher interest rates for these loans and then recouping the costs by selling the loans into the secondary market for a premium representing the difference between the interest rate on the loan and the par, or wholesale market interest rate. Alternatively, the lender can hold the loan and earn the above market return in exchange for any lender paid settlement costs.

HUD's current rules require lenders to disclose only direct fees paid to them by borrowers including origination fees or ''origination points'' as well as other direct fees for named services and discount points. However, neither the current GFE, nor the HUD–1, provides totals of all charges paid to the lender. The rules also do not require lenders to disclose indirect fees earned in secondary market transactions from the sale of borrowers' loans. This is because the compensation earned from the bona fide transfer of the loan obligation in the secondary market is exempt from HUD's RESPA rules. HUD's RESPA rules provide ''[i]n determining what constitutes a bona fide transfer HUD will consider the real source of funding and the real interest of the funding lender.'' 24 CFR 3500.5(b)(7). HUD's rules explicitly provide, however, that table-funded mortgage broker transactions are not secondary market transactions. Lender sales into the secondary market are considered secondary market transactions.

Legality of Mortgage Broker Fees

Over the last decade, there has been persistent litigation concerning the legality of indirect fees to mortgage brokers. More than 150 lawsuits have been brought since the mid-1990s seeking class action certification, based in whole or in part on the theory that the indirect fees paid by lenders to mortgage brokers are fees for the referral of business in violation of section 8 of RESPA.[23]

[21] Mortgage broker fees are not always described in the same terms. Sometimes mortgage brokers fees are expressed in straight dollar amounts and sometimes as ''points.'' ''Points'' are charges based on a percentage of the borrower's loan. Points therefore have a dollar equivalent to the borrower.

[22] Lenders' fees are not always described in the same terms. Sometimes lenders' fees are expressed in straight dollar amounts and sometimes as ''points.'' ''Points'' may be used to describe ''origination fees'' or ''discount points'' and both types of points may be charged in the same transaction. ''Points'' are just percentage amounts of the borrowers loans, and these ''points,'' just like any other terms used to describe fees to loan originators, have a dollar equivalent to the borrower.

[23] See e.g., *Mentecki* v. *Saxon Mortgage,* No. 96–1629–A, slip op. (E.D. Va. Jan. 10, 1997). The court held initially that indirect fees to mortgage brokers in the form of ''yield spread premiums'' violated section 8(a) of RESPA as referral fees. However, subsequently, in an order and opinion dated July 11, 1997, the Court refused to certify the class.

Continued

HUD's RESPA rules, amended in 1992 to require disclosure of indirect fees to mortgage brokers, did not explicitly take a position on whether yield spread premiums or any other named class of back-funded or indirect fees paid by lenders to brokers are per se legal or illegal. See Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B to 24 CFR part 3500. The rule specifically listed ''servicing release premiums'' and ''yield spread premiums'' as fees required to be itemized on the HUD–1/1A Settlement Statement. Accordingly, while the rule specifically acknowledged the existence of such fees and provided illustrations of how they are to be reflected on HUD disclosure forms, HUD took the position that the rule does not create a presumption of per se legality or illegality.

Between 1992 and 1999, HUD provided various interpretations and other issuances under its RESPA rules stating the Department's position that the legality of a payment to a mortgage broker does not depend on the name of the particular fee. Rather, HUD has consistently advised that the issue under RESPA is whether the total compensation to a mortgage broker is reasonably related to the total value of the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or 8(b) of RESPA, whether the compensation results from a direct or indirect payment or a combination thereof.

In 1995, as a result of concerns that the requirement that mortgage brokers disclose indirect fees placed mortgage brokers on an unequal footing with other mortgage loan providers, and that information on indirect fees was confusing to borrowers, HUD issued a proposed rule to obtain the public's views on the disclosure and legality of broker fees. 60 FR 47650 (September 13, 1995). At that time, plaintiff borrowers began initiating class action lawsuits claiming that payments to mortgage brokers by lenders were per se illegal. Shortly afterwards, HUD embarked on a negotiated rulemaking on these subjects. See notices published on October 25, 1995 (60 FR 54794) and December 8, 1995 (60 FR 63008).

The 1995–1996 negotiated rulemaking on mortgage broker fees did not result in a final rule. It did, however, result in a clear consensus by rulemaking participants that borrowers were confused about the functions of mortgage brokers and the amounts and sources of their fees. See Report on Negotiated Rulemaking on Mortgage Broker Disclosure—Final Report, A.L.J. Alan W. Heifetz, (July 19, 1996). This confusion may translate into borrowers failing to compare services and fees, thereby paying unnecessarily high settlement costs. Most of the rulemaking participants, except for the representative of the mortgage brokerage industry and one consumer advocate, agreed on a regulatory framework that would create a pre-application agreement between a borrower and a broker fully disclosing the broker's function and compensation, in return for a limited ''safe harbor'' for transactions where these contracts were entered into. In 1997, HUD issued a proposed rule on mortgage broker fees that would have established a safe harbor for brokers who contractually commit to borrowers regarding their total compensation, along the lines agreed to by the majority in the negotiated rulemaking. The proposed rule also provided that during the rulemaking process, a ceiling on the amount of fees eligible for the safe harbor would be established to protect against predatory lending. The rule was strongly opposed by the mortgage brokerage industry and other segments of the mortgage industry. HUD did not finalize the 1997 rule and efforts to do so were soon eclipsed by HUD's effort to clarify its position on the legality of mortgage broker fees under existing law.

1999 Statement of Policy on Lender Payments to Mortgage Brokers

In 1998, in the Conference Report on HUD's 1999 Appropriations Act, Congress directed HUD to clarify its position on the legality of mortgage broker fees and to work with industry, Federal agencies, consumer groups, and other interested parties on a statement of policy on the subject. The Report also stated that Congress never intended payments by lenders for goods or facilities actually furnished or for services actually performed to violate Section 8(a) or (b) of RESPA.

On March 1, 1999, in response to Congress's directive, HUD issued RESPA Statement of Policy 1999–1 Regarding Lender Payments to Mortgage Brokers, following extensive discussions with industry, consumer groups, and essential agreement among them on the interpretation embodied in the Statement. The Statement said that, in applying Section 8 and HUD's regulations to lender payments to mortgage brokers, HUD did not consider such payments to be legal or illegal per se. The Statement said that the ''fees in cases and classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.'' 64 FR 10084.

The Statement established a two-part test to determine the legality of lender payments to mortgage brokers under RESPA which requires that: (1) Goods or facilities must actually be furnished or services actually performed for the compensation paid; and (2) payments must be reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. In applying this test, HUD stated that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA.[24]

As a Statement of Policy, the 1999 Statement interpreted HUD's existing rules. Nonetheless, beyond these rules, the Statement emphasized the importance of disclosing brokerage fees, including yield spread premiums, to borrowers as early as possible in the borrower's process of shopping for a mortgage. See 64 FR at 10087.

The 1999 Statement said:

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. Mortgage brokers and lenders can improve their ability to demonstrate the reasonableness of their fees if the broker discloses the nature of the broker's services and the various methods of compensation at the time the consumer

Culpepper v. *Inland Mortgage Corp.,* 953 F.Supp. 367 (N.D. Ala. 1997). The court held that a payment for a loan above market was permissible under section 8(c) of RESPA as payment for a ''good.'' *Barbosa* v. *Target Mortgage,* No. 94–1938, U.S.D.C., Southern District of Florida; *Martinez* v. *Weyerhauser Mortgage,* No. 94–160, U.S.D.C., Southern District of Florida; *Monoz* v. *Crossland Mortgage Company,* Civil Action No. 96–12260, U.S.D.C. for the District of Massachusetts. These last two Federal district courts concluded that yield spread premiums (or differentials) were not per se violations of RESPA and therefore refused to certify class actions on this issue.

[24] The 1999 Statement of Policy also said, ''[t]he Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.'' 64 FR 10084.

first discusses the possibility of a loan with the broker. 64 FR at 10087.

Post 1999–1 Statement of Policy Circuit Court Decision

After HUD issued its 1999 Statement of Policy, most Federal District courts held that yield spread premium payments from lenders to mortgage brokers are legal provided that such payments meet the test for legality articulated in the 1999 Statement of Policy and otherwise comport with RESPA. However, in *Culpepper* v. *Irwin Mortgage Corp.,* 253 F.3d 1324 (11th Cir. 2001), the U.S. Court of Appeals for the Eleventh Circuit upheld class certification in a case alleging that yield spread premiums violated Section 8 of RESPA where the defendant lender, pursuant to a prior understanding with mortgage brokers, paid yield spread premiums to brokers based on the lender's use of a rate sheet and the brokers' delivery of above par interest rate loans, without the lender knowing whether, or to what extent, the brokers had performed services. The court concluded that a jury could find that yield spread premiums were illegal kickbacks or referral fees under RESPA where the lender's payments were based exclusively on interest rate differentials reflected on rate sheets, and the lender had no knowledge of what services, if any, the brokers had performed. The court also said that HUD's 1999 Statement of Policy was ambiguous.

Following Culpepper,[25] representatives of the mortgage industry urged HUD to issue a clarification to the 1999 Statement of Policy to make clear that the lenders could make payments to brokers through rate sheets and that, to properly apply the 1999 test, all payments must be examined, not simply the payment from the lender, to determine if the broker's total compensation is reasonable. These representatives said that if the Culpepper interpretation prevailed, without further guidance from HUD, the industry could no longer offer yield spread premiums as an option to borrowers to lower their up front settlement costs.

Representatives of the mortgage industry, including representatives of the Mortgage Bankers Association and the National Association of Mortgage Brokers, assured the Department that following a clarification by HUD, they also would support a HUD rule requiring improved fee disclosure.[26]

Statement of Policy 2001–1

On October 17, 2001, the Department issued Statement of Policy 2001–1, Clarification of Statement of Policy 1999–1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b). The 2001 Policy Statement reiterated and clarified the test articulated in the 1999 Statement of Policy that where compensable services are performed, application of both parts of the HUD test is required before a determination can be made regarding the legality of a lender payment to a mortgage broker. 66 FR 53052, 53054–55. The 2001 Statement also said:

> [n]either Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed. 66 FR 53052, 53055.

The 2001 Statement of Policy also interpreted HUD's existing rules then further detailed what HUD regards as meaningful disclosure of mortgage broker fees to borrowers:

> In HUD's view, meaningful disclosure includes many types of information: What services a mortgage broker will perform, the amount of the broker's total compensation for performing those services (including any yield spread premium paid by the lender), and whether or not the broker has an agency or fiduciary relationship with the borrower. The disclosure should also make the borrower aware that he or she may pay higher up front costs for a mortgage with a lower interest rate, or conversely pay a higher interest rate in return for lower up front costs, and should identify the specific trade-off between the amount of the increase in the borrower's monthly payment (and also the increase in the interest rate) and the amount by which up front costs are reduced. HUD believes that disclosure of this information, and written acknowledgment by the borrower that he or she has received the information, should be provided early in the transaction. Such disclosure facilitates comparison shopping by the borrower, to choose the best combination of up front costs and mortgage terms from his or her individual standpoint. HUD regards full disclosure and written acknowledgment by the borrower, at the earliest possible time, as a best practice. 66 FR 53056.

The 2001 Policy Statement also specifically acknowledged the utility to borrowers of treating and reporting all interest rate based lender payments as monies belonging to the borrower. The Policy Statement endorsed this approach, stating:

> [I]t has been suggested to the Department that the yield spread premium should be reported as a credit to the borrower in the "200" series, among the "Amounts Paid by or in Behalf of Borrowers." The homebuyer or homeowner could then see that the yield spread premium is reducing closing costs, and also see the extent of the reduction.
>
> HUD believes that improved early disclosure regarding mortgage broker compensation and the entry of yield spread premiums as credits to borrowers on the GFE and the HUD–1 settlement statement are both useful and complementary forms of disclosure. The Department believes that used together these methods of disclosure offer greater assurance that lender payments to mortgage brokers serve borrowers' best interests. 66 FR 53056.

C. HUD's Commitment to Mortgage Reform

The HUD-Federal Reserve Report

Since the mid-1990s, HUD has been examining ways to improve the mortgage process for borrowers to lower settlement costs.[27] In June of 1998, in response to a Congressional directive in Section 2101 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Pub. L. 104–208, 110 Stat. 3009), HUD and the Board of Governors of the Federal Reserve ("the Board") issued a joint report on reforming RESPA. The HUD-Federal Reserve Report. The Report called for legislative changes to reform both laws. The Report did not attempt to differentiate where changes could be made under existing law pursuant to the Board's and HUD's existing regulatory authorities from areas where new legislation was required. Subsequently, the Board has exercised its regulatory authority under TILA to effectuate certain of the Report's recommendations. See 66 FR 65604, December 20, 2001.

Major Findings of the Report

The HUD-Federal Reserve Report posed and addressed several questions involving the disclosure scheme under both RESPA and TILA, and both HUD

[25] In this proposed rule Culpepper refers to *Culpepper* v. *Irwin Mortgage Corp.,* 253 F.3d 1324 (11th Cir. 2001). There were earlier reported decisions in this same litigation.

[26] Letter to Secretary Martinez, Submitted by America's Community Bankers, American Banking Association, Consumer Mortgage Coalition, and Mortgage Bankers Association of America (December 27, 2001); National Association of Mortgage Brokers, Position Paper: Prospective HUD Rulemaking Concerning Mortgage Originator Disclosure, Correspondence to the Department (December 4th, 2001).

[27] HUD and others have considered proposals to permit lenders to package settlement services almost from the time the law was enacted. Senator Proxmire introduced S. 2775 which would have required lenders to bear certain settlement costs with the view that the lenders have the sophistication and bargaining power to keep costs down.

and the Board recommended in part [28] that:

- Loan originators be required to provide firmer quotes for settlement costs disclosed under RESPA; and
- The timing of RESPA and TILA disclosures to borrowers be advanced, so that borrowers receive them earlier and use them to shop.

In order to achieve firmer cost information, both agencies also recommended that lenders and other providers be given the choice of:

- Offering a ''packaging'' or a guaranteed cost approach; or
- Providing a GFE where estimated costs would be subject to tolerances, to improve the current disclosure scheme by reducing the instances in which consumers may incur additional costs at closing.

Both agencies recommended an exemption from Section 8 to facilitate packaging. HUD also said that to receive the exemption, both the settlement costs and the interest rate on a mortgage should be guaranteed.

Timing of Disclosures

The Report observed that in home secured transactions, the borrower currently receives TILA or RESPA disclosures at several different times. Borrowers receive generic information such as HUD's Special Information Booklet at the time of application. Additionally, for residential mortgage transactions, lenders and brokers provide through mailing or delivery within 3 days after application, specific information including the GFE and the initial TILA disclosure disclosing the finance charge and the ''APR'' or ''annual percentage rate'' for the mortgage. TILA § 128(b)(2); Reg. Z § 226.19(a). TILA may require additional new disclosures for home-purchase loans if early disclosures have become inaccurate. See TILA 128(b) and Reg. Z § 226.17(b). A settlement agent gives final disclosures on the HUD–1 at settlement based on information provided by the lender.

Both agencies recommended that the disclosure process could be improved for industry if the timing requirements for disclosures were made more consistent between RESPA and TILA [29] and it would be improved for borrowers if disclosures were given when they would be most useful. In the Report, HUD recommended that generic information, e.g., HUD's Special Information Booklet, be given when the borrower first contacts settlement service providers, including loan originators and real estate agents. Both HUD and the Board also recommended that borrowers be given initial disclosures, including firm information about settlement costs, interest rates and points as early in the shopping process as possible so that they can shop and make informed choices. The HUD-Federal Reserve Report at 41. Although HUD and the Board differed somewhat in their approaches, both indicated that advances in technology and market competition promised to provide borrowers better information at or near the time of application. HUD said that it supported requiring that estimated costs disclosures be provided earlier than three days after application—ideally at first contact with lenders. HUD indicated, however, that while it seeks early disclosures, it recognizes that sometimes there will be a trade-off between having an early disclosure and ensuring that a disclosure is firm and complete enough to allow borrowers to shop and protect against increases in costs. In such cases, HUD recommended that timing requirements be flexible to allow enough time to provide guaranteed information.

Moreover, in the interest of promoting shopping, HUD recommended that borrowers not be required to pay a significant fee to the loan originator prior to receiving initial cost information. Id. at 42.

Providing Firmer Cost Disclosures

In arriving at the recommendation that cost disclosures must be firmer, the Report observed that borrowers reported many instances in which the costs disclosed on the GFE were significantly lower than those actually charged at settlement or that costs were completely left out of the GFE. The HUD-Federal Reserve Report at 20. The Report noted that more reliable settlement cost information could promote shopping. Id. at 32. In recommending that the choice of providing ''guaranteed cost packages'' or a more reliable GFE subject to tolerances be offered, the agencies stated that a dual system would create an opportunity for the market to test whether guaranteed cost arrangements offer more economical and efficient means for consumers to obtain mortgage loans.

Packages/Guaranteed Costs

Under the packaging or guaranteed cost approach envisioned in the Report, the lender or other packager would set a lump-sum price for settlement costs and would be held to that figure from the time the package is agreed to through settlement. Most charges for services that the borrower currently pays at settlement for origination, title work and insurance, credit report, appraisal, document review, inspection, up front mortgage insurance, pest inspection and flood review, etc., would be included in the package.[30] Government charges associated with filing a mortgage or release that can be determined easily also would be included. The Report suggested that any costs excluded from the guaranteed settlement costs would be disclosed as either ''other required costs'' or as ''optional costs.'' ''Other required costs'' would include charges such as per diem interest, which fit the definition of those costs that the borrower will have to pay at settlement, but the amount of which the packager cannot be readily determined at the time the package is provided to the borrower.[31] The Report suggested, however, that there are means for per diem interest to be included in the package; lenders could be required to state a maximum amount

[28] The Report also concluded that the APR and finance charge disclosures under TILA should be retained and improved to include all costs required by the creditor to get the credit and that additional substantive protections should be added to TILA.

[29] Under current TILA rules, Regulation Z, the TILA disclosure may be given simultaneously along with the GFE, TILA § 128 (b); Reg. Z § 226.17(b).

[30] In developing the Report, the agencies considered whether services should be itemized within the package. Some entities claim that for there to be true competition, borrowers must be able to know what is included in each package to compare. These entities point out that borrowers generally like to know what services are included in packages and that without itemization lenders may choose to forego many services for their packages while insisting that nonlenders have more expansive packages, making borrower information and competition impossible. On the other hand, it was observed that a requirement for full itemization of services might lead some packagers to create longer lists, ultimately confusing borrowers and hindering their evaluation of different loans. Also, lenders 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. The Board and HUD concluded that in packages, lenders could disclose the guaranteed amount for settlement costs without any elaboration on the early disclosure, and subsequently provide a list of services actually performed on the final settlement disclosure. Alternatively, lenders could provide a list of services that might be performed on the early disclosure with an explanation, if appropriate, that all items may not be performed, and then indicate on the settlement statement the services actually performed. The Report also observed that disclosing the cost of each service also could present problems, particularly where lenders or other packagers enter into volume-based contracts. The HUD-Federal Reserve Report at 25–26.

[31] Charges for per diem or ''odd days'' interest, which floats along with the interest rate, cover the time between the date of settlement and the date regular monthly interest starts accruing. As an illustration, if a loan closes on January 15 and the first monthly payment (due on March 1) begins to accrue interest on February 1, interest for the days between January 15 and February 1 is generally required to be paid at settlement as per diem interest. Some lenders do not collect per diem interest at settlement but add the amount to the first monthly payment.

based on thirty days (a full month) or to disclose the daily interest to allow borrowers to calculate the actual amount as the date of settlement becomes certain. The Report also suggested that mortgage insurance should be included in the package price even though it is difficult to calculate until final underwriting.

According to the Report ''optional costs'' would include charges that depend on whether the borrower chooses to purchase the service, and on the level of service chosen. The HUD-Federal Reserve Report at 27–28. Examples include owner's title insurance and optional hazard insurance chosen by the borrower.

The Report observed that packagers would arrive at their package prices based on their experience or, more likely, enter into volume-based contracts with affiliated and other settlement service providers for those goods and services required by lenders to close a loan. Id. at 23.

Support for Packaging

Many of the nation's largest mortgage lenders and their representatives expressed support for a ''packaging'' approach. They said that borrowers rarely shop for individual settlement services, and also that borrowers are more interested in the overall price of their mortgage loan than the prices of individual settlement services, and that borrowers would shop for mortgages if all they needed to compare was a single guaranteed price for all the settlement services needed to close the loan. Advocates of packaging said that by packaging services, discounts that would be secured by lenders under these arrangements will be passed on to borrowers. Through this dynamic and by making it easier for borrowers to shop, costs would be lowered.[32]

In the development of the Report, entities other than lenders, including real estate firms and affinity groups, also expressed some interest in packaging. These entities asserted that if packaging was restricted only to lenders, competition would be unnecessarily restricted and borrowers could be deprived of lower prices. Some industry representatives voiced the fear that large lenders will make it difficult for non-lenders to develop any packages other than those the lenders themselves retail, by refusing to participate in other entities' packages.[33] On the other hand, lenders asserted that since settlement services are largely required to protect the lender's security, lenders should not have to accept unconditionally any other settlement service providers' settlement packages. In the HUD-Federal Reserve Report HUD recommended that any entity should be permitted to package as long as it can provide a Guaranteed Mortgage Package and a mortgage loan at a guaranteed interest rate.

Consumer advocates also supported packaging, but asserted that any packages must include a loan with an interest rate guarantee to be useful to borrowers. Although consumer advocacy groups believed that guaranteeing settlement costs has value, they noted that these costs are a small portion of the overall cost of a mortgage loan. Advocates said that unless borrowers also receive a firm commitment on the interest rate and any applicable points they cannot truly comparison shop. Without such a firm commitment, consumer advocates said some lenders may provide the borrower with a guaranteed settlement cost quote and then increase the interest rate to offset any savings offered to the borrower on the settlement costs. These lenders would then realize additional profits based on the mortgage's pricing. These advocates expressed the fear that unwary borrowers will be lured into particular loan products by inexpensive or below-market settlement cost packages and then find themselves in higher rate loans that more than offset any purported cost savings. The HUD-Federal Reserve Report at 22.

Lender representatives expressed varying views on guaranteeing rates as part of a specific package. Some lenders stated that underwriting is costly and time-intensive and that mortgage brokers and other retail originators cannot provide guaranteed rates that bind lenders early in the mortgage loan process. Other industry representatives asserted, however, that requiring lenders to provide guaranteed rates along with guaranteed settlement costs is viable. Many of today's mortgage originators provide firm rate information to shoppers early in the process based on nearly instantly available credit information, without any assurance that the borrower will go forward with the transaction and the originator will receive compensation.

Section 8 Exemption for Packaging

Lenders' representatives asserted at the time of the Report that an exemption from RESPA's Section 8 prohibitions is necessary for packaging to work. These representatives pointed out that Section 8 prohibits volume-based discounts between settlement service providers, since they fear such arrangements would be viewed as compensated referral arrangements in violation of the statute. Also, while Section 8 prohibits kickbacks, compensated referrals, and unearned fees, the statute provides no bright line on how to determine when a payment has been earned for goods or services (which is permissible under RESPA) or is compensation for a referral, or is an unearned fee (which are illegal and subject to criminal sanctions and civil action under Section 8). Moreover, RESPA prohibits requiring the use of an affiliated settlement service provider except in limited circumstances,[34] which can be an additional impediment to packaging services. Proponents of packaging further asserted that because of Section 8's prohibitions and questions about how they apply, lenders and others do not currently package. These proponents said that were an exemption granted and packaging of services prevalent, borrowers would benefit more from the resulting lower costs than they do from RESPA's current Section 8 prohibitions. The HUD-Federal Reserve Report at 30. Consumer groups generally also supported an exemption for packaging, as long as packagers are required to guarantee both settlement costs and interest rates.

Members of the settlement services industry other than large lenders, however, including small lenders and title companies, expressed strong concern about and, in some cases, outright opposition to an exemption from Section 8 to encourage packaging. They said that only lenders would offer packages and that the lenders would squeeze out savings from small providers and then retain these savings in the form of higher profits, without passing them on to borrowers. Small settlement service providers also said that the only way they could remain competitive would be by offering packages themselves, and they expressed serious concern about their ability to do so. They further asserted

[32] For example, a packager could contract to have XYZ Appraisal Company complete all its appraisals for a given period for $300 each rather than the $350 the company normally charges for a standard appraisal. The packager could rely on that discounted contract price in pricing the package of guaranteed costs to the borrower. With their own costs negotiated in advance, packagers could disclose the cost for the entire package early in the borrower's mortgage shopping process with certainty, and the borrower then could compare different vendors' packages.

[33] Nonlenders also suggested that to provide a level playing field, the services in the package should be itemized.

[34] Generally, under Section 8(c)(4) of RESPA an entity may refer business to an affiliate as long as the affiliate arrangement is disclosed, there is no required use, and the only return to the entity making the referral is a return on capital.

that borrowers do in fact already shop for settlement services, that prices for these services are currently competitive, and that lifting Section 8 restrictions will harm rather than help borrowers because any savings from packaging will not be passed on to borrowers and fewer providers will be available to compete. Id. at 22.

During the development of the HUD-Federal Reserve Report the agencies noted that technology is enabling the provision of earlier, firmer, settlement cost information. Id. at 39. Moreover, during the development of the Report, HUD became aware of promising proposals that were advanced by consumer advocates and some industry representatives where lenders, after obtaining credit reports, would provide borrowers guaranteed rate and point information.[35] This guarantee would be subject to appropriate conditions such as market changes in the cost of money (where the rate and points are not locked), and verification of the value of the collateral and the borrower's creditworthiness. HUD supported these and similar efforts because it regards the full costs of obtaining a loan—including settlement costs, interest rate, and points—as the information that is essential to assist borrowers in shopping for a mortgage loan.

HUD concluded that an exemption should be provided for packaging to facilitate earlier comparison shopping by borrowers, greater competition among mortgage lenders and others, and guaranteed prices to borrowers from the time the borrower applies for a mortgage through settlement. The Board recommended an exemption to improve the consumer's ability to shop effectively and to allow competition to reduce the cost of financing a home. To encourage packaging, HUD recommended that a Section 8 exemption should be made available to loan originators and others who: (1) Offer borrowers a comprehensive package of settlement services needed to close a loan; (2) provide borrowers with a simple prescribed disclosure that gives the guaranteed maximum price for the package of services through settlement; and (3) disclose the rate offered to the borrower for the loan, with a guarantee that the rate will not increase, subject to prescribed conditions.

The Report suggested that fees paid and arrangements within packages would be exempt from Section 8. Fees for referrals to or from the packager of settlement services to or from those outside the package would continue to be subject to Section 8. For example a real estate agent could not receive a fee for referring a borrower to a packager. Entities that do not meet the requirements of the exemption would be subject to Section 8. The HUD-Federal Reserve Report at 33.

A More Reliable GFE

As an alternative to packaging, both the Board and HUD also recommended making disclosures firmer under the current practice, by requiring a more reliable GFE, subject to tolerances. The HUD-Federal Reserve Report at 31.

The Report suggested that tolerances could be based on a percentage of the total estimated costs; if the actual costs at settlement exceeded the sum of the estimated costs and the amount of the tolerance, the loan originator would generally be held liable. Alternatively, the tolerance could apply only to certain categories of costs such as those within the loan originator's control. The Report said that charges imposed directly by the loan originator would have to be accurate. On the other hand, an increase in costs resulting from a borrower's choice would not count against the loan originator in determining whether the total costs exceeded the tolerance. The HUD-Federal Reserve Report at 31.

The HUD-Treasury Report

Early in 2000, HUD, in cooperation with the Department of the Treasury, reviewed the problem of predatory mortgage lending. Following five hearings in New York, Chicago, Atlanta, Los Angeles and Baltimore, in June, HUD and the Treasury issued a major report on the subject of predatory mortgage lending. The Report, entitled ''Curbing Predatory Home Mortgage Lending'' (HUD-Treasury Report), detailed predatory or abusive lending practices in connection with higher cost loans in the mortgage market. In addition, among numerous recommendations to address predatory lending, the Report reiterated support for RESPA/TILA reform along the lines recommended in the HUD-Federal Reserve Report.

The HUD-Treasury Report stated: ''that borrowers need firm information early in the loan process so that they can compare the products of one settlement service provider with another. If borrowers receive firm information but it comes too late in the loan process, they will not have the opportunity to shop. Moreover, if the information is available but the borrower must pay a significant fee to obtain it, borrowers may be disinclined to seek comparable information from multiple sources. *See* HUD-Treasury Report, 2000 at 66.

The HUD-Treasury Report pointed out that unscrupulous mortgage brokers ''may receive compensation as a result of inflated upfront charges paid by borrowers and indirect fees paid by lenders * * *. Brokers and lenders may also structure charges so that they are less transparent to the borrower, through the use of mechanisms such as yield spread premiums, which may disguise the true cost of credit.'' HUD-Treasury Report, 2000, at 80.

III. This Proposed Rule

With the above background in mind, today's rule proposes a new framework for borrower disclosures under RESPA that would:

1. Address the issue of mortgage broker compensation, specifically the problem of lender payments to mortgage brokers, by fundamentally changing the way in which such lender payments in brokered mortgage transactions are recorded and reported to borrowers;
2. Significantly improve HUD's Good Faith Estimate (GFE) settlement cost disclosure, and amend HUD's related RESPA regulations, to make the GFE firmer and more usable, to facilitate shopping for mortgages, and to avoid unexpected charges to borrowers at settlement; and
3. Remove regulatory barriers to allow guaranteed packages of settlement services and mortgages to be made available to borrowers, to make borrower shopping for mortgages easier and further reduce settlement costs. A description of each of these aspects of the rule follows.

A. Addressing Mortgage Broker Compensation and Lender Payments to Brokers

The proposed rule would fundamentally change the way in which information on the mortgage broker's functions and charges are reported in the Good Faith Estimate as described below.

1. Describing the Loan Originator's Function

Under this proposed rule, the new GFE at Section I would require that mortgage brokers and all other loan originators describe their services. The proposed form does not ask that only brokers provide this description because the description of other originators' services is equally useful to borrowers. The GFE would advise that the loan originator performs origination services by arranging funding from one or more

[35] At the time of the Report some consumer and industry groups discussed the possibility that borrowers could pay credit repositories the costs of and arrange the provision of credit information to lenders to expedite the process and to avoid significant fees.

sources for the borrower. It also advises that the originator does not shop for nor offer loans from all mortgage funding sources and the originator cannot guarantee the lowest price or best terms available in the market. The GFE makes clear that the borrower should compare the prices on the form and shop for the loan originator, mortgage product, and settlement services that best meet the borrower's needs.

The rule would require that this information be provided on the GFE to effectuate the GFE's purpose of providing borrowers with settlement cost information and avoiding confusion particularly with respect to the role of mortgage brokers. This language seeks to disabuse borrowers of the notion that brokers or other loan originators are their agents, and therefore are automatically shopping for them, a notion that can prevent their own shopping. This new provision will be coupled with increased education through the Settlement Cost Booklet and other means to help borrowers.

2. Explaining to the Borrower the Option of Paying Settlement Costs through the Use of Lender Payments Based on Higher Interest Rate

The new GFE, at Section IV, would clearly show borrowers the effect of alternative interest rates and their effect on monthly payments and cash needed for settlement. The GFE would inform borrowers that they have the options to pay settlement costs: (1) Through cash payments at settlement, (2) by borrowing additional funds to pay settlement costs, (3) by paying settlement costs through a higher interest rate and higher monthly payment, or (4) by lowering the interest rate and monthly payment by paying discount points. These options are available in loans from originators other than brokers. The Department in both the 1999 and 2001 Policy Statements on Mortgage Broker Fees especially called for the provision of this information to borrowers by brokers in brokered loans.

The provision of this information on the form will help borrowers understand their options for paying settlement costs and decide whether to use any lender payments to the borrower, discussed in (4) below, to help defray some costs or all of their settlement costs, including but not limited to the mortgage broker's charges.

3. Disclosing the Loan Originators' Charges—Including the Mortgage Broker's and Lender's Total Charges to Borrowers

HUD's current rules require that the broker's direct charges be disclosed on the GFE while all indirect payments including yield spread premiums are disclosed separately as ''Paid Outside of Closing'' (P.O.C.).[36] The existing disclosure requirements and instructions do not make clear to the borrower the broker's total charges so that the borrower can focus on them, shop among brokers, or negotiate these total costs with the broker. Instead, because of the way indirect broker compensation is currently disclosed, many borrowers conclude incorrectly that such indirect payments have no effect on their loan costs.[37]

Section III A of the GFE, as proposed, would disclose to the borrower as a consolidated figure the total origination charges of the mortgage broker and the lender. (The zero tolerance applies to the total origination charges of the mortgage broker and the lender rather than any split between them.) Additionally, on Attachment A–1 there would be a breakdown of the origination charges into the total charges, respectively, of the broker and of the lender. This approach of providing total origination charges initially is taken to assist borrowers in comparing total origination charges of brokered loans to loans originated by lenders. At the same time, it ensures that the borrower knows the broker's and lender's charges. For mortgage brokers, these charges shall include all charges from the borrower that are paid to the mortgage broker for the transaction. For lenders, these charges shall include all or any portion of direct charges from the borrower that the lender receives for the transaction, other than discount points reported in line III B (2). Under the secondary market exemption, any additional fees realized by a lender from a bona fide transfer of a loan is not required to be disclosed under HUD's RESPA regulations. See 24 CFR 3500.5 (b)(7).

4. Requiring That in Brokered Transactions Lender Payments to the Borrower and Borrower Payments to the Lender Be More Appropriately Reported

A major provision of this rule is the requirement that in all loans originated by mortgage brokers, any payments from a lender based on a borrower's transaction, other than a payment to the broker for the par value of the loan, including payments based upon an above par interest rate on the loan (including payments formerly denominated as yield spread premium), be reported on the GFE (and the HUD–1/1A Settlement Statement) as a lender payment to the borrower. Additionally, the rule would require that any borrower payments to reduce the interest rate (discount points) in brokered loans must equal the discount points paid to the lender, and be reported as such on the GFE (and HUD–1/1A) as a borrower payment to the lender. These changes would require mortgage brokers to disclose the maximum amount of compensation they could receive from a transaction, by including the amount in the ''origination charges'' block of the GFE, and indicating the amount of the lender payment to borrower that would be received at the interest rate quoted, if any. Mortgage brokers would be unable to increase their compensation without the borrower's knowledge, by placing the borrower in an above par loan and receiving a payment from the lender (yield spread premiums), or by retaining any part of any borrower payment intended to reduce the loan rate (discount points).

Through these changes in reporting requirements, HUD believes that virtually all disputes regarding broker compensation in table-funded transactions and intermediary transactions involving yield spread premiums will be resolved. All mortgage broker compensation will be reported as direct compensation in the origination block of the GFE, maximum broker compensation will be clear and brokers will have no incentive to seek out lenders paying the largest yield spread. They will, instead, be motivated to find the best loan product they can for the borrower.

In requiring this methodology for reporting lender payments and discount points, it is important to note what the Department has not done. HUD has not taken away from borrowers the ability to select a higher rate loan in order to pay settlement costs (including, where the

[36] HUD's existing RESPA regulations do not provide explicit guidance on where to place a yield spread premium on the GFE, nor is there any express reference to such indirect payments on the GFE format. The regulations do suggest generally, however, that Appendix A Instructions for the HUD–1 should be followed in completing the GFE. See 24 CFR 3500.7(c)(1). As described above, these Instructions state that a mortgage broker's fee is to be disclosed on one of the blank lines in the 800 series. A corresponding line appears on HUD's current suggested GFE format (Appendix C to Regulation X) for listing such fees. HUD's instructions, however, do not require that the amount to be reported in the 800 series for mortgage broker fees must include yield spread premiums. To the contrary, HUD's Appendix A Instructions advise that yield spread premiums and other lender payments to mortgage brokers should be disclosed on the HUD–1 as payments by the lender to the broker that are ''paid outside of closing'' (''P.O.C.''), and expressly state that such amounts should not be shown in the borrower's column. 24 CFR part 3500, Appendix A.

[37] HUD's Settlement Cost Booklet is also not helpful. It suggests, incorrectly, that yield spread premiums are not costs to the borrower. It will be revised.

borrower so chooses, broker compensation), or to pay additional sums at settlement in order to lower their interest rate and monthly payments. HUD has long recognized that these financing tools provide flexibility and have value to borrowers in specific circumstances. The Department emphasized this point most recently in Statement of Policy 2001–1. HUD's proposed rule, therefore, preserves these options, but seeks to the maximum extent possible within the Department's statutory and regulatory framework, to eliminate the possibility of abuse in the application of these financing tools, by ensuring that the full value of selecting either option is known and redounds to the borrower.

The Department acknowledges that the proposed rule results in different treatment of compensation in loans originated by lenders and those originated by mortgage brokers. This is not because the Department believes that the latter are necessarily more suspect or susceptible of abuse than the former. It results simply from the fact that the reporting of total lender compensation cannot be meaningfully regulated under RESPA, while total broker compensation can be regulated. This is so for both legal and practical reasons; first, as indicated above, lenders enjoy a secondary market exemption from RESPA Section 8 scrutiny, meaning that under HUD's regulations any compensation derived from the sale of a loan in the secondary market by a lender is outside RESPA's purview. Second, were there no such exemption, measuring indirect lender compensation (compensation derived from the loan rate) would be very difficult. A lender may retain the loan in its portfolio for the life of the loan, or sell it long after the settlement. Payments from lenders to borrowers in brokered loans, however, based on the lenders' rate sheets or otherwise, as well as discount points paid to lenders, are capable of quantification down to the last penny.

Currently, as indicated in the background, the GFE requires disclosure of the lender payment to the borrower (formerly the "yield spread premium") as a charge that is "POC" or "paid outside of closing," which has been a cause of confusion for borrowers. The form as proposed would now require that the lender payment be disclosed immediately after the origination charges. HUD believes that this new location for the disclosure of the lender payment will cure any confusion and clearly tell borrowers how much their mortgage broker is earning from the transaction. Furthermore in order to avoid borrower confusion about the mortgage brokers' charges as compared to other loan originators' charges and the impact of a lender payment, the proposed rule would require that immediately following disclosure of the lender payment the form will show the net loan origination charge due from the borrower. It is this number that HUD intends the borrower to focus on and HUD seeks to achieve this by highlighting that total on the form, so that the borrower understands that the payment is applied as a credit to reduce the borrower's total origination charges. HUD believes that this approach ensures clearer disclosure of all relevant broker fees and lender payments while avoiding disadvantaging brokers. With the understanding provided by the form the borrower can compare his or her net origination charges loan-to-loan, originator-to-originator.

B. Significantly Improved Good Faith Estimate (GFE)

As described in the Background, under RESPA and its implementing regulations, loan originators must provide the GFE either by delivering the GFE or by placing it in the mail to the loan applicant, not later than 3 business days after an application is received or prepared.[38] Frequently, a GFE is provided only after the borrower pays a significant fee or fees. The current suggested GFE calls for a listing of charges that may itself lead to a proliferation of charges. Moreover, there are few standards for loan originators to follow in calculating estimated costs, which allows the GFE to be unreliable.[39] For these reasons, the GFE is generally not a useful shopping tool to compare the charges of loan originators, other settlement service providers, or loan products. The GFE, and its attendant rules, also do not effectively prevent surprise costs at settlement.

Today's rule would make the GFE firmer and more usable, to facilitate borrower shopping for mortgages by making the mortgage transaction more transparent, and to prevent unexpected charges to the borrower at settlement. In order to improve the GFE HUD has concluded that establishment of a new required GFE format is necessary.

The rule therefore would establish a new, more informative, required GFE format to be provided to borrowers by loan originators in all RESPA covered transactions and new requirements for its provision. HUD believes that the content of the material in these proposed forms gives the consumer the information needed to shop for loan products and to assist them during the settlement process. HUD recognizes that in order for these forms to be useful shopping tools, they must be consumer friendly. The Department seeks public comment on these forms. In addition, the Department will arrange focus groups during the comment period to elicit comments on how to make the material in the new proposed forms as consumer friendly as possible, including considering how the new proposed forms are best compared by consumers to the HUD–1 and what revisions, if any, to the HUD–1 would be most helpful.

1. The New GFE

The proposed format for the new GFE and Instructions for completing it appear as Appendix C to this rule. The proposed form is intended for use in all federally related mortgage transactions. In addition to the changes to the GFE described in A above, the new required GFE format would:

a. Provide the Interest Rate and Costs for the Loan the Borrower Seeks

The current requirements for the GFE do not require the inclusion of an interest rate. Nonetheless, borrowers shop for mortgages based on the interest rate as well as settlement costs, and the inclusion of this information would be useful to borrowers. Accordingly, the new GFE, in Section II, would list the note rate, Annual Percentage Rate (APR), and loan amount for the loan that the GFE is based on. Any mortgage insurance premium included in the APR would be separately disclosed in Section II. Section V would contain information on interest rates and adjustments to adjustable rate mortgages and applicable prepayment penalties and balloon payments. In Section III, the GFE would include a disclaimer indicating that unless the borrower locks at this time, the interest rate may change.

b. Simplify and Consolidate Major Categories on the GFE

As detailed in the Background section, under current RESPA rules, the GFE simply lists estimated charges or ranges of charges for settlement services. There is no requirement for grouping or subtotaling charges to the same recipients. The costs listed on the GFE include loan originator/lender-retained charges, such as loan origination and underwriting charges; charges by third parties for lender required services, such as appraisal, title and title

[38] The rule indicates that the GFE must be given within 3 days of the time an application is received or prepared to accommodate those instances where originators prepare applications for borrowers.

[39] See note 13, infra.

insurance fees; state and local charges imposed at settlement, such as recording fees or city/county stamps; and amounts the borrower is required to put into an escrow account, or reserves, for items such as property taxes or hazard insurance. At settlement, borrowers receive a second RESPA disclosure—the Uniform Settlement Statement (the HUD–1/1A)—that enumerates the final costs associated with both the loan and, if applicable, the purchase transaction.

As proposed, the revised GFE, in Section III, would group and consolidate all fees and charges into major settlement cost categories, with a single total amount estimated for each category. This approach would reduce any incentive for loan originators and others to establish a myriad of ''junk fees'' and provide them in a long list, in order to increase their profits. Loan originators would be required to include all fees they receive in their total, including all points and origination charges. The interest rate dependent payment would include all fees formerly to the mortgage broker from the lender as well as any such fees in the future.

In addition to the loan originator charges and the interest rate dependent payment, the major cost categories on the revised GFE would be: (1) Lender required and selected third party services; (2) title charges and title insurance premiums; (3) shoppable lender required third party services; (4) state and local government charges; (5) escrow/reserves (for taxes and insurance); (6) hazard insurance; (7) per diem interest; and (8) optional owner's title insurance. The proposed form then would include a final total of all settlement charges so the borrower can focus on the total costs to properly compare offers.

c. Identifies Shoppable and Required Services

The GFE in Section III E, would aid shopping after application by requiring loan originators to separately identify those third party settlement services that are loan originator selected and required and those that the borrower may shop for independently.[40] This provision will enable borrowers to shop for major services to the extent possible, even after the borrower has selected a loan originator. As described above, HUD's current rules at 24 CFR 3500.7(e) requires lenders to list on the GFE the particular providers of settlement services that they require their customers to use.[41] Attachment A–1 to the proposed form will list those ''Required Use'' providers while also identifying the services that are required, but which borrowers can shop for providers on their own. Additionally, the rule proposes to ease the ''Required Use'' disclosure requirement, by only requiring the loan originator to state the service, the name of the provider, and the cost estimate. The Department proposes to forego the requirement that this listing also include the lender's relationship to the required provider.

Attachment A–1 will, as noted, also include the breakdown of the origination charges into lender and broker charges so that borrowers can better understand the respective lender and broker charges, and where possible even negotiate lower costs. 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.

2. New GFE Requirements

To improve the existing disclosure scheme, this proposed rule would amend Regulation X to establish new rules for the GFE including the following:

a. Clarifying the Application Requirements

Under the proposed rule, the GFE would be delivered or mailed at or within 3 days of application. The proposed rule, however, would only require a borrower to provide basic credit information and a property address in verbal, written or computerized form, but before the payment of any significant fee to the loan originator in order to receive a GFE. The GFE would be conditioned on the borrower's credit approval following final underwriting and appraisal of the property to be secured by the mortgage.

To carry out this approach, the rule proposes to first clarify the definition of the term application, in HUD's RESPA rules at 24 CFR 3500.2(b). The new definition of application would make clear, in accordance with informal HUD advice, that an application is deemed to exist whenever a prospective borrower provides a loan originator sufficient information (typically a social security number, a property address, basic employment information, the borrower's information on the house price or a best estimate on the value of the property, and the mortgage loan needed), whether verbally, in writing or computer generated, to enable the loan originator to make a preliminary credit decision concerning the borrower so that the originator can provide a GFE. See HUD Old Informal Opinion (March 27, 1980) and HUD Old Informal Opinion (October 15, 1982). HUD proposes this new definition to facilitate the provision of GFEs in response to virtually any type of request for a GFE, in order to give the borrower the necessary information for shopping. Under current rules, an application is the ''submission of a borrower's financial information, in anticipation of a credit decision whether written or computer generated relating to a federally related loan'' identifying a specific property. The proposed rule would explicitly broaden the definition to cover verbal and other requests as long as these requests contain sufficient information for the originator to provide a GFE. HUD also will consider comments on whether it should provide a brief form for the application.

Under RESPA, a ''Good Faith Estimate'' is to be provided with a settlement cost booklet by a lender to each person ''from whom it receives or for whom it prepares a written application.'' 12 U.S.C. 2604(d). Because an originator begins the process of preparing an application on behalf of the borrower when the borrower submits application information, the borrower's information itself need not be provided in writing.

RESPA's time limits for delivery of the GFE would run from the point that an originator receives ''an application.'' While the statute allows the loan originator to mail or deliver the GFE 3 days after application, it is likely that the originator will provide the GFE as quickly after the borrower's request as possible.[42] HUD recognizes that the proposed rule's change of the definition of application, and the requirement that

[40] Lender required, lender selected third party services are to include items such as flood certification services and mortgage insurance, to the extent an upfront premium is charged.

[41] HUD's RESPA regulations contain certain restrictions on Affiliated Business Arrangements. See 24 CFR 3500.15. Section 9 of RESPA also prohibits sellers of property from requiring, directly or indirectly, the buyer to purchase title insurance from any particular title company.

[42] As indicated in the background section, supra, during the development of the HUD/Fed Report, HUD became aware of proposals where borrowers would arrange and pay for credit reports to loan originators of their selection. HUD supports these efforts as a way to lessen the burden on the originator's customers of paying the costs of those who are shopping.

GFE be provided to prospective borrowers early in the shopping process, frequently before they select a loan originator, may have implications for the content and delivery of required disclosures under the Truth in Lending Act (TILA). Question 28 specifically seeks comments on how HUD's proposed GFE changes impact other federal disclosure requirements, and invites suggestions on ways to consolidate or coordinate existing statutory disclosure requirements.

The rule proposes that GFE estimates would be valid for a minimum of 30 days from when the document is delivered or mailed to the borrower. This is proposed in light of the tolerances to avoid committing originators indefinitely. Within the 30 days the borrower must agree to go forward and pay any additional money required to complete the underwriting process. If the borrower fails to accept the offer within 30 days, the borrower would need to return to the loan originator to request the originator to provide a new GFE or ratify the previous one. Commenters are asked in Question 5 below whether this is an appropriate time period for the GFE.

b. Facilitating Shopping With the GFE

As stated above, to achieve the purposes of the Act, the proposed rule would limit fees paid by the borrower for the GFE, if any, to the amounts necessary for the originator to provide the GFE itself. The fee could not include amounts to defray later appraisal or underwriting costs. This approach would both facilitate shopping and reduce the possibility that fees for the GFE are unearned, in violation of RESPA's proscription against such fees. While HUD recognizes that there may be costs attendant to obtaining credit information from third parties and evaluating that information manually and/or electronically, the provision of the GFE does not today, and would not in the future, necessitate full underwriting and appraisal. These steps come afterwards, and under the approach in this proposal, GFEs explicitly would be given subject to underwriting and appraisal. Therefore, any charge at the time of application should be limited only to those costs that result directly from providing the GFE. This is not to say that all loan originators would be expected to charge for GFEs. HUD would prefer that originators not impose any charge for a GFE, since providing a GFE before the payment of any fee will further facilitate shopping. HUD believes it would be reasonable for loan originators to treat shoppers for mortgages in much the same way other retailers treat shoppers, where the price of the product includes marketing expenses and purchasers pay the costs incurred to serve shoppers who do not purchase the goods or services. Such an approach would better serve the purposes of the statute.

c. Providing an Accurate GFE

As described in the background section, Regulation X currently defines "Good faith estimate" as "an estimate, prepared in accordance with Section 5 of RESPA, of charges that a borrower is likely to incur in connection with a settlement." Pursuant to 24 CFR 3500.7(c) of Regulation X, loan originators are required to state on the GFE the dollar amount or range of charges that the borrower will normally pay at or before settlement based upon common practice in the locality of the mortgaged property. While the rules require that the estimate be made in "good faith" and "bear a reasonable relationship" to the charges the borrower is likely to incur at settlement, there is no further explication of what a "Good Faith Estimate" demands, either with respect to the loan originator's own charges/compensation, or with regard to lender required third party charges and other settlement costs.

Three decades of experience has shown that too often the estimates appearing on GFEs are significantly lower than the amount ultimately charged at settlement, are not made in good faith (*e.g.*, a range of $0–$10,000), and do not provide meaningful guidance on the costs borrowers ultimately will face at settlement. The Department recognizes that, occasionally, unforeseeable circumstances can and do drive up costs in particular transactions. HUD believes, however, that in most cases loan originators have the ability to estimate final settlement costs with great accuracy. The loan originator's own fee/compensation, which is entirely within the originator's control, can be stated with certainty, absent unforeseeable and extraordinary circumstances. Moreover, most third party costs such as appraisal charges, pest inspection fees, and tax/flood reviews, are fixed, and others, such as upfront mortgage insurance premiums, and title services and insurance, typically only vary depending on the value of the property or the loan amount. State and local recording charges, stamps, taxes are also generally well known to loan originators or, where necessary, can readily be calculated based on the loan amount or estimated precisely, on a pro rata basis, based on a projected settlement date.

HUD also believes that recent advances in technology and telecommunications in loan processing make the routine provision of accurate estimates of third party costs both easier and cheaper.

Notwithstanding, the GFE has too often failed to represent an accurate estimate of final settlement costs for a number of reasons. The absence of more precise regulatory standards for measuring accuracy has not helped ensure greater accuracy and reliability. Beyond that, some originators appear to purposely underestimate settlement costs as a means of inducing prospective borrowers to use their services, or as a way to obfuscate the amounts they plan to receive later in the final mortgage transaction. In too many cases, charges that never appeared on the GFE materialize at settlement. Such "junk fees" typically result in additional compensation for the originator and/or third party settlement service providers.

In light of these considerations, HUD believes that in order for the GFE to serve its intended purpose, which is to apprise prospective borrowers of the charges they are likely to incur at settlement, new standards must be established under existing law to better define "good faith" and the standards applicable to the GFE.[43] Accordingly, the proposed rule would make a number of specific changes to GFE requirements.

First, the rule would prohibit loan originators from exceeding the charges stated on the GFE for their own services, lender required and lender selected third party services, and government charges at settlement absent "unforeseeable and extraordinary circumstances" beyond the loan originator's control such as acts of God, war, disaster, or any other emergency, making it impossible or impractical to perform.

Second, the rule would establish an upper limit, or 10% "tolerance," so that actual charges at settlement for shoppable lender required third party services, borrower selected title services and insurance, and reserves/escrow, cannot vary by more than 10% of the estimates of those fees and charges

[43] Differing editions of Black's Law Dictionary have defined "good faith" as "a state of mind consisting in * * * honesty in belief or purpose * * * [and faithfulness to one's duty or obligation," and "freedom from knowledge of circumstances which ought to put the holder upon inquiry" as well as "absence of all information, notice, or benefit or belief of facts which render [a transaction unconscientious." Inherent in these definitions is the concept that where a party makes an estimate in good faith they will take into account all relevant information available to them, and will exercise reasonable care in ascertaining and evaluating such information before providing such an estimate.

stated on the GFE absent unforeseeable and extraordinary circumstances. The 10% tolerance applies to all lender selected third party services, and to third party services from providers who have been suggested to the borrower by the loan originator. It does not apply to third party services from providers selected by the borrower independently of the originator's recommendation.

The inclusion of these tolerances will assure that borrowers can either find prices within the estimates in the marketplace or return to the lender who will identify sources that will honor those prices. However, if the borrower chooses to purchase a more expensive service than is available or than the lender can provide, the lender will not be held to have exceeded the tolerance. The 10% level for tolerances has been selected to inject discipline into estimates while providing a margin for legitimate error based on market changes. Commenters are asked to provide their views on whether this is or is not the appropriate tolerance level, tolerance, and why.

Third, the rule would include redisclosure requirements triggered by changed circumstances. Specifically, if, after full underwriting, a loan originator selected by a borrower to obtain a mortgage loan determines that the prospective borrower does not qualify for the loan product identified in a previously provided GFE, the loan originator shall inform the borrower that the loan originator does not offer loan products meeting the borrower's needs or credit status. Alternatively if the loan originator does offer other products meeting the borrower's circumstances, the loan originator must so inform the borrower and the borrower may request a new GFE. Furthermore, when, after receiving a GFE, a borrower selects a loan originator to obtain a mortgage loan and qualifies for the loan product identified, but elects not to lock-in the interest rate and the interest rate dependent payment quoted on the GFE, the loan originator shall provide the borrower with an amended GFE at such time as the borrower does lock the rate and the interest rate dependent payment if either has changed from that quoted on the original GFE. The amended GFE shall identify those cost categories that have changed as a result of the change in the interest rate. In no case may an amended GFE include increases in cost categories which are not dependent on the interest rate (Section III. B.).

By limiting the extent to which final settlement charges can exceed GFE estimates, the Department intends to render the GFE a much firmer, more reliable, and meaningful disclosure for borrowers. If the cost at settlement exceeds the amount reported on the Good Faith Estimate, absent unforeseeable and extraordinary circumstances, the borrower may withdraw the application and receive a full refund of all loan-related fees. Such circumstances would have to be documented in writing by the loan originator and such documentation retained by the loan originator. These circumstances may be further defined in HUD's final regulations, and comments are requested in response to Question 2 below on both the definition of unforeseeable and extraordinary circumstances, and borrower rights where there is noncompliance with GFE requirements. Concurrent with finalization of this rule, HUD also will establish procedures for closely scrutinizing loan originators that fail to meet these new GFE requirements for possible Section 8 violations.

d. Negotiating Discounts From Third Party Settlement Service Providers

The establishment of tolerances under the proposal will require that loan originators actively follow the market prices for settlement services in their communities. 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. As part of negotiations for such arrangements, many originators, particularly those with a substantial volume of business, may seek prices from third party providers that are lower than those providers offer on a retail basis. However, because Section 8 of RESPA broadly prohibits providing a ''thing of value,'' which is specifically defined to include discounts, in exchange for the referral of business, many loan originators have been reluctant to openly seek such pricing benefits, even where any such discount in the price is passed on to the borrower. HUD believes that the fundamental purpose of RESPA is to lower settlement costs to borrowers, and it is therefore contrary to the law's objectives to interpret the anti-referral fee provisions of Section 8 to prohibit one settlement service provider from using its market power to negotiate discounted prices, as long as the entire discounted price negotiated by the originator is charged to the borrower and reported as part of the total charge within Sections III(C) through (J) as appropriate. The proposed rule amends Regulation X to make this clear. HUD also solicits comments on this issue in Question 4 below.

e. Revising the HUD–1/1A and Appendix A Instructions

Consistent with the proposed rule's new approach to the reporting of lender payments to borrowers, the proposal would require that on the HUD–1 all such payments be reflected in the borrower's column, in the applicable series (e.g., 800 series for payments to mortgage brokers; 1300 series for payments to other third party settlement service providers). However, inasmuch as there is no place for identifying and reporting credits on the HUD–1 A, in any transaction where there is such payment, the rule requires that the HUD–1 must be used. The proposed rule's revisions to the Appendix A instructions for the HUD–1 appear immediately following the proposed amendments to Regulation X.

Also, the proposed new GFE, while reducing the number of cost items reported on the face page, and consolidating the presentation to the borrower of important cost information, is not readily comparable to either the HUD–1 or HUD–1A form, which the borrower will receive at settlement. This is because certain cost items on the GFE are currently reported in numbered sections of the HUD1/1A forms not corresponding to their GFE counterparts. Thus, for example, while the proposed GFE clearly distinguishes between those settlement costs attributable to the loan originator(s) (section A. on the new GFE) and other lender required third party settlement services (sections C. and E. on the new GFE), the HUD–1/1A forms combine loan originator costs and some third party costs under the same heading (''Items Payable in Connection with the Loan'') and numbered section (800). The HUD1/1–A forms include credit report fees, appraisal fees, mortgage insurance application fees, and inspection fees in this category. Other third party services, such as pest inspection fees, permit fee, and surveys are separately reported on the HUD–1/1A (1300). In addition, the new GFE identifies as separate major cost categories some items reported, in whole or in part, under the same heading on the HUD–1/1A. For example, the new GFE lists hazard insurance and per diem interest as separate categories. However, on the HUD–1/1A, where hazard insurance premiums are paid in advance they are reported, along with other items such as per diem interest and pre-paid mortgage insurance premiums, in section 900, ''Items Required by Lender to be Paid in

Advance.'' Moreover, where a portion of the hazard insurance premium is required to be escrowed, that amount is reported on the HUD–1/1A in section 1000, along with other escrow items, as ''Reserves Deposited With Lender.''

As proposed, the new GFE would consolidate certain charges into lump sum categories (e.g. lender required third party services). The Department has made only minor changes to the HUD–1 instructions, to assist the borrower in comparing the new GFE to the HUD–1. The Department took this approach because the HUD–1 is well accepted as a listing of settlement service charges by industry and consumers alike and HUD is reluctant to change the form unnecessarily. However, there is a risk that if the forms are not clearly comparable, lenders could deviate from the prices given in the GFE or GMPA and the borrower would not realize the deviations. Modifications could be made to the HUD–1 so that the fee categories on the new GFE would correspond to similar groupings on the HUD–1 and the two documents could be more easily compared. HUD invites comments in Question 9 below on whether or not the HUD–1 should be modified. HUD plans to use focus groups to ensure that the proposed forms are consumer friendly including considering, among other things, how the new proposed forms are best compared by consumers to the HUD–1 and what revisions, if any, to the HUD–1 would be most helpful.

For purposes of TILA, the packager must list the finance charges needed to calculate the APR on an addendum to the HUD–1 or HUD–1A and HUD invites comments in Question 20 on this issue. The proposed rule seeks comment on whether there should be further modifications to the HUD–1/1A forms so that they more accurately correspond to the new GFE. However, the Department believes that, in the absence of further changes to the HUD–1/1A forms, borrowers can be assisted in comparing the two disclosures, and, to that end, the new GFE identifies, next to each GFE category, where on the current HUD–1/1A the corresponding cost information is to be found. As the preceding discussion makes clear, this necessitates identifying more than one HUD–1/1A section number next to some GFE categories.[44]

3. Section 6 Transfer of Servicing Language

In 1990, Congress amended RESPA to include a disclosure, which informs borrowers that their loan or the servicing of their loan, may be sold. 12 U.S.C. 2605, Public Law 93–533 section 6 (November 28, 1990). In 1997, HUD proposed a rule to implement the amended statute. Many comments were received and the rule was never finalized. 62 FR 25740. The Department plans to finalize the 1997 proposed rule shortly. However, in the meantime, the Section 6 language in the statute may be provided in conjunction with the GFE instead of the language currently indicated in § 3500.21 and Appendix MS–1.

C. Remove Regulatory Barriers To Allow Guaranteed Packages of Settlement Services and Mortgages To Be Made Available to Borrowers

1. A New Safe Harbor for Guaranteed Mortgage Packages (GMP) Created Through HUD's Exemption Authority

Consistent with its earlier recommendations in the HUD-Federal Reserve Report, described in the background section of this rule, the Department believes that the most effective means of simplifying the process of obtaining a mortgage, promoting competition to lower costs and facilitating shopping is to offer borrowers Guaranteed Mortgage Packages containing a lump sum price for all loan originator and governmental required settlement costs associated with obtaining a mortgage combined with an interest rate guarantee for the loan. The Department believes that such packages offer borrowers the possibility of lower prices through innovation by packagers, the pricing discipline involved in arranging packages, and competition among packagers.

Under a Guaranteed Mortgage Package approach packagers would offer a lump-sum price for settlement costs, and an interest rate guarantee at no cost to the borrower until the borrower selects the package. The packager would be held to those figures from the time the package is agreed to through settlement. This approach would allow the borrower to rely on the quoted price and rate and to compare fewer numbers in shopping for the best loan to meet his or her needs. Even with improvements to the current disclosure scheme, including more reliable quotes for major settlement costs under the new GFE (see B(2)(c), above), it will not be as easy for borrowers to shop and compare as it would be if they could simply comparison shop for mortgages based on a few prices as under this proposal.

The Secretary has determined, therefore, that effective packaging of settlement services will depend on packagers negotiating lower costs with third party settlement service providers, and then providing borrowers with an alternative disclosure, the Guaranteed Mortgage Package Agreement (GMPA). This proposal will increase the opportunities for borrowers to shop among packages fostering competition to lower costs further. Under Section 8(c)(5) of the Act, the Secretary is authorized to issue regulations that remove certain payments or classes of payments or other transfers from the Section 8 prohibitions on kickbacks and unearned fees after consultation with designated regulatory agencies. Also, under Section 19 (a) of the Act, the Secretary is authorized to grant reasonable exemptions for classes of transactions as may be necessary to achieve the purposes of the Act. Accordingly, under these authorities, HUD is proposing to establish a carefully circumscribed safe harbor from RESPA's provisions at Section 8 to facilitate the development and marketing of Guaranteed Mortgage Packages.

2. Who May Package

The purpose of the Guaranteed Mortgage Package safe harbor is to stimulate competition and improve the borrower's ability to shop. Under this proposal, entities other than lenders may qualify as packagers for a safe harbor, as long as their packages include a mortgage and otherwise satisfy the requirements of the safe harbor. In this connection, in order to ensure that the borrower receives the settlement package of services and the mortgage loan, the proposed rule would require that the packager sign the GMPA agreeing to provide the Guaranteed Mortgage Package at the Guaranteed Mortgage Package price and that non-lender packagers have a lender sign the GMPA after borrower acceptance agreeing to provide the loan included in the Guaranteed Mortgage Package.

3. Requirements for the Safe Harbor

Packagers that provide the GMP and abide by its terms and the other requirements of this rule, along with any settlement service providers participating in such a package, would receive a safe harbor from scrutiny under Section 8 of RESPA as described below. Specifically, to qualify for the

[44] Specifically, the new GFE contains the following cross-references to the HUD–1/1A for each GFE category: A. Origination Fees, 800; C. Lender Required/SelectedThird Party Services, 800, 900, 1000, 1300; D. Title Services/Insurance, 1100; E. Lender Required/Shoppable Third Party Services, 800, 900, 1000, 1300; F. Government Charges—Taxes, 1000, 1200; G. Reserves/Escrow, 1000; H. Per Diem Interest, 900; I. Hazard Insurance, 900, 1000; J. Optional Owner's Title, 1100.

safe harbor, packagers, within 3 days of borrower's application, would have to offer, without an upfront fee: (1) A guaranteed price for the loan origination and virtually all other lender required settlement services needed to close the mortgage, including without limitation, all application, origination, underwriting, appraisal, pest inspection, flood and tax review, title services and insurance, and any other lender required services, and governmental charges; (2) a mortgage loan with an interest rate guarantee, subject to change (prior to borrower lock-in) resulting only from a change in an observable and verifiable index or based on other appropriate data or means to ensure the guarantee; [45] and (3) a Guaranteed Mortgage Package Agreement (GMPA) as a prospective contract with the borrower that is binding through settlement containing the maximum settlement costs. The GMP offer would remain open as an offer for a minimum of 30 days from when the document is delivered or mailed to the borrower. The GMPA becomes a binding contractual commitment immediately upon borrower acceptance of the package and payment of a minimal engagement fee, subject only to acceptable final underwriting and property appraisal.

The guaranteed package also would include up-front costs of mortgage insurance. The cost of mortgage insurance is based on the ratio of the loan amount to the value of the property and is not finally determined with certainty until the lender knows the property value. In the GMP price, the packager shall include any maximum upfront mortgage insurance premium based upon the borrower's estimate of the property value and the amount that needs to be borrowed. The GMPA will inform the borrower that the upfront mortgage insurance premium, if any, may decrease or become unnecessary depending on the final appraised value of the property. The ''Other Required Settlement Costs'', discussed immediately below, would include any required reserves for mortgage insurance premiums. Because full underwriting information will not be available to the packager at the time the GMPA is provided, implementation issues are presented. Commenters are invited in Question 21 below to provide their views on how mortgage insurance should be addressed in Guaranteed Mortgage Package Agreements.

Under the proposal, reserves that are escrowed would be disclosed on the GMPA as ''Other Required Costs'' and subject to a 10% tolerance. The only costs that could be excluded from the guarantee and not subject to any tolerance would be those that fluctuate depending upon the borrower's choice, such as hazard insurance, per diem interest, and optional owner's title insurance. However, the Questions below ask commenters whether these items should also be included in the package at the required minimum amounts with a notation that ''optional costs'' are the responsibility of the borrower.

The proposal does not require packagers to itemize the services included in the GMPA. HUD believes however, that there are certain settlement services that are of specific interest and value to the borrower such as pest inspection, appraisal and the purchase of lender's title insurance (which may affect the cost of owner's title insurance). Some lenders may choose to forego some or all of these services. Therefore, HUD proposes that if any of these particular services are not anticipated to be included in the GMP, this fact must be disclosed on the GMPA.

Packagers may in GMP transactions provide a GMPA in lieu of the GFE. The revised instructions for the HUD–1/1A require that in Guaranteed Mortgage Packages, the HUD–1/1A must itemize the services provided, but not the specific charges for those services. However, because the amounts of certain individual charges needed to compute the finance charge and the APR under TILA and HOEPA, the packager must list the finance charges needed to calculate the APR on an addendum to the HUD–1 or HUD–1A. At Question 20, commenters are asked to provide their views on whether this approach adequately protects and preserves consumers' rights under TILA and HOEPA while facilitating packaging, and to suggest alternatives, if needed. Entities that do not choose to seek this safe harbor will continue to provide the GFE and HUD–1/1A disclosure scheme, as amended by this rule.

4. Contents of the Guaranteed Mortgage Package Agreement

The premise underpinning packaging is that firm, simple, guaranteed price quotes will enable borrowers to shop for mortgage loans with much greater confidence and certainty. The GMPA starts with a brief description of the function of the packager—what the packager is providing—and a statement that the interest rate on the proposed form, and the settlement costs quotation (if any), represent an offer to the borrower which is open and guaranteed for 30 days from when the document is delivered or mailed to the borrower, and which will immediately become a binding contractual agreement upon borrower acceptance and payment of a minimal engagement fee, subject only to acceptable final underwriting and property appraisal. The opening description also makes clear that any required settlement costs not separately itemized and estimated in Section III of the GMPA are the responsibility of the packager.

Section I of the GMPA provides the interest rate guarantee and APR along with an explanation that the interest rate is guaranteed through settlement if the borrower agrees now to the GMPA and locks-in this rate by a specified date/time. Any mortgage insurance premium included in the APR would be separately disclosed in Section I. It provides that if the borrower does not choose to commit immediately, it is guaranteed that the quoted interest rate will not change except in relation to changes in a specified index rate (or other such appropriate data or means as HUD may determine to assure that changes in the rate are reflective of the cost of funds and not simply to increase the packager's compensation).

Section II of the GMPA states that this package price covers all services, besides those listed in Section III, that are necessary to close the loan. The packager would, however, be required to inform the borrower if certain designated items are not anticipated to be included as part of the package including lender's title insurance, the pest inspection, and appraisal. Under the GMPA, any pest inspection report, credit report, and appraisal would be provided to the borrower upon the borrower's request. (On the HUD–1, borrowers will receive a listing of the specific services provided, but not the specific prices for each service. The total settlement costs will be provided.)

Section III of the GMPA provides a description of ''Other Required Settlement Costs'' which are outside the package and informs the borrower that reserves/escrow are subject to a 10% upper limit, or tolerance, at settlement absent unforeseeable and extraordinary circumstances. However, the 10% tolerance does not apply to hazard insurance and per diem interest in this category. The GMPA also makes clear that any required settlement cost not specifically identified on the GMPA as

[45] Through this requirement, discussed infra, HUD seeks to ensure that the rate of the loan does not vary after the borrower commits to a packager for reasons other than an increase in the cost of funds. There may be a variety of ways to solve this problem and HUD is seeking comments, in particular, on how to implement an interest rate guarantee.

outside a package, and itemized on the GMPA, is included in the guaranteed price quote and is the responsibility of the packager.

Section IV of the GMPA provides the borrower the cost of owner's title insurance, if available. For any package where the packager offers the borrower the option of paying all or part of the stated guaranteed and/or estimated settlement costs through a higher interest rate, that option will be explained in accordance with Section V of the GMPA. Similarly, where a packager offers the borrower the option of lowering the stated guaranteed interest rate by paying additional amounts at settlement, commonly referred to as discount points, that option will also be explained in accordance with Section V of the GMPA.

Section VI provides interest rates and adjustment terms related to adjustable rate mortgages, applicable prepayment penalties, and balloon payments. Section VII of the GMPA must be signed by an authorized agent of the packager and the borrower to become a binding contract for the Guaranteed Mortgage Package at the Guaranteed Mortgage Package price. After acceptance by the borrower, non-lender packagers must ensure that the lender sign the GMPA agreeing to provide the loan included in the Guaranteed Mortgage Package. HUD solicits comments on the issue of lender signatures on the GMPA in Question 18 below. Notwithstanding the basic objective of packaging, which is to dramatically improve the borrower's capacity to comparison shop, different entities may offer two types of packages. Some packagers may offer GMPs in which all settlement costs are included in the interest rate guarantee (in which case no guaranteed settlement cost quote will be provided), while other packagers may quote a guaranteed price for all settlement costs along with a (presumably lower) interest rate guarantee. The Special Information Booklet and other consumer education materials will alert borrowers to compare the combined impact of both settlement cost and interest rate guarantees when shopping among packagers, and will suggest that a borrower might wish to compare the APRs of the two products as well as consider how long the borrower plans to stay in the property; a longer mortgage term may mitigate in favor of a borrower choosing to pay settlement costs through a higher rate.

5. Interest Rate Guarantee

In the rule, HUD is requiring that Guaranteed Mortgage Packages include an interest rate guarantee. HUD's rationale for this requirement is that both the settlement costs and the interest rate need to be firm for borrowers to compare loan products. HUD recognizes, however, that after a borrower requests a GMPA but before locking in a rate, the interest rate on a loan may change based on market forces. Similarly, some borrowers choose to float even after they have committed to an originator, in the hopes that market interest rates will fall. In such instances, HUD believes that in the context of GMPs, it is necessary to assure that when the borrower is ready to lock, the interest rate will only be changed based on observable market changes, or based on other data or appropriate means to ensure the guarantee. One possibility is to have the rate move with an observable and verifiable index. Another is to have a rate publicly available. Whatever the ultimate methodology, it must be easily useable and verifiable by the borrower and the industry. Commenters are asked to address Question 13 concerning the use of an index or a substitute therefore to address this problem.

6. Scope of the Safe Harbor

The Secretary is exercising exemption authority under Section 8(c)(5) and Section 19 of RESPA to establish this carefully circumscribed guaranteed mortgage packaging safe harbor. The Secretary is establishing this safe harbor only for those Guaranteed Mortgage Package transactions that meet the requirements set forth in this rule. The Secretary has determined that the establishment of this safe harbor is necessary to allow this class of transactions— guaranteed packages of settlement services with the protections required under this rule— to be available to consumers to achieve the purposes of the Act. The Secretary has concluded that the availability of these packages to consumers will simplify their shopping for settlement services and allow them to gain the benefit of an active competitive marketplace where market forces lower settlement costs. For the same reasons, the Secretary has determined that payments and pricing arrangements between packagers and participating settlement service providers for Guaranteed Mortgage Packages as set forth in this rule shall not be construed as prohibited under Section 8 of RESPA as long as the requirements in this rule are satisfied. Pursuant to Section 8(c) (5) the Secretary has undertaken the necessary consultation with other agency heads as required prior to promulgating this exemption.

This safe harbor will allow packagers to inject pricing discipline to negotiate firm overall prices for essentially all settlement services and mortgage interest rates with participating settlement service providers. Some GMPs may require the use of affiliated entities, a practice prohibited by Section 8 except in limited circumstances. Other GMPs may involve arrangements between independent providers based on the projected volume of business to be referred. The safe harbor will apply in both of these arrangements. Without this safe harbor, Section 8(a)'s prohibition on referral fees may bar such arrangements and Section 8 (b)'s prohibitions may deter packagers from retaining profits that result from packaging, which could be regarded as unearned. Outside the safe harbor, where loan originators arrange discounted prices that are charged to consumers, HUD is proposing in this rulemaking to clarify that Section 8 is not violated (see above). Because HUD believes that the benefits to borrowers of packaging outweigh any protections offered by Section 8's provisions, the Secretary has concluded that such a carefully circumscribed safe harbor is appropriate, subject to the eligibility conditions set forth in this rule.

Accordingly, pursuant to Section 19, the Secretary has determined that the safe harbor is necessary for these prescribed transactions to achieve the purposes of the Act. Where the requirements are met, the safe harbor from Section 8 will permit payments or other things of value exchanged between a packager and entities participating in the package, and will insulate packager earnings from Section 8 scrutiny. Section 8 would, however, continue to prohibit any payments for the referral of business, kickbacks, splits of fees and unearned fees between the packager and any of the entities participating in the package on the one hand, and entities outside of the package on the other.[46] As long as the requirements of the safe harbor are satisfied, the exemption authority under Section 19 will create a safe harbor for packagers from the Section 8 requirements.

Under the safe harbor, as noted above, packagers would provide the GMPA in lieu of a GFE. HUD regards the provision of a GMPA as fully, indeed, more than satisfying the requirements of Section 5 of RESPA that borrowers receive a Good Faith Estimate of the

[46] Thus, for example, a real estate agent, outside of the package, would continue to be subject to Section 8 for accepting a payment from a packager for referring a customer to a package.

amount of charges for settlement services the borrower is likely to incur. Additionally, HUD believes that the GMPA, by itemizing a Guaranteed Mortgage Package price encompassing virtually all settlement charges, along with a limited number of itemized charges, including owner's title insurance, also more than satisfies the requirements of Section 4 of RESPA. Nevertheless, HUD is prepared to exercise the exemption authority under Section 19 to create a safe harbor for packagers from the disclosure requirements of Sections 4 and 5 of RESPA, if it deems such an exemption necessary.

The safe harbor is proposed to be available only where the transaction does not result in a high cost loan as that term is defined in the Home Ownership Equity Protection Act. See 15 U.S.C. 1601 (Supp II 1996). The safe harbor also may not be available for mortgages that exceed other limits or include other features identified by the Department during the course of this rulemaking as resulting in unreasonable settlement charges or other loan terms inimical to the purposes of RESPA.

In this rulemaking, in Question 12 below, HUD is soliciting comments on the scope of the safe harbor and in particular, how the safe harbor should apply to affiliated business arrangements.

D. Scope of the Proposed Rule

The proposed rule's new regulatory requirements will apply to first and second lien transactions, purchase money loans, and refinances. Home equity transactions are addressed in § 3500.7(f), under current RESPA regulations. At Question 26 the Department invites comments on this issue.

E. Contractual Remedies and Enforcement Priorities

For the safe harbor, the proposed rule intends that borrowers, individually or, where appropriate, as a class, may sue for specific performance or for damages pursuant to applicable State contract law provisions in the event a packager breaches a contract entered into pursuant to C., above.

Beyond any contractual remedies available to borrowers under state laws, HUD will regard noncompliance with a GMPA as an enforcement priority, and any entity found in violation of such a contract will not be able to claim a safe harbor under Section 8. As a result, those found in violation of a GMPA will be subject to Section 8 scrutiny and possible penalties as well as individual or class relief.

F. Preemption

Pursuant to Section 18 of RESPA, 12 U.S.C. 2616, the Secretary is authorized to determine whether any provisions of State law are inconsistent with any provision of RESPA. Where such a determination is made, after consultation with other appropriate Federal agencies, the Secretary may exempt any person subject to RESPA from compliance with said State law to the extent such compliance is inconsistent with RESPA. Question 22 below seeks comments on how this provision of RESPA should be applied in light of the provisions in the proposed rule.

IV. Questions for Commenters

Commenters are asked to address the following questions in their comments to the extent that they have views on these subjects.

The New Good Faith Estimate (GFE) Requirements

1. As proposed in Section III.A.(1), the proposed GFE form would briefly explain the originator's functions and that the borrower, not the originator, is responsible for shopping for his or her best loan. Does the language proposed adequately convey this message? If the commenter thinks otherwise, it should provide alternative language for the form that better explains the loan originator 's function to the borrower. Should the form also address agency requirements under state laws and how?

2. In Section III.B.(2) c., the proposed rule requires that the amounts estimated on the GFE for mortgage broker and lender origination charges may not vary at settlement absent unforeseeable circumstances. Should the rule provide for this ''unforeseeable circumstances'' exception? Are the particular circumstances specified in HUD's formulation in this proposal sufficiently encompassing? What evidence should a broker or lender be required to retain to prove the existence of such circumstances and justify any increase in charges at settlement?

3. In Section III.B.(2) c., the proposed rule establishes a 10% limit, or ''tolerance,'' for categories of settlement services and costs including third party services that the borrower shops for and escrow/reserves by which such costs cannot exceed the GFE estimates by 10% at settlement absent unforeseeable and extraordinary circumstances. It also establishes zero tolerances for origination charges and lender required lender selected third party costs and government charges that cannot vary from the estimate through settlement absent unforeseen circumstances. Are these appropriate tolerances and tolerance levels or should other tolerances/tolerance levels be established for these categories? Also, should a tolerance be established for borrower's title insurance? What alternative or additional means might be employed to ensure that loan originators take the care necessary to complete the GFE to ensure that it represents a Good Faith Estimate of final settlement costs?

4. In Section III.B.(2) d., the proposed rule would amend Regulation X to make clear that loan originators may enter into volume arrangements where such discounted prices are charged to their customers. Commenters are invited to provide their views on the ramifications, if any, of this clarification.

5. In Section III.B.(2) c., the proposed rule requires that the tolerances will apply to the GFE from the time the form is given by the loan originator through settlement. Also, in case it takes a substantial time for the borrower to decide to use the loan originator from the date the form is given, the rule and the form provide that the GFE need only be open for borrower acceptance for a minimum of 30 days from when the document is delivered or mailed to the borrower. After that time, the GFE could be ratified or superseded by the originator at the borrower's request. Is this expiration date appropriate to protect against unnecessary costs flowing from an indeterminate liability or for other reasons? Is 30 days too long or too short? Another possibility that commenters may consider is whether the numbers on the GFE should apply only from the time the borrower enters into an agreement with the loan originator. HUD also invites commenters' views on whether HUD now should require a borrower's signature on the GFE to memorialize acceptance and begin the period during which the estimates are binding.

6. In Section III.B.(1) b., the proposed rule simplifies the GFE by placing all loan origination costs in a small number of primary categories. This is intended to facilitate borrower understanding and shopping of major loan costs and minimize the proliferation of ''junk fees'' and duplicative charges. How could the GFE be made even simpler to facilitate borrower shopping? If the commenter believes greater itemization is desirable, what should be itemized and why?

7. In Section III.A.(3), the proposed rule requires that on the front of the proposed form mortgage brokers disclose the lender credit right below the total origination charges to: (a) Make

the borrower aware of the effect that the credit has to reduce total origination costs; (b) avoid confusion among borrowers; and (c) avoid giving any competitive disadvantage to either a broker or lender for the same loan. What, if any, other approach to address these concerns is better and why? Should the new GFE form disclose this credit at the bottom of the proposed form because the credit can be applied to all settlement costs?

8. As proposed in Section III. A. (3), as another step to avoid borrower confusion and any competitive disadvantage among lenders and brokers, the proposed rule breaks out on Attachment A–1, rather than on the front of the proposed form, the ''Loan Origination Charges'' into ''Lender Charge'' and ''Broker Charge.'' How, if at all, does this approach advantage or disadvantage either lenders or brokers or confuse borrowers in comparison shopping? Would the industry and borrowers be better served if there is a breakout of ''Lender charges'' and ''Broker charges'' on the front of the form and why?

9. As proposed in Section III. B. (2) e, the new GFE will consolidate certain charges into lump sum categories (e.g. lender required third party services). To permit the borrower to compare the new GFE to the HUD–1, it will be necessary for HUD to establish additional instructions to guide the reader so that the new GFE could be compared to the HUD–1. Would it be better to change the HUD–1 so the fee categories correspond to the groupings on the GFE and the two documents can be more easily compared? If commenters support changes to the HUD–1 to make it more comparable to and compatible with the new GFE, how extensive should these changes be and in what areas? Should the HUD–1 continue to list all charges for services or should it also be shortened and simplified as well to cover only categories of services?

10. Should a safe harbor from Section 8 scrutiny be established for transactions where the mortgage broker signs and contractually commits to its charges on the GFE? The purpose of proposing this safe harbor would be to encourage a firm contractual commitment to borrowers, before they pay a fee and commit to a particular mortgage broker, so that the borrower can shop among mortgage brokers. Considering the proposed changes to the GFE, the proposed packaging safe harbor and HUD's current guidance on mortgage broker fees, is this safe harbor necessary for industry or borrowers and why? In light of the proposed rule's other provisions is any other additional disclosure for mortgage brokers warranted, such as an additional statement of what the broker's fees are and how they function?

Guaranteed Mortgage Package Agreements

11. Is a safe harbor along the lines proposed in Section III. C. (1) of this rule necessary to allow lump sum packages of settlement services to become available to borrowers? Would the proposed clarification by HUD that discounts may be arranged, if passed on to borrowers and not marked up, suffice to make packages available to borrowers? Would a rule change to approve volume discounts and/or mark-ups when a package is involved suffice? Would it suffice to trim the disclosure requirements for packaging and offer the option of providing a streamlined GFE to those who packaged?

12. As proposed in Section III. C. (6) is the scope of the safe harbor appropriately bounded in applying to all packagers and participants in packages? The safe harbor also currently does not apply to referrals to the package. Should there also be a bar against part time employees of other providers working for the package to steer business? How should the safe harbor apply to affiliated business arrangements to protect borrowers from steering?

13. As proposed in Section III. C (5), to qualify for the safe harbor, the packager must include an interest rate guarantee with a means of assuring that when the rate floats, it reflects changes in the cost of funds not an increase in originator compensation. For this purpose, the rule suggests tying the rate to an observable index or other appropriate means. What other means could assure borrowers that the rate of a lender was not simply being increased to increase origination profits? For example, would a lender's commitment to constantly make rates public on a web site be a useful control? If an index is the best approach, how should it be set? If an index approach is approved, should each lender be allowed to pick its own observable index?

14. As discussed in the preamble to the rule in Section III. C (5), if an observable index or other appropriate means of protecting borrowers from increases in lender compensation when the borrower floats in a guaranteed packaging approach is not practical, should HUD provide a packaging safe harbor only for mortgage brokers? Such a mortgage broker safe harbor would require disclosing the lender credit to the borrower in broker guaranteed packages. The theory for the safe harbor would be that any amounts in indirect fees could be credited to borrowers taking away any incentive for an increase in rates to increase compensation. Should this be offered in any event?

15. As proposed in Section III. C (6), under the rule, mortgages with total fees or a rate covered by the Home Ownership and Equity Protection Act (HOEPA) would be subject to the new GFE disclosure requirements; however, HOEPA loans would not qualify for the guaranteed package safe harbor. Is this exclusion appropriate considering, on the one hand, that packaging promises borrowers a simpler way to shop and make transactions more transparent? On the other hand, the safe harbor could be provided for a loan that has very high rate and/or fees and may be predatory. The proposal also says that during the rulemaking other limitations may be established to exclude high cost and/or loans with predatory features from the packaging provisions. HUD invites comments on whether HOEPA loans, any other loans, or features of loans should be included or excluded from the safe harbor and why.

16. As proposed in Section III.C (3), the GMPA provides that the offer must be open to the borrower for at least 30 days from when the document is delivered or mailed to the borrower. Is this an appropriate minimum time period to ensure that the borrower has an adequate opportunity to shop?

17. As proposed in Section III. C (4), the rule currently provides that the Guaranteed Mortgage Package agreement must indicate that certain reports such as the appraisal, credit report, and pest inspection are available to the borrower upon the borrower's request. Also, packagers may decide to forego such reports or services (i.e. lender's title insurance) and must inform the borrower that such reports or services are not anticipated to be included in the package price. Are these adequate protections for the borrower? HUD is aware that other laws such as Regulation B (ECOA) provide certain rights to borrowers with respect to obtaining some of these reports. In order to qualify for the safe harbor HUD has created additional reporting requirements. Are these additional reporting requirements appropriate?

18. Should additional consumer protections be established for packaging? For example, should additional qualifications be established for ''packagers'' to ensure that borrowers are protected against non-performance including the unavailability of a mortgage that could result in a borrower ''losing'' a house? For example, should

there be a requirement that a packager must have sufficient financial resources to credibly back the guarantee? Is it necessary to require a lender signature on the GMPA to ensure that the borrower receives the loan at the time of settlement? How can the borrower's interests be protected without unduly burdening the process or unduly limiting the universe of packagers?

19. Consistent with the HUD-Fed Report, the rule proposes that certain charges, such as hazard insurance and reserves, are outside the package as other or optional costs. Is this the right approach or should these charges be disclosed as the minimum amounts required by the lender and required to be inside the package? Would the latter better serve the objective of establishing a single figure for the borrower to shop with?

20. The rule proposes in Section III. C (3), that under Guaranteed Mortgage Packaging, the HUD–1 will list the settlement services in the package but not the specific charges for each service. Certain third party charges are excluded from the calculation of the finance charge and the APR under TILA and HOEPA. Commenters are invited to express their views on whether the approach in the rule satisfies or whether alternative approaches to cost disclosures should be established to ensure consumers' rights under TILA and HOEPA are protected while facilitating packaging. More broadly, commenters are invited to provide their views on means of better coordinating RESPA and TILA disclosures.

21. Commenters are asked to provide their views on how the rules should treat mortgage insurance? The rule proposes in Section III. C (3), that the guaranteed package would include any mortgage insurance premiums in the APR and up-front costs of mortgage insurance in the guaranteed package. ''Other Required Costs'' would include reserves for mortgage insurance premiums. However, because the packager will not have an appraisal at the time the GMPA is provided, the packager may not have firm information to provide a definite figure. Another possibility is to exclude mortgage insurance from the package but notify the borrower that mortgage insurance may be an ''Other Required Costs'' and present the borrower an estimate subject to a tolerance, if mortgage insurance is necessary. This approach would exclude a major charge from the package. HUD recognizes that there are state laws that prohibit rebates or any splitting of commissions for mortgage insurance. How, if at all, should this impact the decision to include mortgage insurance in packages of settlement services?

22. To what extent, if any, do inconsistencies currently exist, or would they exist upon promulgation of the proposed rule between State laws and RESPA? Specifically, what types of State laws result in such inconsistencies and merit preemption? What, if any, provisions of the proposal should be revised to facilitate any necessary preemption?

23. The rule proposes that the GFE and the GMPA be given subject to appraisal and underwriting. How should the final rule address the matter of loan rejection or threatened rejection as a means of allowing the originator to change the GFE or GMPA to simply earn a higher profit?

24. To what extent, if any, should direct loan programs such as those provided by the Rural Housing Service of the Department of Agriculture be treated differently under the new regulatory requirements proposed by this rule?

25. As proposed, the GFE and GMPA currently contain sections for loan originators and packagers to indicate the specific loan terms for adjustable rate mortgages, prepayment penalties, and balloon payments. Are these appropriate loan terms to include on these forms, and what, if any, other mortgage terms or conditions should be listed on the forms?

26. What are the arguments for or against limiting the proposed rule to purchase money, first and second lien, and refinancing loans as opposed to offering it to home equity, reverse mortgage and other transactions? Should there be any additional requirements for so-called B, C, and D loans?

27. As proposed, the Guaranteed Mortgage Package includes one fee for settlement services required to complete a mortgage loan. The fee for the package will include loan origination fees, typically referred to as ''points.'' As points are generally deductible under IRS rules, comments are invited as to how to determine which portion of the package prices should be deemed to constitute points.

28. To what extent do the proposed changes to the definition of application in Section III. B (2) a., and requirements for delivery of the GFE impact other federal disclosure requirements, such as those mandated by the Truth in Lending Act? How can the disclosure objectives of the proposed rule be harmonized with such other disclosure requirements?

29. The proposed rule in Section III. B (2) c., would require a loan originator capable of offering an alternative loan product to provide a prospective borrower, upon the borrower's request, with a new GFE if, after full underwriting, the borrower does not qualify for the loan identified on the original GFE. Is this approach appropriate? What other options should be considered where borrowers do not qualify for the loan product initially sought?

30. The proposed rule in Section III. B (2) c., would require loan originators to provide qualified borrowers with an amended GFE, identifying any changes in costs associated with changes in the interest rate, where the borrower elects not to lock-in the interest rate quoted on the original GFE at the time it is provided. Is this an appropriate requirement? What alternatives, if any, should HUD consider?

V. Findings and Certifications

The Paperwork Reduction Act

The information requirements contained in this proposed rule have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). The Real Estate Settlement Procedures Act of 1974 requires settlement providers to disclose to homebuyers certain information at or before settlement and pursuant to the servicing of the loan and escrow account. This includes a Special Information Booklet, a Good Faith Estimate, an Initial Servicing Disclosure, a Settlement Statement (the Form HUD–1 or Form HUD 1–A), and when applicable an Initial Escrow Account Statement, an Annual Escrow Account Statement, an Escrow Account Disbursement Disclosure, an Affiliated Business Arrangement Disclosure, and a Servicing Transfer/Disclosure. This information requirement under OMB control number 2502–0265 consolidates information previously collected under OMB control numbers 2502–0458, 2502–0491, 2502–0501, 2502–0516, and 2502–0517.

Estimate of the total reporting and recordkeeping burden that will result from this information requirement is as follows:

Respondents: Individuals or households, business or other for-profit entities.

Frequency of submission: On occasion and annually.

Reporting burden: Number of respondents: 20,000, Annual responses: 105,300,000, Hours per response: 0.04.

Total estimated burden hours: 6,500,000.

The status of this information collection is that it is a reinstatement, with changes, of a previously approved collection. In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Comments must be received within sixty (60) days from the date of this proposal. Comments must refer to the proposal by name and docket number (FR–4668) and must be sent to:

Lauren Wittenberg, HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503, *lauren_wittenberg@opm.eop.gov,* Fax: (202) 395–6974

and;

Gloria Diggs, Reports Liaison Officer, Office of the Assistant Secretary for Housing—Federal Housing Commissioner, Department of Housing & Urban Development, 451 Seventh Street, SW, Room 9116, Washington, DC 20410.

Environmental Impact

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4223). The Finding of No Significant Impact is available for public inspection between the hours of 7:30 a.m. and 5:30 p.m. weekdays in the Office of General Counsel, Regulations Division, Room 10276, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410–0500.

Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this proposed rule under Executive Order 12866 (entitled ''Regulatory Planning and Review''), which the President issued on September 30, 1993. This rule was determined economically significant under E.O. 12866. Any changes made to the proposed rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the office of the Rules Docket Clerk, Room 10276, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC, 20410–0500. The Initial Economic Analysis prepared for this rule is also available for public inspection in the Office of the Rules Docket Clerk.

Federalism Impact

This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of Executive Order 13132 (entitled ''Federalism'').

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this proposed rule and has determined that the rule would have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act.

In accordance with section 603 of the Regulatory Flexibility Act, an Initial Regulatory Flexibility Analysis (IRFA) has been prepared and has been made part of the Economic Analysis prepared under Executive Order 12866. The IRFA portion, however, of the combined analysis is published as an appendix to this proposed rule. The IRFA was also submitted to the Chief Counsel for Advocacy of the Small Business Administration for review and comment on its impact on business.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA) requires Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and on the private sector. This proposed rule does not, within the meaning of the UMRA, impose any Federal mandates on any State, local, or tribal governments nor on the private sector.

Congressional Review of Final Rules

This rule constitutes a ''major rule'' as defined in the Congressional Review Act (5 U.S.C. Chapter 8). At the final rule stage, this rule will have a 60-day delayed effective date and be submitted to the Congress in accordance with the requirements of the Congressional Review Act.

VI. Rule Language

List of Subjects in 24 CFR part 3500

Consumer protection, Condominiums, Housing, Mortgagees, Mortgage servicing, Reporting, and recordkeeping requirements.

Accordingly, for the reasons set out in the preamble, part 3500 of title 24 of the Code of Federal Regulations is proposed to be amended as follows:

1. The authority citation shall continue to read as follows:

Authority: 12 U.S.C. 2601 *et. seq.;* 42 U.S.C. 3535(d).

2. In § 3500.2, paragraph (b) is amended by revising the definitions of Application, Good faith estimate, and Mortgage broker and adding the following definitions of Guaranteed mortgage package, Loan originator, Mortgage broker loan, No tolerance, Packager, Packaged services, Participating settlement service provider, Par value, Tolerance, Unforeseeable and extraordinary circumstances, and Zero tolerance:

§ 3500.2 Definitions.

* * * * *

(b) * * *

Application means the submission of credit 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) by a borrower in anticipation of a credit decision, whether oral, written or electronic, relating to a federally related mortgage loan. If the submission does not state or identify a specific property, the submission is an application for a pre-qualification and not an application for a federally related mortgage loan under this part. The subsequent addition of an identified property to the submission converts the submission to an application for a federally related mortgage loan.

* * * * *

Good faith estimate means an estimate of settlement costs on the required format prescribed at Appendix C to this part prepared in accordance with § 3500.7.

* * * * *

Guaranteed mortgage package means a guaranteed package of mortgage related settlement services and an interest rate guarantee for a federally related mortgage loan that is offered to a consumer under a Guaranteed Mortgage Package Agreement (GMPA) in accordance with § 3500.16.

Loan originator means a lender or mortgage broker.

* * * * *

Mortgage broker means a person or entity that renders origination services in a table funding or intermediary transaction. Where a mortgage broker is the source of the funds for a transaction, the mortgage broker is a ''lender'' for purposes of this part.

* * * * *

Mortgage broker loan is a federally related mortgage loan that is originated by a mortgage broker.

No tolerance means that the charges may vary without being subject to any tolerance.

Packager means a person or other entity that offers and provides guaranteed mortgage packages to borrowers in accordance with § 3500.16.

Packaged services are settlement services that the lender requires for settlement and includes all services except per diem interest, hazard insurance, escrow/reserves, and optional settlement services.

Participating settlement service provider means a settlement service provider that provides settlement services in a guaranteed mortgage package and whose charges are included in the guaranteed mortgage package price.

Par value means the principal amount of the loan.

* * * * *

Tolerance means a variation above an estimate of a category of settlement costs. Tolerance is expressed as a percentage of the estimate.

Unforeseeable and extraordinary circumstances means acts of God, war, disaster, or any other emergency, making it impossible or impractical to perform.

Zero tolerance means the amount listed may not vary at closing, except in unforeseeable and extraordinary circumstances.

* * * * *

3. In § 3500.7, paragraph (a) introductory text and (a)(2) through (e) are revised, paragraph (f) is redesignated as paragraph (g); and a new paragraph (f) is added to read as follows:

§ 3500.7 Good faith estimate

(a) Lender to provide. Except as provided in paragraphs (a), (b) or (f) of this section, or where a guaranteed mortgage package agreement is provided in accordance with § 3500.16 of this part, the lender shall provide all applicants for a federally related mortgage loan with a good faith estimate. The lender shall provide the good faith estimate either by delivering the good faith estimate or by placing it in the mail to the loan applicant, not later than three business days after an application is received or prepared. If the application is denied before the end of the three-business-day period, the lender need not provide the denied borrower with a good faith estimate. A lender shall not collect any fee in connection with the application or the good faith estimate beyond that which is necessary to provide the good faith estimate.

* * * * *

(2) For all mortgage loans, third party settlement services, governmental fees and charges, any other loan related expenses that are not paid to and retained by the originator must be reported in their entirety in the appropriate categories on the good faith estimate.

* * * * *

(b) Mortgage broker to provide. In the event an application is received by a mortgage broker who is not an exclusive agent of the lender, the mortgage broker must provide a good faith estimate by delivering the good faith estimate or by placing it in the mail to the loan applicant, not later than three business days after an application is received or prepared. As long as the mortgage broker has provided the good faith estimate, the funding lender is not required to provide an additional good faith estimate, but the funding lender is responsible for ascertaining that the good faith estimate has been delivered. If the application is denied before the end of the three-business-day period, the mortgage broker need not provide the denied borrower with a good faith estimate. A mortgage broker shall not collect any fee in connection with the application or the good faith estimate beyond that which necessary to provide the good faith estimate.

(c) Content of good faith estimate. As prescribed in and completed in accordance with the instructions in Appendix C to this part, the good faith estimate must state the property address, loan amount, interest rate used to calculate the estimated amounts, the Annual Percentage Rate (APR) for the loan including mortgage insurance, and the monthly payment for principal and interest and mortgage insurance. The form must also state whether the loan is an adjustable rate mortgage, contains a prepayment penalty clause or has a balloon payment, the functions of the originator, and the total amount of charges for each category of services: loan origination, interest rate dependent payment, lender required and selected third party services, title services and title insurance, shoppable lender required third party services, government services, amounts for escrow/reserves, per diem interest, hazard insurance and optional owner's title insurance. Attachment A–1 of the good faith estimate must indicate the subtotals of the origination charges to the lender and to the mortgage broker, and the subtotals of all the charges and fees for title and for settlement agent services.

(d) Accuracy of good faith estimate. (1) The amounts of the categories of loan origination charges, lender required and selected third party settlement service provider charges, lender selected title services and title insurance, and governmental fees and charges reported on the good faith estimate shall not vary from the time the good faith estimate is given to the borrower and may not be exceeded at settlement absent unforeseeable and extraordinary circumstances. The estimates in the good faith estimate shall be open to the borrower for a minimum of 30 days from when the document is delivered or mailed to the borrower. Within the 30 days the borrower must agree to go forward and pay the additional money to complete the underwriting process. If the offer expires, the borrower may ask the loan originator to ratify such estimate or request a new one. If the cost at settlement exceeds the estimate reported on the good faith estimate, absent unforeseeable and extraordinary circumstances, the borrower may withdraw the application and receive a full refund of all loan-related fees and charges. The loan originator must document any such circumstances and retain the document in accordance with § 3500.10(e).

(2) The amounts for lender required third party services must include an estimate of the maximum mortgage insurance premium to be charged upfront to the borrower based upon the borrower's assertion of the value of the property and loan amount needed and indicate that the mortgage insurance premium may decrease or be removed after full underwriting;

(3) The amounts of the categories of borrower selected title services and title insurance, shoppable lender required third party services, and reserves/ escrow deposits charged to a borrower may not vary at settlement by greater

than a tolerance of 10% from the amounts for such categories reported on the good faith estimate, except when a borrower chooses to purchase a more expensive service, absent unforeseeable and extraordinary circumstances.

(4) The amounts of the categories of per diem interest, hazard insurance and optional owner's title insurance reported on the good faith estimate shall be carefully prepared based upon the originator's knowledge of relevant prices, but are not subject to tolerances, which means that charges may vary without being subject to any tolerance.

(5) In mortgage broker loans, the borrower payment to the lender for a lower interest rate must be paid in full to the lender and the lender payment to the borrower for a higher rate must include any lender payments for the transaction other than for the par value of the loan.

(6) Loan 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 of charges for categories III(C) through (J) of the good faith estimate. The Loan originator shall include all of its charges in the origination charges and interest rate dependent categories.

(7) No loan originator shall be held responsible for charges imposed on the borrower at settlement for shoppable lender required third party services unless the borrower asked where the services could be obtained within the tolerance, used a settlement service provider identified by the originator, and was charged an amount in excess of the tolerance.

(e) Form of good faith estimate. A good faith estimate required format is set forth in Appendix C to this part. The good faith estimate may be provided together with disclosures required by the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, so long as all required material for the good faith estimate is grouped together.

(f) Particular providers required by lender. (1) If the lender requires the use (see § 3500.2, ''required use'') of a particular provider of a settlement service, other than the lender's own employees, and also requires the borrower to pay any portion of the cost of such service, the good faith estimate must identify the required settlement service provider.

(2) Except for a provider that is the lender's chosen attorney, credit reporting agency, or appraiser, if the lender is in an affiliated business relationship (see § 3500.15) with a provider, the lender may not require the use of that provider.

(3) If the lender maintains a controlled list of required providers (five or more for each discrete service) or relies on a list maintained by others, and at the time of application the lender has not yet decided which provider will be selected from that list, then the lender may satisfy the requirements of this section if the lender provides the borrower, on the good faith estimate, with the names of the required providers, and the estimated charge for the particular settlement service.

* * * * *

4. In § 3500.8, the third sentence of paragraph (a) is revised to read as follows:

§ 3500.8 Use of HUD–1 or HUD–1A settlement statements.

(a) * * * Alternatively, the form HUD–1A may be used for these transactions, but not for transactions in which there is a lender credit to the borrower. * * *

* * * * *

5. In § 3500.10, a new sentence is added to paragraph (e) to immediately follow the second sentence to read as follows:

§ 3500.10 One-day advance inspection of HUD–1 or HUD–1A settlement statement; delivery; recordkeeping.

(e) * * * Loan originators shall retain documentation of unforeseeable and extraordinary circumstances related to good faith estimates provided to borrowers and packagers shall retain documentation of such circumstances related to guaranteed mortgage package agreements provided to borrowers for five years after settlement.* * *

* * * * *

6. In § 3500.14, a new paragraph (g)(1)(viii) is added to read as follows:

§ 3500.14 Prohibition against kickbacks and unearned fees.

* * * * *

(g)(1)(viii) Any discounts negotiated among settlement service providers, packagers, or any other entities for settlement services 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) of the good faith estimate as appropriate.

* * * * *

§ 3500.16 [Redesignated as §3500.20]

7. In § 3500.16 is redesignated as § 3500.20 and a new § 3500.16 is added to read as follows:

§ 3500.16 Guaranteed Mortgage Package—Safe Harbor.

(a) General. A guaranteed mortgage package is defined in § 3500.2.

(b) Violation and safe harbor. A guaranteed mortgage package, including payments, discounts, pricing arrangements or any other exchanges of things of value by and between persons or entities offering their services and compensated through guaranteed mortgage packages (hereinafter ''packagers'') and participating settlement service providers as part of such a transaction, shall not violate section 8 of RESPA or § 3500.14 and satisfies sections 4 and 5 of RESPA if the conditions set forth in this section are met.

(c) Criteria for guaranteed mortgage package. In order to qualify for the safe harbor stated in paragraph (b) of this section, packagers must deliver a guaranteed mortgage package offer within 3 days of application or such time as may be reasonable in special cases but prior to the borrower paying any fee, that includes:

(1) A package of designated lender required settlement services at a guaranteed price from the time the guaranteed mortgage package is offered by the packager to the borrower through settlement provided that the borrower accepts the guaranteed mortgage package agreement within 30 days, or such greater period offered by the packager, from when the document is delivered or mailed to the borrower;

(2) A mortgage loan with an interest rate guarantee and an Annual Percentage Rate (APR) that is guaranteed through settlement provided that the borrower accepts the guaranteed mortgage package agreement within 30 days, or such greater period offered by the packager, and the interest rate is adjusted only to reflect changes in market interest rates based on movement in a observable and verifiable index or other appropriate measure; and

(3) A guaranteed mortgage package agreement as prescribed in and completed in conformity with Appendix F to this part which:

(i) Explains that the guaranteed mortgage package includes necessary settlement services required by the lender and guarantees a package price for these services through settlement provided that the borrower accepts the GMPA within 30 days, or such greater period offered by the packager, from when the document is delivered or mailed to the borrower;

(ii) Commits the packager to provide all settlement services and includes all charges required to complete your mortgage except those specified as other required settlement costs and advises the borrower if the packager anticipates whether a pest inspection, lender's title insurance, credit report, and/or appraisal will be anticipated;

(iii) Identifies and provides estimates for other required settlement costs, such as per diem interest, reserves/escrow, and hazard insurance, and optional owner's title insurance and explains that any required settlement costs not separately itemized and estimated are the responsibility of the packager;

(iv) Identifies and explains any borrower option to utilize payments to or from the lender as a result of the interest rate to pay settlement costs or adjust the interest rate and mortgage payments;

(v) Identifies any reports such as the pest inspection, lender's title insurance, appraisal or credit report for the loan transaction that are available to the borrower at the borrower's request;

(vi) Specifies that the packager will ensure that a mortgage loan is provided as part of the package and that, after acceptance by the borrower and the lender, the lender participating in the package shall provide a loan with the same terms as set forth in the guaranteed mortgage package agreement;

(vii) Advises the borrower of whether the loan is an adjustable rate mortgage and the terms of the mortgage, whether there is a prepayment penalty and that the borrower can request its terms, whether there is a balloon payment, whether the guaranteed mortgage package price includes an upfront maximum mortgage insurance premium based upon the borrowers assertion of the value of the property and loan amount needed and that the mortgage insurance premium may decrease or be removed after full underwriting; and

(viii) Commits the packager to the terms of the guaranteed mortgage package agreement upon borrower acceptance and payment of any fee, subject only to acceptable final underwriting and property appraisal.

(d) Impact on Good faith estimate and HUD–1/1A. Where a packager satisfies the criteria in paragraph (c) of this section, the packager shall provide the borrower the guaranteed mortgage package agreement in lieu of the good faith estimate. In loans originated through guaranteed mortgage package agreements, the HUD–1/1–A shall be completed at settlement by itemizing all the included services (but not the charges) of third party settlement service providers that were performed for the guaranteed mortgage package price. The guaranteed mortgage package price shall be shown as the origination fee on line 801 of the HUD–1/HUD–1A. Additionally, the packager must list the finance charges needed to calculate the APR on an addendum to the HUD–1 or HUD–1A.

(e) Exclusions from safe harbor.

(1) Notwithstanding the existence of a guaranteed mortgage package, section 8 of RESPA remains applicable to payments by and between packagers or participating settlement service providers and parties outside the guaranteed mortgage package.

(2) The Affiliated Business Arrangement (AfBA) exemption requirements, set forth in § 3500.15, remain in effect when a borrower is referred to a packager by a person or entity not otherwise participating in the guaranteed mortgage package who is an affiliate of the packager or any participating settlement service provider.

(3) The guaranteed mortgage package safe harbor shall not be available where the rate or points and fees of a Federally related mortgage loan make the loan subject to the Home Ownership Equity Protection Act (HOEPA).

§ 3500.19 [Amended]

8. In § 3500.19(c) the cross references to ''§ 3500.16'' and to ''section 3500.16'' are both revised to read ''§ 3500.20''

9. Appendix A to part 3500—Instructions for Completing HUD–1 and HUD–1A Settlement Statements is amended as follows:

Appendix A to Part 3500—Instructions for Completing HUD–1 and HUD 1–A Settlement Statements; Sample HUD–1 and HUD 1A Statements

a. The second paragraph of the General Instructions is revised to read as follows:

General Instructions

* * * * *

Except with respect to a loan resulting from a Guaranteed Mortgage package, the settlement agent shall complete the HUD–1 to itemize all charges imposed upon the Borrower and the Seller by the loan originator and all sales commissions, whether to be paid at settlement or outside of settlement, and any other charges which either the Borrower or the Seller will pay for at settlement. Charges to be paid outside of settlement, including cases where a non-settlement agent (i.e., attorneys, title companies, escrow agents, real estate agents or brokers) holds the Borrower's deposit against the sales price (earnest money) and applies the entire deposit towards the charge for the settlement service it is rendering, shall be included on the HUD–1 but marked ''P.O.C.'' for ''Paid Outside of Closing'' (settlement) and shall not be included in computing totals. P.O.C. items should not be placed in the Borrower or Seller columns, but rather on the appropriate line next to the columns. In the case of loans where settlement services are paid through the interest rate, any charges to be paid by the lender should not be marked as P.O.C. but should be shown in the appropriate column and used in computing totals. In loans originated through guaranteed mortgage package agreements, the HUD–1/1-A shall indicate through checkmarks in the appropriate column which third party settlement services were performed for the guaranteed mortgage package price. The guaranteed mortgage package price shall be shown on line 801. Additionally, the finance charges needed to calculate the APR will be disclosed in an addendum on the HUD–1.

* * * * *

b. The Line Item Instructions for the HUD–1 paragraph describing line 204–209 are revised to read as follows:

* * * * *

Lines 204–209 are used for other items paid by or on behalf of the Borrower. Examples include cases in which the Seller has taken a trade-in or other property from the Borrower in part payment for the property being sold. They may also be used in cases in which a Seller (typically a builder) is making an ''allowance'' to the Borrower for carpets or drapes which the Borrower is to purchase separately. Lines 204–209 can also be used to indicate any Seller financing arrangements or other new loan not listed in Line 202. For example, if the Seller takes a note from the Borrower for part of the sales price, insert the principal amount of the note with a brief explanation on Lines 204–209. Additionally, a blank line in this series shall be used to record the total of all payments from the Lender to the Borrower based on the transaction, including payments based on a higher interest rate.

* * * * *

c. Following the instructions for HUD–1 Line 603, Section L. Settlement Charges is revised to read as follows:

* * * * *

Section L. Settlement charges. For all items except for those paid to and retained by the Loan Originator, the name of the person or firm ultimately receiving the payment should be shown. In the case of loans where settlement services are paid through the interest rate, any charges to be paid by the lender should be shown in the appropriate column used in computing totals.

* * * * *

d. The paragraph immediately following ''Line Item Instructions for Completing HUD—1A'' is revised to read as follows:

* * * * *

Note: HUD–1A is an optional form that may be used for refinancing and subordinate lien federally related mortgage loans, as well as for any other one-party transaction that does not involve the transfer of title to residential real property or does not involve any lender payments to the borrower based on the transaction, including any payments based on a higher interest rate. The HUD–1 form may also be used for such transactions, by utilizing the borrower's side of the HUD–1 and following the relevant parts of the Line Item Instructions. The use of the HUD–1 or HUD–A is not mandatory for open-end lines of credit (home-equity plans), as long as the provisions of Regulation Z are followed.

* * * * *

e. For HUD 1–A, the second paragraph following ''General Instructions'' is revised to read as follows:

* * * * *

The settlement agent shall complete the HUD–1A to itemize all charges imposed upon the borrower by the lender, whether to be paid at settlement or outside of settlement, and any other charges that the borrower will pay for at settlement. For all items except for those paid to and retained by the lender, the name of the person or firm ultimately receiving the payment should be shown together with the total amount paid to such person in connection with the transaction. In loans originated through guaranteed mortgage package agreements, the HUD–1A shall be completed at the time of settlement by indicated through checkmarks in the appropriate column which settlement services were performed for the guaranteed mortgage package price. The guaranteed mortgage package price shall be shown on line 801. Additionally, the finance charges needed to calculate the APR will be disclosed in an addendum on the HUD–1A.

10. Appendix C to part 3500 is revised in its entirety, including the heading, to read as follows:

Appendix C to Part 3500—Instructions for Completing Good Faith Estimate; Sample Good Faith Estimate

Instructions for completing the Good Faith Estimate

The following are instructions for completing the Good Faith Estimate required under section 5 of RESPA and Regulation X of the Department of Housing and Urban Development (24 CFR 3500.7). This form is to be used as a statement of estimated settlement charges. The instructions for completion of the Good Faith Estimate are primarily for the benefit of the loan originator who prepares the form and need not be transmitted to the borrower(s) as an integral part of the Good Faith Estimate.

General Instructions

The loan originator preparing the Good Faith Estimate may fill in information and amounts on the form by typewriter, hand printing, computer printing, or any other method producing clear and legible results. Under these instructions the ''form'' refers to the Good Faith Estimate form.

All fees and charges shall be disclosed in dollar amounts. Percentages may be added, when applicable.

Specific Instructions

I. *Our Services.* Loan originators shall include a paragraph substantially the same as the paragraph set forth on the form in this Appendix. This paragraph explains the services provided by the loan originator and emphasizes that the borrower should shop and compare different loans and originators to find the best loan for his or her individual situation.

II. *Loan Terms.* Loan originators shall fill in the mortgage amount, indicate whether the loan is a fixed or variable loan, specify the interest rate and Annual Percentage Rate (APR) and fill in the length of the loan (i.e. number of years/months) and the monthly payment, including any mortgage insurance.

III. *Settlement Costs.* This section covers the settlement costs associated with the mortgage loan and warns the borrower that the costs may change if a different mortgage product is chosen or the interest rate changes.

III.A. *Origination Charges.* Loan originators shall total all origination charges to the lender and the broker in this category on the form. For mortgage brokers, these charges shall include all charges from the borrower that are paid to the mortgage broker for the transaction. For lenders, these charges shall include all direct charges from the borrower for the transaction, other than discount points reported in line III B (2). The estimated total origination charges shall not vary from the actual costs at the time of settlement (0% tolerance), absent unforeseeable and extraordinary circumstances.

III.B. *Interest Rate Dependent Payment.*

(1) In loans originated by mortgage brokers, mortgage brokers shall subtotal any lender payments to the borrower for a higher interest rate as well as any other lender payments for the transaction other than for the par value of the loan in this category on the form.

(2) In loans originated by mortgage brokers, mortgage brokers shall subtotal any borrower payments to the lender for a lower interest rate.

The mortgage broker shall include the payments in (1) and (2) when computing the net loan origination charge due from borrower (Sum of A and B). Lenders may complete this section at their option.

III.C. *Lender Required and Selected Third Party Services.* Loan originators shall subtotal all charges for lender required and lender selected third party services in this section on the form. This subtotal shall cover all such services except for title related services and title insurance in connection with the borrower's loan and shall not vary from actual costs at the time of settlement (0% tolerance), absent unforeseeable and extraordinary circumstances.

III.D. *Title Services and Title Insurance.* Loan originators shall subtotal all fees or charges for title and settlement agent services and title insurance in this category of the form. On the form, the loan originator also must indicate whether the services and insurance are loan originator selected or borrower selected. If title services and insurance are loan originator/lender selected, the estimate shall not vary from actual costs at the time of settlement (0% tolerance), absent unforeseeable and extraordinary circumstances. If title services and/or insurance are shoppable by the borrower, and the borrower ultimately elects to use a provider identified by the loan originator/lender, the final amount at settlement may not exceed the estimate by more than 10% (10% tolerance) absent unforeseeable and extraordinary circumstances, except when a borrower chooses to purchase a more expensive service.

III.E. *Shoppable Lender Required Third Party Services.* Loan originators shall subtotal all charges for loan originator/lender required third party services in this section. If services are shoppable by the borrower, and the borrower ultimately elects to obtain some or all of these services through the loan originator, the final amount at settlement may not exceed the loan originator's estimate by more than 10% (10% tolerance) absent unforeseeable and extraordinary circumstances, except when a borrower chooses to purchase a more expensive service.

III.F. *Government Charges—Taxes (State and Local).* Loan originators shall subtotal all state and local fees, charges, and taxes that will be required at settlement in this section. This estimate shall be based on an assumed settlement date that the loan originator will specify on the form. The estimate shall not vary from actual costs at the time of settlement (0% tolerance) for the assumed settlement date, absent unforeseeable and extraordinary circumstances.

III.G. *Reserves/Escrow.* Loan originators shall subtotal reserves/escrow amounts that will be required by the lender at settlement. This section shall include only required escrow items such as taxes, hazard insurance, and mortgage insurance. The estimate shall not vary from the actual costs required for reserves/escrow at the time of settlement by more than 10% (10% tolerance) absent unforeseeable and extraordinary circumstances, except when a borrower chooses to purchase a more expensive service.

III.H. *Per Diem Interest.* Loan originators shall disclose the estimated cost of the minimum amount of per diem interest that the lender will charge in this section. Although loan originators are expected to provide reliable figures in this section based on their experience, no tolerance applies to this section, which means that charges may vary without being subject to any tolerance.

III.I. *Hazard Insurance.* Loan originators shall disclose the estimated cost of the minimum amount of hazard insurance that the lender will require in this section. Although loan originators are expected to provide reliable figures in this section based on their experience, no tolerance applies to this section, which means that charges may vary without being subject to any tolerance.

III.J. *Optional Owner's Title Insurance.* Loan originators shall disclose the estimated subtotal of optional homeowner's title insurance that the borrower may choose to purchase. Although loan originators are expected to provide reliable figures in this section based on their experience, no tolerance applies to this section, which means that charges may vary without being subject to any tolerance.

IV. *Options to Pay Settlement Costs and Lower Your Interest Rate.* Loan originators shall explain the borrower's options for paying settlement costs in this section of the form by using material that is essentially the same as that contained in paragraphs A, B, C and D of this section at Appendix C along with discussing these issues with the borrower, as needed. The loan originator must fill in the chart to demonstrate to the borrower how the borrower's chosen interest rate, monthly payments, and settlement costs compare to a loan of the same size with a lower and a higher interest rate. The completed chart serves as an example for the loan originator of how to fill out the categories. Loan originators shall use figures relevant to the borrower's transaction.

V. *Additional Loan Terms.* Loan originators shall indicate whether the mortgage loan is subject to a prepayment penalty and whether the loan has a balloon payment due at the conclusion of the loan term. If there is a prepayment penalty, the loan originator shall advise the borrower that he or she is entitled to a copy of the prepayment penalty terms upon request. For Adjustable Rate Mortgage Loans, loan originators must indicate the interest rates and adjustment terms of the adjustable rate mortgage loan.

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Good Faith Estimate of Settlement Costs (GFE)

This form provides a reliable estimate of the funds that will be required from you, ____________________, the borrower(s) to obtain a mortgage using our company as your loan originator. This GFE covers both our charges, the charges of other settlement service providers who perform services that are required by the lender to close your mortgage loan, and applicable State and local government charges and taxes due at settlement.

The following estimate is valid for ____ days [30 days or greater] from the date this form is delivered or mailed to you, if you qualify for this mortgage based on your credit rating, the appraisal, and other appropriate criteria.

THE PROPERTY: You seek to [purchase][refinance] a residential property at
(Address)____

I. OUR SERVICES:

As a loan originator, we perform the services necessary to obtain and process your mortgage loan with our own funds or one or more funding sources. **We do not offer loans from all funding sources and we cannot guarantee the lowest price or best terms available in the market.** **You should compare the prices in the boxes below and shop for the loan originator, mortgage product, and settlement services that best meet your financing needs.**

II. LOAN TERMS:

For a mortgage amount of $_______, at a [fixed] interest rate of ___%, your APR will be ____%,, which includes ____% for mortgage insurance. Your loan term will be [ ] years with [ ] monthly payments. Your [initial] monthly payment for principal and interest and mortgage insurance on this loan will be $ ______. *See Section V. for loan terms related to adjustable rate mortgages, applicable prepayment penalties and balloon payments.*

III. SETTLEMENT COSTS:

If you choose a different mortgage product or you do not lock your interest rate, some of the estimates listed below may change. The following costs will have to be paid at or before loan closing:

A. Origination Charges(HUD-1 800 Series)* $_______
See Attachment A-1 listing origination charge subtotals for the lender and the broker.

B. Interest Rate Dependent Payment (200, 900)***
Until you lock in your interest rate these payments may change.
(1) (+) Borrower Payment to Lender for Lower Interest Rate: $_______
(2) (-) Lender Payment to Borrower for Higher Interest Rate: $_______

NET LOAN ORIGINATION CHARGE DUE FROM BORROWER (Sum of A and B): $_______

C. Lender Required and Selected Third Party Services (800, 1300)* $_______
These are third party services that are required and selected by the lender, these services must be disclosed to you. *See Attachment A-1 itemizing these services.*

D. Title Services and Title Insurance (1100) $_______
(1) ____ lender selected*
(2) ____ borrower selected**

E. Shoppable Lender Required Third Party Services (800, 1300)** $_______
These are third party services that are required by the lender but you may shop for (other than title services and title insurance). *See Attachment A-1 itemizing these services.*

F. Government Charges –Taxes, State and Local (1200)* $_______
Government charges due at the time of settlement assuming a closing on _______.

G. Reserves/Escrow, (if required) (1000)** $_______

H. Per Diem Interest (900) *** $_______
Per Diem Daily Rate $_______ at _____ days with an estimated settlement date of_______.

I. Hazard Insurance(900)*** $_______

J. Optional Owner's Title Insurance (1100)*** $_______

TOTAL SETTLEMENT COSTS DUE FROM BORROWER (Sum of A-J): $_______

***The charges listed in A, C, D (if selected by the lender), F, and H (daily rate) will not vary except in unforeseeable and extraordinary circumstances as prescribed by federal regulation.**
****The charges listed in D (if selected by the borrower), E, and G must not be exceeded at settlement by more than 10% absent unforeseeable and extraordinary circumstances, except when a borrower chooses to purchase a more expensive service.**
*****The charges listed in B, H, I, and J are not subject to a tolerance, therefore these charges may vary.**

IV. OPTIONS TO PAY SETTLEMENT COSTS AND LOWER YOUR INTEREST RATE

A. Cash Payment at Settlement: You may pay all or part of your required settlement costs at settlement using your available funds.

B. Borrowing Additional Funds to Pay Settlement Costs: You may be able to pay all or part of your settlement costs by borrowing the needed funds as part of your mortgage loan principal. If you chose this option, your monthly payments will increase.

C. Pay Settlement Costs Through a Higher Interest Rate:
You may be able to lower your settlement costs in exchange for paying a higher interest rate on your mortgage loan. This higher interest rate will increase your monthly payments.

D. You May Lower Your Interest Rate:
You may be able to lower the interest rate on your loan by paying additional funds at closing, commonly referred to as "discount points." The reduced interest rate will lower your monthly payments.

The following table will show you how higher and lower interest rates affect your loan and loan payments.

	GFE Terms You Selected	Higher Interest Rate	Lower Interest Rate
New Loan Balance	$100,000	$100,000	$100,000
Interest Rate	7.00%	7.25%	6.75%
Monthly Principal & Interest & PMI	$700.30	$717.18	$683.60
Credit	$100	$1,100	N.A.
Discount Points	N.A.	N.A.	$900
Change in Cash to Close From GFE Terms You Selected		$1,000 less	$1,000 more
Change in Monthly P&I from GFE Terms You Selected		$16.88 more	$16.70 less

V. ADDITIONAL LOAN TERMS

- ☐ **This mortgage IS subject to Prepayment Penalty.**
- ☐ **This mortgage IS NOT subject to Prepayment Penalty.**
- ☐ **This mortgage HAS a balloon payment of ______, which will be due at the conclusion of the loan term.**
- ☐ **This mortgage DOES NOT HAVE a balloon payment.**

Adjustable Rate Mortgage (ARM) Loans

This is an Adjustable Rate Mortgage (ARM) Loan. The initial interest rate for this ARM loan is _____. The first adjustment will occur after ____months/years and every _____months/years thereafter for a period of ______ months/years. The interest rate is based on the ____index and may increase by a margin of ____ percent over this index with each adjustment. The maximum rate increase adjustment per period is ________and the maximum interest rate that can ever apply to this loan is _____.

Attachment A–1 instructions

Attachment A–1. ''Required Use'' and Shoppable Third Party Providers.

A. The loan originator must itemize on this form any services that may be independently obtained by the borrower and the estimated cost (based on local market averages for the area where the property is located). The loan originator must also indicate (by checking the appropriate box) any lender-required, lender selected services, along with the estimated charge (based on local market averages for the area where the property is located), and name of the provider.

B. 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.

Attachment A-1

A. "Required Use" and Shoppable Third Party Providers

Federal regulation 3500.7(f) requires that if a lender requires the use of a particular provider of a settlement service, other than the lender's own employees, and also requires the borrower to pay any portion of the cost of such service, then the good faith estimate must: (1) state that the particular provider is required; (2) state the providers name; and (3) state the estimated charge. These services are marked as "required use."

The services marked as shoppable on this list that are also required by us to close your loan, however, unlike the "required use" services, we do not require that you use a particular provider. You may want to shop for these services on your own to find the best price and service to meet your needs. However, if you chose to use a company that is more expensive then our selection, then the excess over our estimate below is excluded from the 10% limit on the closing cost estimate given by us. The following lists the services and companies used by us and price estimates for those services.

Req. Use	Shoppable	Service	Provider	Estimate

B. Loan Origination and Title Services Subtotals

Federal regulation 3500.7(c) requires that this Attachment indicate the subtotals of the lender and mortgage broker origination charges; 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.

Service	Subtotal
Mortgage Broker Charges (HUD 1 line 800)	
Lender Charges (800)	
Title Agent Charges(1101)	
Title Insurance Premium (1108)	

BILLING CODE 4210–27–C

11. A New Appendix F to part 3500 is added to read as follows:

Appendix F to Part 3500—Instructions for Completing Guaranteed Mortgage Package Agreement; Sample Guaranteed Mortgage Package Agreement

Instructions for Completing the Guaranteed Mortgage Package Agreement

The following are instructions for completing the guaranteed mortgage package agreement under Regulation X of the Department of Housing and Urban Development (24 CFR 3500.16(g)(1)(ix)). This form is to be used as a statement of guaranteed settlement charges, interest rate, and costs. The instructions for completion of the guaranteed mortgage package agreement are primarily for the benefit of the packager who prepares the form and need not be transmitted to the borrower(s) as an integral part of the guaranteed mortgage package agreement.

General Instructions

The loan packager preparing the guaranteed mortgage package agreement may fill in information and amounts on the form by typewriter, hand printing, computer printing, or any other method producing clear and legible results. Under these instructions the ''form'' refers to the guaranteed mortgage package agreement form.

The guarantee includes all services provided in connection with the mortgage package, except for per diem interest, reserves/escrow, hazard insurance, and optional owner's title insurance.

Specific Instructions

Packagers shall include a paragraph substantially the same as the introductory paragraph set forth in Appendix F that explains the nature of the package and that the guaranteed mortgage package agreement remains open for a minimum of 30 days, or such greater period offered by the packager, from when the document is delivered or mailed to the borrower. Within that time period the borrower must accept the agreement and pay a minimal fee to make it binding. The packager shall fill out the property address and indicate whether the transaction is a purchase or refinance.

I. *Interest Rate Guarantee.* The packager shall specify an interest rate guarantee and Annual Percentage Rate (APR), as well as the amount of any mortgage insurance that is the APR, in this section of the form, which the borrower may accept and lock at application. While the guaranteed mortgage package agreement offer is open, if the borrower does not accept or lock, the interest rate shall be tied to an observable and verifiable index, or other appropriate data or means, and may not change except in relation to said index or measure during the time the offer is pending. If the borrower does not apply for a loan within 30 days, or such greater period offered by the packager, the offer will expire.

II. *Guaranteed Mortgage Package.* The packager shall specify a lump sum package price for covered settlement services in this section of the form. At a minimum, this amount must include all origination services, title services and title insurance, other packager or lender required third party services, all government charges, and an upfront maximum mortgage insurance premium, if applicable.

III. *Other Required Settlement Costs.* The packager shall itemize any other required settlement charges in this section of the form as permitted under § 3500.16. Any settlement costs not separately itemized in this section are presumed to be included in the Section II guarantee.

III.A. *Per Diem Interest.* The packager shall disclose the estimated cost of the minimum amount of per diem interest that the lender will require in this section. Although loan originators are expected to provide reliable figures in this section based on their experience, no tolerance applies to this section, which means that charges may vary without being subject to any tolerance.

III.B. *Reserves/Escrow.* The packager shall accurately indicate the estimated subtotal for reserves/escrow in this section on the form. This estimate shall cover all reserves/escrow deposits required by the lender for such items as taxes, hazard insurance, and mortgage insurance. The final amount required to be placed in reserves/escrow at settlement may not exceed the estimate by more than 10% (10% tolerance), absent unforeseeable and extraordinary circumstances. The packager must document any such circumstances and retain the document in accordance with § 3500.10(e) of this part.

III.C. *Hazard Insurance.* The packager shall estimate the cost of the minimum amount of hazard insurance that the lender will require in this section on the form. Although loan originators are expected to provide reliable figures in this section based on their experience, no tolerance applies to this section, which means that charges may vary without being subject to any tolerance.

IV. *Optional Owner's Title Insurance.* The packager shall estimate the cost of optional owner's title insurance that the borrower may choose to purchase. Although packagers are expected to provide reliable figures in this category, no tolerance applies to this section, which means that charges may vary without being subject to any tolerance.

V. *Options to Pay Settlement Costs and Lower Your Interest Rate.* Packagers shall explain the borrower's options for paying settlement costs in this section by using material that is essentially the same as that contained in paragraphs A, B, C and D of this section at Appendix F, along with discussing these issues with the borrower, as needed. The packager must fill in the chart to demonstrate to the borrower how the borrower's chosen interest rate, monthly payments, and settlement costs compare to a loan of the same size with lower and higher interest rates. The completed chart serves as an example for the packager of how to fill out the categories. Packagers shall use figures relevant to the borrower's transaction.

VI. *Additional Loan Terms.* Packagers shall indicate whether the mortgage loan is subject to a prepayment penalty and whether the loan has a balloon payment due at the conclusion of the loan term. If there is a prepayment penalty, the packager shall advise the borrower that he or she is entitled to a copy of the prepayment penalty terms upon request. For Adjustable Rate Mortgage Loans, packagers must indicate the interest rates and adjustment terms of the adjustable rate mortgage loan.

VII. *Guaranteed Mortgage Package Agreement.* This section must be signed by an authorized agent of the packager and the borrower to become a binding contract for the guaranteed mortgage package at the guaranteed mortgage package price. After acceptance by the borrower, non-lender packagers must ensure that the lender signs the GMPA agreeing to provide the loan included in the guaranteed mortgage package.

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Guaranteed Mortgage Package Agreement

This **GUARANTEED MORTGAGE PACKAGE AGREEMENT** commits us, ______________, the **PACKAGER**, to provide you, ________________, the **BORROWER(S)**, upon your acceptance and payment of a $____ fee within ____days (30 days or greater)] of the date this form is delivered or mailed to you: **(1)** a mortgage loan on the property described below at a **GUARANTEED INTEREST RATE**; (2) a **GUARANTEED MORTGAGE PACKAGE PRICE** for settlement services required by the lender; **(3)** a firm estimate (within 10%) of the amount of **OTHER REQUIRED SETTLEMENT COSTS** you will pay at or before settlement; and **(4)** a sum of the **TOTAL ESTIMATED SETTLEMENT COSTS** that you will be required to pay at or before settlement to obtain your mortgage.

This Agreement is subject to verification of your credit rating, final property appraisal, and other appropriate underwriting criteria. **Other providers offer similar packages, or alternative approaches to mortgage origination. You should shop to find the best packager or originator and mortgage product to meet your needs.**

THE PROPERTY: You seek to [purchase][refinance] a residential property at
(Address)____

I. INTEREST RATE GUARANTEE

We guarantee to provide you an [initial] interest rate of ____on a [fixed rate] [adjustable] mortgage of $______ for [ ] years with [ ] monthly payments. Your [initial] monthly payment for principal and interest and monthly mortgage insurance on this loan will be $ ______. Your APR will be ____%, which includes _____% for mortgage insurance.

This interest rate is guaranteed through settlement if you accept and sign this agreement now, and lock-in this rate by [insert date/time]. If you choose not to accept by this time, we guarantee that the interest rate will not exceed ____% [over] [under] the [prime] [index] rate for ____days [30 days or greater]. If you do not accept within this period, this offer will expire. If you accept this agreement, but elect not to lock-in the rate at the time of acceptance, we further guarantee that your interest rate will not exceed ___% [over][under] the [prime][index] rate or other standard measurement in lieu of an index when you do lock-in.

II. GUARANTEED MORTGAGE PACKAGE

We will provide you a **GUARANTEED MORTGAGE PACKAGE** for all settlement services and charges required to complete your mortgage, except those specifically set forth in Section IV below, at a **GUARANTEED MORTGAGE PACKAGE PRICE**. You will pay this **GUARANTEED PRICE** in addition to the **OTHER REQUIRED SETTLEMENT COSTS** itemized in Section III. The precise services for each transaction may vary. See Attachment A-1 for an indication of whether we anticipate pest inspection, lender's title insurance and property appraisal services being included in your guaranteed mortgage package.
This guaranteed mortgage package price may include a maximum mortgage insurance premium based upon your assertion of the value of the property and loan amount needed. The mortgage insurance premium may decrease or be removed after full underwriting.

GUARANTEED MORTGAGE PACKAGE PRICE: $______

III. OTHER REQUIRED SETTLEMENT COSTS:

In addition to the **GUARANTEED MORTGAGE PACKAGE PRICE**, you are or may be required to pay advanced mortgage and hazard insurance premiums, and to establish escrow reserves at settlement. Some of these costs may vary depending on when your loan closes and how much insurance you are required to obtain. **No cost may be imposed on you at settlement that is not specifically itemized and estimated in this Section other than the Guaranteed Mortgage Package Price.**

A. Per Diem Interest (HUD-1 900 Series) $______
Per Diem at $_______ @ _____ days with an estimated settlement date of_______.

B. Reserves/ Escrow, (if required) **(1000)*** $_______

C. Hazard Insurance (900) $_______

IV. OPTIONAL OWNER'S TITLE INSURANCE (1100) $_______

TOTAL ESTIMATED SETTLEMENT COSTS (SUM OF SEC. III, IV, AND V): $______

*** Generally, pursuant to federal regulations, the amount stated in line B may not be exceeded at settlement by more than 10% absent unforeseeable and extraordinary circumstances**

V. OPTIONS TO PAY SETTLEMENT COST& LOWER YOUR INTEREST RATE

A. **Cash Payment at Settlement:** You may pay all or part of your required settlement costs at settlement using your available funds.

B. **Borrowing Additional Funds to Pay Settlement Costs:** You may be able to pay all or part of your settlement costs by borrowing the needed funds as part of your mortgage loan principal. If you chose this option, your monthly payments will increase.

C. **Pay Settlement Costs Through a Higher Interest Rate:**
You may be able to lower your settlement costs in exchange for paying a higher interest rate on your mortgage loan. This higher interest rate will increase your monthly payments.

D. **Lower Your Interest Rate:**
You may be able to lower the interest rate on your loan by paying additional funds at closing, commonly referred to as "discount points." The reduced interest rate will lower your monthly payments. The following table will show you how higher and lower interest rates affect your loan and loan payments.

	GMPA Terms You Selected	Higher Interest Rate	Lower Interest Rate
New Loan Balance	$100,000	$100,000	$100,000
Interest Rate	7.00%	7.25%	6.75%
Monthly Principal & Interest & PMI	$700.30	$717.18	$683.60
GMPA Price	$2,600	$1,600	$3,600
Change in Cash to Close From GMPA Terms You Selected		$1,000 less	$1,000 more
Change in Monthly P,I, & PMI from GMPA Terms You Selected		$16.88 more	$16.70 less

VI. ADDITIONAL LOAN TERMS

- ☐ **This mortgage IS subject to Prepayment Penalty.**
- ☐ **This mortgage IS NOT subject to Prepayment Penalty.**
- ☐ **This mortgage HAS a balloon payment of ______, which will be due on __________.**
- ☐ **This mortgage DOES NOT HAVE a balloon payment.**

Adjustable Rate Mortgage (ARM) Loans

This is an Adjustable Rate Mortgage (ARM) Loan. The initial interest rate for this ARM loan is _____. The first adjustment will occur after ____months/years and every _____months/years thereafter for a period of ______ months/years. The interest rate is based on the ____index and may increase by a margin of ____ percent over this index with each adjustment. The maximum rate increase adjustment per period is ________and the maximum interest rate that can ever apply to this loan is _____.

VII. Guaranteed Mortgage Package Agreement:

We are providing this GMPA to you at no cost. If you agree to seek a mortgage loan using our services within 30 days, by signing, dating, and returning this GMPA to us on or before ____, along with a $___ application fee, we will be contractually bound to the terms of this GMPA provided that you qualify for this mortgage based on your credit rating, the appraisal, and other appropriate criteria.

Signature of Authorized Agent Date Signature of Lender Date

Signature(s) of Borrower(s) Date

Attachment A–1 instructions

Attachment A–1. The packager shall indicate in the chart (either yes or no) whether specific services are anticipated to be included in the guaranteed mortgage package price, such as the pest inspection, lender's title insurance, appraisal, and credit report.

Attachment A-1

This list indicates whether we anticipate specific services being included in your guaranteed mortgage package. Upon request, you are entitled to receive a copy of the reports generated by any of the services listed below that are included in your package.

Service	Anticipated (Y/N)
Pest Inspection (HUD-1 line 1302)	
Lender's Title Insurance (HUD-1 line 1109)	
Property Appraisal (HUD-1 line 803)	
Credit Report	

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Dated: July 5, 2002.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

Appendix to FR–4727 Proposed Rule Regulatory Flexibility Analysis

Note: This appendix will not appear in the Code of Federal Regulations.

The following Regulatory Flexibility Analysis is Chapter 5 of the rule's Economic Impact Analysis, which is available for public inspection.

Summary of the Rule's Benefits and Impacts on Small Businesses

The proposed RESPA rule offers a dual approach to problems in the settlement market: A new, simplified GFE combined with tolerances on final settlement costs and a new method for reporting wholesale lender payments in broker transactions; and a guaranteed cost approach based on packaging of settlement services. This chapter provides a summary of benefits, costs, transfers, efficiencies, and market impacts of these two approaches, highlighting the effects on small businesses. Section I discusses the new GFE approach while Section II discusses the guaranteed cost approach, or packaging. The chapter also summarizes alternative approaches that HUD considered that potentially impacted small businesses. The format in this chapter is to list the major findings; additional details about the new GFE approach and packaging are available in Chapters 3 and 4, respectively.

I. New GFE Approach

The main benefits, costs, transfers, and market impacts of the new GFE approach are outlined below, along with the specific impacts on small businesses. Since most brokers and settlement service providers are small businesses, the main impacts of the new GFE approach on these entities are highlighted below in subsections I.C, I.D and I.F.

A. Shopping Benefits

The new GFE approach will improve consumer shopping for mortgages, which will result in better mortgage products at lower prices for consumers.

- The new GFE format in the proposed rule simplifies the process of originating mortgages by consolidating costs into a few major cost categories. This is a substantial improvement over today's GFE, which contains a long list of individual charges that encourages fee proliferation and junk fees, and can often overwhelm and confuse consumers.
- The new GFE contains a statement that clarifies the role that the originator plays in the loan process. It states, for example, that the originator does not distribute the loan products of all funding sources, that the originator does not guarantee the best loan terms, and that the consumer should shop. This will put all borrowers on notice that they should protect their interests by shopping.
- The new GFE also makes cost estimates more certain, by requiring that loan originators adhere to amounts reported on the GFE for major cost categories (such as origination fees), and on additional cost categories give estimates subject to a 10% upper limit, or tolerance. This will reduce the all too frequent problem of borrowers being surprised by additional costs at settlement.
- The new GFE will better inform consumers about their financing choices by requiring that lenders explain the different interest rate and closing cost options available to consumers. For example, consumers will fully understand the trade-offs between reducing their closing costs and increasing the interest rate on the mortgage.
- Altogether, the simplicity and certainty offered by the new GFE should improve comparison shopping for mortgage loans, reduce interest rates and settlement prices for borrowers, and eliminate surprises at settlement. There will be less of the sub-optimal consumer shopping that often characterizes today's mortgage market. In addition, originators will be less able to take advantage of uninformed shoppers.

B. Summary of Estimated Benefits, Costs, Transfers, and Efficiencies

Chapter 3 provided estimates of the magnitude of the benefits, costs, transfers, and efficiencies. Transfers totaled $6.3 billion to borrowers, with $4.5 billion coming from originators and $1.8 billion from third party settlement service providers. In addition to these transfers, there are efficiency gains: Borrowers realize $826 million in efficiency gains from less time spent shopping; and loan originators and third party settlement service providers experience $1.630 billion in efficiency gains, some or all of which have the potential to be passed through to borrowers through competition. Costs to originators rise by approximately $250–$275 million. These estimates are explained further below. While they are based on specific assumptions (see Chapter 3), they provide a sense of the overall effects of the new GFE approach.

- Under one set of assumptions, Chapter 3 estimates that $7.5 billion of the $15 billion in total yield premium payments (YSPs) is not passed through to borrowers to reduce closing costs. If the proposed rule results in half of this $7.5 billion being recaptured by borrowers, then the annual impact would be $3.75 billion. While this figure will vary depending on specific assumptions, it provides a sense of how large the effects of the proposed rule could be on the return of YSPs to borrowers as reduced closing costs.
- Direct origination fees are estimated to be $15 billion (which when added to the $15 billion in YSPs results in total originator compensation of $30 billion). In addition to the $3.75 billion in YSPs recaptured by borrowers, it is also assumed that improved shopping enables borrowers to capture five percent (or $0.75 billion) of originators' direct origination fees of $15 billion.
- Chapter 3 estimates that $18 billion in third-party fees would be subject to increased price pressure as a result of the imposition of tolerances and expanded shopping by originators. While it is difficult to estimate how much tolerances and expanded originator shopping will reduce the $18 billion, this figure provides a base on which this effect will be felt. The estimates reported below assume that third-party fees would fall by 10 percent, or $1.8 billion.
- It was estimated that borrowers would save $6.3 billion in annual settlement

charges.[1] This $6.3 billion represents transfers to borrowers from higher priced producers, with $4.5 billion coming from originators[2] and $1.8 billion from third party settlement service providers. While these figures will vary depending on specific assumptions, it provides a sense of how large the effects of the proposed rule could be on settlement charges to borrowers.

• In addition to the transfers, there are several efficiencies associated with the GFE. Borrowers realize $826 million savings in time spent shopping for loans and third party services. Loan originators save $1.280 billion in time spent with shoppers, in efforts spent seeking out vulnerable borrowers, and from the substitution of more efficient for less efficient originators. Third party settlement service providers save $350 million in time spent with shoppers and from the substitution of more efficient for less efficient third party settlement service providers. Some or all of the $1.280 billion and $350 million in efficiency gains have the potential to be passed through to borrowers through competition.

• Costs to originators rise by $226 million if it takes 10 extra minutes to handle the forms and by $26 to $52 million to make third party arrangements in response to tolerances. (See ''Costs and other Impacts'' below.)

• As discussed throughout this chapter, the benefit, cost, transfer, and efficiency estimates are based on specific assumptions. The estimates provide a sense of the overall net benefits of the proposed new GFE approach to consumers. The rest of this summary highlights the main impacts of the new GFE approach.

C. New Treatment of Wholesale Lender Payments and Impacts on Brokers

An important feature of the new GFE approach is that it addresses the problem of lender payments to mortgage brokers.

• The proposed rule ensures that in brokered transactions, borrowers receive the full benefit of the higher price paid by wholesale lenders for a loan with an above-par interest rate, that is, yield spread premiums will go directly to the borrower. On both the GFE and HUD–1, the portion of any wholesale lender payments that arise because a loan has an above-par interest rate is passed through directly to borrowers as a credit against other costs. Thus, there is assurance that borrowers who take on an above-par loan receive funds to offset their settlement costs.

• Similarly, the proposed rule ensures that in brokered transactions, consumers who choose to pay discount points receive the full market benefit in terms of lower mortgage interest rates.

• Under these new rules, brokers must report the total origination fees they receive on the GFE and the HUD–1—rather than their origination fees *net* of any yield spread premium they receive. Thus, the new GFE clarifies what brokers are receiving for loan origination.

• Most brokers are small businesses. The above changes in the method for reporting wholesale lender payments on the GFE and HUD–1 will reduce the incomes of those brokers who have been overcharging consumers by receiving a combination of origination fees and yield spread premium payments that is greater than that suggested by competitive markets. The new GFE will clearly indicate both (a) the broker's total origination fee received and (b) the net upfront origination fee to the borrower, after reduction for any yield spread premium that the wholesale lender pays the borrower. Consumers will have full information about broker fees, which will allow them to comparison shop and pay lower fees, compared with the situation they face in today's market.

• As explained in the proposed rule, it is not practical to implement such a system for lenders, which means that lenders can continue to report their origination fees on a net basis if they so choose.[3] However, HUD has designed the new GFE form so that it reduces any anti-competitive effects between brokers and lenders. For purposes of comparing lender and broker offers, the new GFE focuses the borrower's attention on the right number, which is the subtotal after reducing total origination fees by any lender payment to the borrower (i.e. yield spread premium). This should reduce any anti-competitive impacts of the proposed rule on small businesses.

• Furthermore, it is anticipated that market competition will increase the likelihood that yield spread premium payments will be passed through to borrowers throughout the market, in lender (i.e., non-broker) as well as broker transactions. The information that consumers gain from broker transactions concerning the money back on premium loans should make consumers act competitively with respect to premiums on similar loans from non-brokers.

• Brokers as a group will remain highly competitive actors in the mortgage market. Chapter II discusses the factors that will continue to keep brokers competitive with other lenders. As noted above, HUD has also designed the GFE to lessen any anti-competitive effects from the different reporting requirements of lenders and brokers on the new GFE. Therefore, there is no evidence to suggest that there would be any major anti-competitive impact on the broker industry as a whole from the new GFE provisions in the proposed rule.

• Rather, the main impact on brokers (both small and large) of the proposed new treatment of payments by wholesale lenders would be on those brokers (as well as other originators) who have been overcharging uninformed consumers, through the combination of high origination fees and yield spread premiums. As noted above, it is anticipated that market competition, under this new GFE approach, will have a similar impact on those lenders (non-brokers) who have been overcharging consumers through a combination of high yield spread premiums and origination costs.

• As noted above, according to some estimates $7.5 billion in YSPs is not passed through to borrowers to reduce closing costs. While this figure will vary depending on specific assumptions, it provides a sense of how large the effects of the proposed rule could be on the return of YSPs to borrowers as reduced closing costs.

D. Lower Settlement Service Prices

In addition to reducing originator fees, the tighter tolerances of the new GFE approach would result in lower prices for third party settlement services. Settlement service providers who are small businesses would be impacted by any reduction in settlement service prices arising from the tighter tolerances on settlement fees.

• The imposition of tolerances on fees will encourage originators to seek discounts and cut settlement service prices. The proposed rule clarifies that loan originators can make arrangements with their third party settlement service providers (appraisers, settlement service agents, etc.) to lower prices for their customers (i.e., borrowers), provided these prices or any fees on the GFE are not ''marked up'' or ''up charged.''

• Section V of Chapter 3 examines the magnitude of third-party fees that would be subject to increased price pressure as a result of the imposition of tolerances and expanded shopping by the originator. As noted above, $18 billion in third party fees would fall into this category. While it is difficult to estimate how much tolerances and expanded originator shopping will reduce the $18 billion, this figure provides a base on which this effect will be felt. The estimates reported above under ''Summary of Estimated Impacts'' assumed that third-party revenues would fall by $1.8 billion, or 10 percent.

• It is estimated that small settlement service providers would account for $1.3 billion of the $1.8 billion decline in third party revenues. But as discussed in Chapter 3, this estimate is subject to variation.

E. Costs and Other Impacts

Chapter 3 identifies several factors might impact the costs of handling the new GFE form. As noted below, many of these factors tend to offset each other with end result being that annual additional costs appear to be small.

• There are some direct costs to originators from complying with the GFE portion of the proposed rule. These do not appear to be very large. While the new GFE format requires less itemization than today's GFE, the HUD–1, with its detailed itemization, remains essentially the same. Originators and closing agents will have to expend some minimal effort in explaining to consumers the cross walk between the new streamlined GFE and the more detailed HUD–1. There is a new page of the GFE showing interest rate

[1] As explained in Section IV.C of Chapter 3, the $6.3 billion represents about 13 percent of the baseline settlement costs, which include origination fees and selected third party costs (appraisal, credit report, tax service and flood certificate and title insurance and settlement agent charges). Survey, pest inspection, and mortgage insurance are not included, as they are not required on all loans. Thus, the $6.3 billion may be a conservative figure. This assumes, of course, that all the other assumptions underlying this scenario are correct.

[2] The $3.75 billion in YSPs recaptured by borrowers plus the $0.75 billion in reduced direct origination fees give $4.5 billion in transfers to borrowers from originators.

[3] This also includes those brokers who have wholesale lines of credit.

alternatives, which should not impose much additional costs, given that most originators do that in some form today. Annual costs to originators rise by $226 million if it takes 10 extra minutes to handle the new GFE form. Chapter 3 also estimates that first-year startup costs could range from $55–$95 million.

• There will be some costs to originators from the need for additional preliminary underwriting in order to generate new GFEs. While this underwriting is already occurring for full applications today, it is expected that some borrowers under the new GFE will get multiple applications and use them to shop. However, it is difficult to estimate how many additional GFEs and preliminary underwritings will result under the new GFE scheme. In addition, as discussed in Chapter 3, the number of applicants going to full underwriting could decline under the proposed rule.

• The imposition of zero and 10 percent tolerances on fees will require lenders to take some actions that will increase their costs. For example, arrangements will have to be made with third party settlement service providers, in order for the originator to come up with estimates that can be delivered within the 10 percent tolerance. As noted above, these are estimated to range from $26 to $52 million.

F. Small Business Impacts—A Summary and Alternatives Considered

Chapter 3 estimates that $3.5 billion of the $6.3 billion in transfers would come from small businesses. The above summary bullets highlight the mechanisms in which this will happen. Improved consumer shopping among originators and more aggressive competition by originators for settlement services will lead to price reductions. Originators (both small and large) and settlement service providers (both small and large) that have been charging high prices will experience reductions in their revenues. Of the $3.5 billion impact on small businesses, it is estimated the $2.2 billion will come from small originators and $1.3 billion, from small settlement service providers.

Market impacts on different types of businesses are discussed throughout Chapter 3, as well as in the summary bullets under C and D above. Chapter 3 also discussed alternative policies that HUD considered when developing the rule. Examples of alternatives that would impact small businesses include:

• One alternative considered was to place the interest rate dependent payment at the bottom of the form rather than directly after the origination charge. This was rejected since an unsophisticated borrower might misinterpret the broker's higher origination charge (relative to a lender who can net the yield spread premium out of the origination charge rather than list it separately as a lender payment to the borrower) as indicating that the broker's loan is more costly.

• The Department considered placing the division of the origination charge into broker and lender portions on the front page of the GFE but rejected that idea since the information was not useful in bottom line comparison shopping. Loans with identical origination charges will now have the same numbers presented in the origination charge whether originated by a broker or lender.

• The Department considered having zero tolerance on both the lender and broker components of the origination charge instead of zero tolerance on the total. Zero tolerance on the components would have given brokers less flexibility in switching lenders, even if the total of the lender and broker fees would remain the same. The method selected makes it easier for brokers to switch lenders, so long as the total origination charge does not rise.

• The Department considered having different statements of the services of the originator. The purpose of this section of the GFE is to alert borrowers to shop in order to protect their interests. Different statements could favor brokers over lenders, or vice versa. The Department adopted the idea that every originator would have to deliver the same message, so that every borrower gets the same warning and no originator is at a disadvantage in delivering the message.

II. Guaranteed Cost Packaging or Packaging

The main benefits, costs, transfers, and market impacts of the guaranteed cost or packaging are outlined below, along with the specific impacts on small businesses. Since most brokers and settlement service providers are small businesses, the main impacts of packaging on these entities are highlighted below in subsection II.F.

A. Overview of Packaging Benefits

First, guaranteed packaging will improve and increase borrower shopping for mortgages. Basically, guaranteed packaging reduces the loan offer to:a settlement package price, an interest rate, an APR, and a PMI premium rate. The package price and the PMI premium has zero tolerance, and the interest rate is guaranteed if locked (otherwise the rate varies with a market index). In addition, the offer is free and, if agreed upon by the borrower, the offer becomes a contract that is enforceable. These are all advantages over today's process of shopping for mortgages. Economic efficiencies result from easier and less time consuming shopping under packaging. Borrowers are better informed, shop better, and reach better deals.

Second, the guaranteed packing approach would remove regulatory barriers that are today preventing market competition from reducing settlement prices. Under current law, a providers' efforts to enter into volume arrangements with settlement service firms may be regarded as illegal and restrictions against mark-ups of third party costs may impede the packaging of services. Under HUD's proposed rule, packagers will be able to enter into cost-reducing, volume-discount arrangements, and competition among packagers will pass these lower costs through to borrowers at mortgage settlement.

B. Summary of Estimated Benefits, Costs, Transfers, and Efficiencies

Chapter 4 presents estimates of the magnitude of the benefits, costs, transfers, and efficiencies associated with packaging. Transfers total $10.3 billion to borrowers, with $6.7 billion coming from originators and $3.6 billion from third party settlement service providers. In addition to these transfers, there are efficiency gains: borrowers realize $1.652 billion in efficiencies from less time spent shopping and loan originators and third party settlement service providers realize $3.410 in efficiency gains, some or all of which have the potential to be passed through to borrowers through competition. These estimates are explained further below. While they are based on specific assumptions (see Chapter 4), they provide a sense of the overall effects of packaging.

While these benefits of packaging are basically similar to the benefits of the new Good Faith Estimate approach discussed in Section I, it is anticipated that packaging will improve shopping and lower settlement costs to an even greater extent than the GFE approach. Above, it was estimated that borrowers could save $6.3 billion in annual settlement costs under the new GFE approach. It is anticipated that a system based on packaging alone would lead to even greater savings for borrowers, as transfers from firms to borrowers will rise by $4 billion for a total of $10.3 billion. Originators contribute $6.7 billion of this and third party settlement service providers, $3.6 billion. This benefit to consumers comes from further reductions in overcharges that competition passes on to borrowers. Under this scenario, the final savings to the borrower would depend on how the market settles down between the two methods of loan origination—the new GFE approach and packaging. If it is half and half, borrower gains are slightly over $8 billion.

In addition to the transfers, there are several efficiencies associated with packaging (see the summary in Section VII in Chapter 4). Borrowers realize $1.652 billion savings in time spent shopping for loans and third party services. Loan originators save $2.710 billion in time spent with shoppers, in efforts spent seeking out vulnerable borrowers, and from the substitution of more efficient for less efficient originators. Third party settlement service providers save $700 million in time spent with shoppers and from the substitution of more efficient for less efficient third party settlement service providers. Some or all of the $2.710 billion and $700 million in efficiency gains have the potential to be passed through to borrowers through competition.

The simplification and other advantages of the new GMPA will lead to lower costs than under the new GFE. It is assumed that costs under the GMPA will be the same as today's GFE. As discussed in Chapter 4, one area of uncertainty about packaging and the new GMPA concerns the index that is used to ensure that changes in the interest (note) rate reflect changes in the market. Until the exact mechanism is selected, it is difficult to determine the effect of the index on packaging.

Concerns have been expressed about the impacts of the packaging approach on small lenders and small service providers. Chapter 4 estimated that small businesses (i.e., small originators and small service providers) would account for $5.9 billion of the $10.3 billion in transfers. The effects on small businesses are discussed below in II.F.

C. Shopping Benefits

Packaging offers numerous shopping advantages for consumers, compared to today's process of shopping for mortgages. Under packaging, borrowers are better informed and better able to comparison shop.

• Guaranteed packaging will improve and increase borrower shopping for mortgages. Basically, guaranteed packaging reduces the loan offer to two numbers (a settlement package price and an interest rate), has zero tolerance on the package price, and guarantees the interest rate if locked (otherwise the rate varies with a market index). In addition, the offer is free and, if agreed upon by the borrower, the offer becomes a contract that is enforceable. These are all advantages over today's process of shopping for mortgages, as well as over the Good Faith Estimate approach outlined in Chapter 3.

• The simplified loan offer under packaging does away with the proliferation of fees, including junk fees that often characterizes today's mortgage offers.

• The packaging agreement eliminates the separate reporting of the premium or discount associated with brokered loans. This is done to facilitate competition and comparison shopping.

• Economic efficiencies result from easier and less time consuming shopping under packaging. Borrowers are better informed, shop better, and reach better deals.

• In this case, the main transfers will be from originators who are charging above market prices to borrowers who are more informed and better able to comparison shop (see the $6.7 billion estimate reported above).

D. Lower Settlement Service Prices

The packaging approach will result in even lower prices for third party settlement services than estimated above for the new GFE approach.

• The Section 8 safe harbor will allow greatest protection to entities within the package from charges of illegal referral fees, kickbacks, and unearned fees. This will free up packagers to pursue lower prices for third party services in their package without concern that the technique used could be a Section 8 violation. Competition is substituted for regulation.

• Thus, packaging will result in lower prices paid for settlement services, as packagers aggressively seek discounts in third-party service prices. A better shopper (the packager) is substituted for the borrower as the searcher for third party settlement services.

• In addition, there are several efficiencies associated with packaging that could lead to lower costs. Under packaging, originators may deal with one packager, rather than a whole array of third party providers and the packager, who specializes in this activity, may be more efficient than the originator.

• Given the likelihood that there will be competition among a number of packagers, the lower third party service prices will be passed through to borrowers as lower costs for closing a loan. In this case, the main transfers will be from settlement service providers to borrowers (see the $3.6 billion estimate reported above).

E. Impact on Business Operations and Market Structure

The proposed RESPA rule offers a dual approach to settlement market problems—(1) a new, simplified GFE combining tolerances on final settlement costs and a new method for reporting wholesale lender payments; and (2) a guaranteed cost approach based on packaging. Consumers and originators can use either approach, which has the advantage of allowing the market determine the best approach under a given set of circumstances. While there are reasons to expect originators to move toward the packaging approach, it is difficult to estimate the share of the market that will ultimately fall under packaging, as well as the timing of the move toward packaging.

• An uncertainty with respect to the implementation of packaging concerns the interest rate index that determines changes in mortgage rates for borrowers who are shopping (before they sign the guaranteed packaging offer) and for borrowers who choose to "float" rather than "lock-in" their interest rate (at the time they sign the offer). Packaging depends on lenders finding an acceptable interest rate index, or some other mechanism for ensuring that any changes in the interest rate reflect overall market changes. As noted below, there will likely be some costs associated with lenders' guaranteeing that interest rates move only with market conditions, depending on the indexing technique chosen.

• As explained in this chapter, packaging could take several forms—for example, originators could develop their own packages or specialized firms could develop packages, or components of packages, which they would then sell them to originators. The section on small business below highlights several additional market impacts of packaging.

F. Compliance and Other Costs

The simplification and other advantages of the new Guaranteed Mortgage Packaging Agreement (GMPA) will lead to lower costs than under the new GFE.

• The GMPA and HUD–1 with packaging will have substantially fewer numbers and less detail than the current GFE and HUD–1. Only six numbers are required on the first page of the Guaranteed Mortgage Packaging Agreement. This will lead to a more efficient origination process since less time will be spent by the originator and the borrower in deciphering the proliferation of fees that now characterizes the GFE and HUD–1.

• Packaging eliminates the reporting of individual fees within the package and in so doing permits, in effect, average cost pricing. This reduces costs because firms do not have to keep up with an itemized, customized cost for each borrower.

• As mentioned above, there could be some additional costs associated with lenders having to use an as yet undetermined index in order to guarantee market interest rates (a) during the time that the consumer is shopping (after the packager has made the offer) and (b) during the time between the offer being accepted and final closing for those borrowers who choose to "float" rather than "lock-in" their interest rate. The proposed rule asks for comments on how the interest rate index could be determined.

• Originators make a free offer that is also guaranteed. This will require additional information gathering and preliminary underwriting to the extent that borrowers seek multiple offers, beyond what they do in today's market. There could also develop some degree of uncertainty and costs associated with originator's making guaranteed offers based on preliminary underwriting, particularly for those borrowers who typically require extensive underwriting. As explained in Chapter 4, however, this would simply result in the originator making a new loan offer or sending their customer elsewhere.

• There will be some costs associated with the arrangements that packagers have to make with third party settlement service providers, in order for the packager to ensure that there would be no change in the pre-arranged third party prices. But as discussed in Chapter 4, other efficiencies resulting from packagers dealing with third party providers are expected to offset these costs.

G. Summary of Small Business Impacts and Alternatives Considered

As noted above, concern has been expressed about the market impacts of packaging, particularly as they relate to small businesses. The main findings regarding the effects of packaging on small businesses are as follows:

• The nature of locally-provided, third party services (such as appraisal, survey, pest inspection, closing agents) could remain the same under packaging—the main change will involve who purchases these services. Packagers will be the new purchasers of these services, and third party service prices will be lower.

• Under packaging, those third party service providers (both large and small) who are currently charging high prices for their settlement services would experience reductions in the prices of their services. To the extent that third party settlement service providers happen to be small businesses, they would, of course, experience a reduction in their revenues. Of the $3.6 billion in price reductions for third party services, the small business share is $2.5 billion.

• It is estimated that small businesses (i.e., small originators and small service providers) would account for $5.9 billion of the $10.3 billion in transfers to consumers noted above—$3.4 billion of this would come from small originators and $2.5 billion would come from small settlement service providers. As in the case with the new GFE approach, firms suffering losers under packaging are originators and third party providers who are currently charging high prices for their services.

• Still, there is no strong reason to expect that locally-based small businesses could not continue providing third party settlement services under packaging, albeit at possibly lower prices and revenues, as noted above. Services that are local in nature (such as appraisals) will continue to be demanded under the packaging approach. Services that are national in nature and characterized by economies of scale (such as credit reporting) are already being conducted by larger firms on a national scale.

• There has also been a concern that small lenders would be placed at a disadvantage under packaging because of the ''bulk'' buying power of large lenders. While this may be the case, it does not have to be. First, there is no evidence of this effect today where large lenders can purchase services such as appraisals on a ''bulk'' basis. Second, if specialized packaging firms develop, it seems reasonable to expect them to offer their packages to small lenders as well as large lenders. It is difficult to reach firm conclusions about the magnitude of the impact on small lenders.

• Brokers, most of whom are small businesses, could pursue a number of avenues under packaging. They could develop their own package, purchase one from specialized firms, or use the package offered by the wholesale lender they are dealing with. Under packaging, brokers will continue their main function of reaching the consumer, just as they do today. This customer outreach function is not going to go away with packaging.

• Furthermore, Chapter 2 of this Economic Analysis reports that technology improvements and other recent changes in the mortgage market have probably increased the competitive position of brokers relative to other originators. These underlying strengths of brokers are also not going to disappear with packaging.

Chapter 4 discusses alternative policies that were considered with respect to packaging. The Department considered writing this proposed rule as if only lenders could package. This idea was rejected in favor of allowing anyone to package so long as the package contains a loan. This further affords smaller firms the opportunity to offer their services and benefit from a packaging environment.

Under packaging, there is no separate treatment of yield spread premiums or discounts and no special rules for brokers. Thus, all originators present their loans the same way and all the market's competitive forces are applied to everything in the package regardless of the type of originator. No broker, or any other kind of originator for that matter, is at a competitive disadvantage.

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