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## WHEN IS A LOAN SALE A TABLE-FUNDED TRANSACTION SUBJECT TO RESPA? U.S. DISTRICT COURT IN CALIFORNIA CASTS DOUBT ON ROUTINE TRANSACTIONS

Section 3500.5(b)(7) of Regulation X states that a bona fide transfer of a loan obligation in the secondary market is not covered by the Real Estate Settlement Procedures Act (RESPA). That section goes on to state that "in determining what constitutes a bona fide transfer, HUD will consider the real source of funding and the real interest of the funding lender."

Mortgage bankers that do not have their own internal source of financing for mortgage loans typically obtain financing from warehouse lenders. The mortgage banker will use loan proceeds from the warehouse lender to fund mortgage loans, and will promptly sell the mortgage loan to an investor, using the proceeds of the sale to the investor to repay the warehouse lender. The warehouse lender, in order to assure repayment by the mortgage banker, often requires the mortgage banker to have a commitment from an investor to purchase funded mortgage loans before the warehouse lender will agree to finance the mortgage banker's mortgage loans. The mortgage loan itself is subject to RESPA, of course, but the mortgage banker and the investor treat the sale of a mortgage loan by the mortgage banker to the investor as a secondary market transaction, which is thereby not subject to RESPA.

A recent decision by the United States District Court for the Eastern District of California has thrown this approach into doubt. In *Brewer v. Indymac Bank*, 2009 Westlaw 700423 (E.D. Cal), the plaintiffs obtained two mortgage loans from Residential Mortgage Capital (RMC), which "quickly" (the court's terminology, without stating an exact date of sale) sold the loan to Indymac Bank. The loan was brokered to RMC by Dan Brown Mortgage. Nearly three years after the loan was funded, the plaintiffs alleged that RMC devised a scheme with Indymac whereby RMC transferred plaintiffs' mortgage loans to Indymac and received a "secret profit" in the form of a yield spread premium which RMC failed to disclose to the plaintiffs in violation of RESPA, that RMC was the plaintiffs' mortgage broker and thereby owed a fiduciary duty to the plaintiffs which it breached, and that RMC attempted to secure holder in due course status by disguising the table funded transaction as a secondary market transaction designed to circumvent the application of RESPA to the transaction. RMC and Indymac filed a motion for summary judgment, seeking to dismiss the plaintiffs' claims.

The court refused to dismiss the plaintiffs' RESPA-based claims, stating that the plaintiffs' claims were

sufficient to withstand a summary judgment motion. The trial court will now decide whether the plaintiffs' claims have any merit.

Based on the description of the facts provided by the court, we believe that Dan Brown Mortgage brokered the loans to RMC. RMC funded the loans, having no intention of functioning as a mortgage broker. RMC then "quickly" sold the loans to Indymac (perhaps pursuant to a commitment to purchase the loans that was in place before the loans were funded), which paid a premium for the loans, a not uncommon occurrence in secondary market transactions. Since the parties viewed this transaction as a run of the mill secondary market transaction, RMC did not disclose its profit to the plaintiffs, who will attempt to convince the court that they have correctly recharacterized the arrangement as a brokered table funding transaction in which Indymac, not RMC, was the true lender.

If the trial court accepts the plaintiffs' description of the transactions here, the ramifications for the secondary market could be enormous. First, the court may have to determine how "quickly" a sale needs to occur after a mortgage loan has funded in order to constitute a table-funded transaction. One day? Two days? A week? Two weeks? Second, and even more significantly, if the court holds that a pre-closing commitment to sell the loan results in the transaction being table funded, it will expose investors to a level of liability that they have not contemplated, and potentially cause havoc in the secondary market.

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