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Under the microscope: RESPA closing cost disclosures yesterday, today, and tomorrow

*By Jonathan W. Cannon**

More than three decades have passed since enactment of the Real Estate Settlement Procedures Act, 12 USC §§ 2601-2617, a law intended to reduce homebuyer confusion about settlement costs and prevent abusive settlement practices. Skyrocketing growth and innovation in the home mortgage industry have occurred simultaneously with constant tinkering of RESPA disclosure requirements, yet the disclosures are still unsatisfactory in the view of many.

Now, with Dodd-Frank implementation on the horizon, RESPA disclosures will be under the microscope as policymakers attempt to combine RESPA and Truth in Lending Act disclosures into a single unified whole. Enacted in 1974, RESPA was initially intended to address:

- Abusive and unreasonable real estate settlement processes that increased costs to homebuyers.
- Homebuyers' lack of understanding about the settlement process and its costs.
- Complexities and inefficiencies in the public land title recording system.

How effective has RESPA been in addressing these matters? Part of the answer came in a substantial revamp of RESPA disclosures in 2008, in which the Department of Housing and Urban Development said its goals were:

- Protecting consumers from "unnecessarily high settlement costs" by improving disclosures to facilitate comparison shopping for mortgage loans.
- Ensuring borrower awareness of final settlement cost.
- Limiting bait-and-switch schemes that result in settlement costs higher than on the "Good Faith Estimate."

RESPA's laudable goal — to provide clear disclosures that satisfy consumer interest groups, the mortgage and settlement services industry, and the regulatory community — has proven elusive. Now comes the Dodd-Frank Act, requiring a complete reworking of RESPA-required disclosures to incorporate disclosures required under TILA.

The evolution of RESPA

A RESPA retrospective provides better understanding of the current state of disclosure requirements. Congress enacted the Emergency Home Finance Act of 1970, which authorized the Administrator of Veterans Affairs and the HUD secretary to limit costs in VA and FHA transactions. These limits were never implemented, however, and a different approach to home-finance regulation ensued.

In 1974, Sen. William Proxmire proposed S. 3232, which would have instituted a program of "lender-pay," in which lenders would pay all settlement costs. The idea was that competition would lead lenders to reduce settlement costs. No action was taken on this bill, but Congress continued its focus on the settlement service industry with another bill that eventually became RESPA. Its original provisions included the elimination of kickbacks, fee splitting, and referral fees; the required disclosure of settlement costs prior to closing; and improved methods of recording. RESPA was enacted Dec. 22, 1974, and became effective June 20, 1975.

However, the potential changes to real estate recording systems never happened. Moreover, the new legislation pleased no one. Criticism by real estate professionals, lenders, settlement agents, and consumers suggested that RESPA created costly red tape without affording any substantial protections. Almost immediately, Congress began considering revisions to the new law.

Only the beginning

The first RESPA amendment came on Jan. 2, 1976, which eliminated requirements for delivery of disclosures 12 days before settlement and for sellers to disclose the prior sales prices of properties sold within the previous two years. The amendments allowed HUD to adopt a more flexible settlement statement, which was required to be delivered only one day before settlement.

RESPA was again amended in 1983, this time to explicitly permit affiliated business arrangements among commonly owned entities offering settlement services, if certain disclosure and financial requirements were satisfied. The title insurance industry was its principal proponent. Thereafter, HUD began writing regulations applicable to affiliated business arrangements, but did not produce a rule until 1992. The final rule permitted compensation for referrals among affiliates, and permitted packaging of settlement services. Further regulations were issued as a proposed rule in 1994 and as a final rule in 1996.

Congress expressed its displeasure by inserting language in that year's HUD appropriation bill that said, "HUD has been interpreting RESPA in a manner that may stifle competition and the development of innovative services in the settlement services industry." The bill earned a presidential veto for other reasons, and Congress voted to delay the effective date of some parts of the rule from 1996 to 1997, and directed HUD and the Federal Reserve Board to streamline RESPA disclosures. In response to these objections, HUD decided not to implement its 1996 rule.

An attempt to fix RESPA's disclosure problems resurfaced several years later when HUD published a proposed

(See **DISCLOSURES** on page 4)

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DISCLOSURES (continued from page 3)

rule in the *Federal Register* on July 29, 2002. It included both a safe harbor from Section 8 anti-kickback liability for settlement service providers offering specified "guaranteed mortgage packages" and a requirement that closing costs estimates on GFE disclosures be exact.

HUD eventually sent a draft final rule for Office of Management and Budget review, but abandoned it in March 2004 because settlement service providers and consumer advocates strongly disagreed both with HUD and one another as to the best approach for RESPA reform.

On March 14, 2008, HUD issued another proposed rule seeking to improve the advanced disclosure of settlement costs. It contained the following provisions:

- Creation of a GFE form to facilitate comparison between the GFE and the HUD-1 closing statement.
- No distinct identification of yield spread premiums in the GFE. Instead, YSPs would be included on the GFE in the origination charge.
- At settlement, a requirement that borrowers be read and provided a copy of a "closing script" explaining final loan terms and settlement costs.
- A clarification explaining when RESPA permits pricing mechanisms, such as volume discounts and average cost pricing, that benefit consumers.
- Amendment of the definition of "required use" to include incentives for the use of a particular service provider (*i.e.*, builder or home seller discounts for the use of an affiliated lender).
- Updated escrow account requirements and mortgage servicing transfer provisions.

This proposal provoked substantial comments. On November 17, 2008, HUD finally issued a final rule which resembled the March 2008 proposal, although without the oral closing script. HUD's rule completely revamped the GFE and HUD-1 Settlement Statements, requiring loan originators to start using them by Jan. 1, 2010.

These revised rules and forms brought about significant changes by:

- Further facilitating comparison between the GFE and the HUD closing statements.
- Limiting charges for delivery of the GFE, limiting additional documents that may be required in connection with the delivery of a GFE, and requiring the customer's affirmation before fees may be charged in the transaction.
- Requiring YSPs be included in the "origination charge" on the GFE, and treating lender payments to mortgage brokers as a credit toward settlement charges.
- Requiring delivery of a list of available settlement service providers when the loan originator allows the consumer to shop for settlement service providers.
- Allowing most fees disclosed on the GFE to increase only when changed circumstances warranted the increase, or when the change results from a borrower request.
- Clarifying that RESPA disclosures may be provided electronically to consumers who consent to receive electronic disclosures, if ESIGN Act requirements are met. (The final rule also permits electronic document retention.)

Deluged with requests for additional guidance as a result of these changes, HUD issued the first version of its informal guidance in the form of RESPA frequently asked questions on Aug. 13, 2009. Within a year, HUD issued 13 versions of its FAQs, with more than three hundred questions and answers. On Nov. 13, 2009, in response to concerns about implementation of the revised forms and rules, HUD announced a 120-day period of "restrained enforcement" for FHA-approved originators who demonstrated "good faith effort" to implement the changes.

HUD stopped issuing FAQs on April 2, 2010, and started issuing informal RESPA guidance through the newly launched *RESPA Roundup* newsletter. To date, two volumes of the newsletter have been published, in July and September 2010. Barton Shapiro, director of HUD's RESPA Office, and Mary Jo Sullivan, deputy director, are identified in the publication as the contact points for RESPA information (or e-mail hsg-respa@hud.gov).

Enter Dodd-Frank

When the Dodd-Frank Act was signed into law on July 21, 2010, a new independent Bureau of Consumer Financial Protection was created, to be housed within the Federal Reserve System. The CFPB is the agency to watch where RESPA reform is concerned, because it will assume all of the consumer protection obligations of HUD under RESPA.

More specifically, the CFPB is required to implement a combined RESPA and TILA disclosure document within one year of July 21, 2011. Considering RESPA's history on rulemaking and disclosure design, this will prove no easy undertaking.

Dodd-Frank has other implications for RESPA's future as well. Enforcement activity may increase as a result of Dodd-Frank's authorization of state attorneys general to bring civil actions to enforce RESPA. If state attorneys general prove to be a sympathetic (and available) audience for consumer complaints about inaccurate or misleading settlement disclosures, enforcement activity could skyrocket.

Current AG solidarity, as demonstrated by the recent foreclosure "robo-signing" investigation by 50 state AGs, suggests unconcealed impatience with the continued housing crisis and a willingness to challenge lending-industry practices. RESPA enforcement efforts, if scattered throughout the states, will increase unpredictability and compliance costs for lenders, who may eventually face inconsistent precedents on similar issues.

Finally, the lending industry will face increased monetary penalties for RESPA violations. Dodd-Frank increases penalties under Section 6 of RESPA, allowing individual awards of up to $2,000 (up from $1,000) and class action awards up to $1,000,000 (up from $500,000).

It is too early to predict what the new RESPA/TILA disclosures will look like, or how the CFPB will exercise its consumer protection power where RESPA is concerned. What *is* predictable now is that a new era of RESPA compliance focus is dawning, violations are more likely to be challenged, and costs of non-compliance are increasing. ❑

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