CONSUMER PROTECTION IN ALABAMA

Real Estate Settlement Procedures Act (RESPA)

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David R. Donaldson
Donaldson & Guin, LLC
505 North 20th Street
Suite 1000
Birmingham, Alabama 35203

(205) 226-2282
DavidD@dglawfirm.com

REAL ESTATE SETTLEMENT PROCEDURES ACT
(RESPA)

HISTORY OF RESPA

In 1932, the federal government established the Federal Home Loan Banks ("FHL Banks") to provide a stable supply of low-cost funds to American financial institutions for home mortgage loans. The FHL Banks and other government-sponsored enterprises, the Federal National Mortgage Association (Fannie Mae) (est. 1938), the Government National Mortgage Association (Ginnie Mae) (est. 1968) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (est. 1970), provide funds to residential mortgage lenders for long-term mortgage loans so that ordinary citizens have an opportunity to gain full ownership of their homes. The FHL Banks introduced 15-year (and later 30-year) 80% loan-to-value mortgages that supplanted the 3, 5, and 7-year balloon loans that had previously been used to finance home purchases. As a result, savings and loan associations sprung up all across the United States and home ownership rates soared.

RESPA was enacted in response to Congressional concerns that consumers were being overcharged for services related to mortgage loan closings (a/k/a "settlements"). 12 U.S.C. § 2601(a). In 1970, Congress directed the Secretary of Housing and Urban Development (HUD) and the Administrator of Veteran's Affairs (VA) to undertake a joint study and make recommendations to Congress regarding proposals to reduce and standardize borrowers' settlement costs. The joint HUD/VA Report issued in 1972 found that there was no price competition for most settlement services and that settlement charges were inflated by a widespread and elaborate system of kickbacks and referral

fees. SENATE REPORT NO. 93-866 (1974).[1] Most borrowers did not shop for settlement service providers.[2] Instead, borrowers were referred to lenders, title insurance companies and other settlement service providers by real estate brokers, closing lawyers and other professionals who had no economic incentives to minimize costs, a phenomenon described as "reverse competition." Barron, FEDERAL REGULATION OF REAL ESTATE AND MORTGAGE LENDING, ¶2.04 at 2-25 (3d ed. 1992).

The HUD/VA Report recommended that Congress grant HUD and the VA the power to proscribe maximum allowable settlement charges and to require the use of uniform settlement statements. 1974 U.S. Code Cong. Admin. News 6546. The real estate industry bitterly opposed the HUD/VA proposals. In lieu of price controls, Congress opted for a statute designed to provide for more "advance disclosure to home buyers and sellers of settlement costs" and the elimination of "kickbacks or referral fees." *See* 12 U.S.C. § 2601(b)(1) and (2). RESPA was also intended to reduce the amounts homebuyers were required to place in escrow accounts and to reform and modernize local recordkeeping of land title information. 12 U.S.C. § 2601(b)(3) and (4).

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[1] For example, a survey in the Washington, D.C. area found that title insurance companies routinely paid referral fees to lawyers that accounted for 27% of every dollar paid by consumers for title insurance.

[2] A 1980 report prepared for HUD by Peat Marwick found that two-thirds of home buyers did no "shopping" at all for a lender and that more than 80% failed to compare prices for settlement services. *See* Vol. 59, No. 139 Fed. Reg. at 37363, n. 3.

APPLICABILITY OF RESPA: "FEDERALLY RELATED" MORTGAGE LOANS

RESPA applies to "federally related" mortgage loans that are secured by a lien on residential real estate designated principally for the occupancy of from one to four families. The term "federally related" refers to loans made by any lender whose deposits or accounts are insured by any agency of the federal government, loans that are intended to be sold to any of the GSEs, and loans made by any creditor who makes or invests in residential real estate loans aggregating more than $1,000,000 per year.

RESPA applies to purchase money mortgages, refinancings, property improvement loans, lines of credit, first mortgages and subordinate liens. 12 U.S.C. § 2602(1)(A). Excluded from the applicability of RESPA are: temporary financing such as construction loans (12 U.S.C. § 2602(1)), loans made by governmental entities (12 U.S.C. §§ 2602(1) and 2606(a)), and loans that are primarily for business, commercial, or agricultural purposes. 12 U.S.C. § 2606(a). HUD is responsible for enforcing RESPA. 12 U.S.C. § 2602(1)(A).

I. DISCLOSURES.

A. Special Information Booklets.

Section 5 of RESPA, 12 U.S.C. § 2604(a), directs HUD to prepare and distribute booklets to help borrowers understand "the nature and costs of real estate settlement services." It requires HUD to distribute the booklets to all lenders which make federally related mortgage loans. The booklet must contain a description and explanation of each

settlement cost, a sample HUD-1, an explanation of the operation of escrow accounts, an explanation of the choices available to buyers of residential real estate in selecting persons to provide necessary services incident to a real estate settlement, and an explanation of the unfair practices and unreasonable or unnecessary charges to be avoided by the prospective buyer with respect to a real estate settlement. *See* Reg. X § 3500.6. Lenders are required to give a copy of the booklet to each applicant who applies for a purchase money mortgage within three days after the lender receives the application, unless the lender declines the application within the three-day period. There is no express private cause of action for violations of section 5 of RESPA, however.

B. The Good Faith Estimate.

Section 5 of RESPA, 12 U.S.C. § 2604(c), also requires lenders to provide borrowers with a Good Faith Estimate (GFE) of settlement costs, listing all charges that the buyer is likely to pay at settlement. Reg. X § 3500.7. If a lender requires the borrower to use a particular settlement provider, the lender is also supposed to disclose this requirement on the GFE. There is no express cause of action for failing to include a charge on a GFE, and courts have refused to imply a cause of action. *See Collins v. FMHA-USDA*, 105 F.3d 1366, 1367-68 (11th Cir.1997); *Cohen v. J.P. Morgan Chase & Co.*, 2006 WL 20596 (E.D.N.Y. Jan. 4, 2006).

C. Servicing Disclosure Statement.

Section 6 of RESPA requires lenders to provide a Mortgage Servicing Disclosure Statement, which discloses to the borrowers whether the servicing of the loan may be

assigned, sold, or transferred while the loan is outstanding. 12 U.S.C. § 2605(a). Although the statute states that the disclosure must be made "at the time of application," HUD's regulations (Regulation X) allows lenders to mail the documents within three business days of receiving the loan application. *See* 24 C.F.R. § 3500.21(b). Regulation X also requires lenders to disclose the approximate percentages (rounded to the nearest quartile (25%)) of mortgage servicing loans originated by the lender in each of the past three calendar years for which servicing has been assigned, sold, or transferred. Lenders who do not service loans have the option of simply informing borrowers that they have not serviced any mortgage loans during the last three years. *See* 24 C.F.R. § 3500.21(b)(3). Unlike Section 5, Section 6 of RESPA does contain an express private cause of action. (*See* discussion of Qualified Written Requests below at pages 11-15.)

D. Affiliated Business Arrangements.

Whenever a settlement services provider refers a borrower to a settlement service provider with whom the referring party has an ownership or other beneficial interest, the referrer must provide an Affiliated Business Arrangement (AfBA) Disclosure. *See* 24 C.F.R. § 3500.15. The disclosure must describe the business arrangement that exists between the two providers and give the borrower an estimate of the second provider's charges. Except in cases where a lender refers a borrower to an attorney, credit reporting agency or real estate appraiser to represent the lender's interest in the transaction, RESPA prohibits the referring party from requiring the consumer to use the particular provider to whom the consumer is being referred.

E. Settlement Statements (HUD-1s).

Section 4 of RESPA, 12 U.S.C. § 2603, requires HUD to develop and proscribe a uniform settlement statement designed to show the actual settlement costs of the loan transaction. 24 C.F.R. § 3500.8. The HUD-1 Settlement Statement is a standard form designed to show all charges imposed on borrowers and sellers in connection with the settlement. Borrowers are entitled to request a copy of the HUD-1 one day before closing. The settlement agent must provide borrowers with a completed HUD-1 Settlement Statement based on information known to the agent at that time.

Despite the absence of a private cause of action for violating the GFE, HUD-1 and other disclosure provisions of RESPA, the disclosure provisions of RESPA are important. Many lenders are affiliated with banks or other institutions that are subject to periodic examinations by federal examiners who check for RESPA compliance. The RESPA disclosures may constitute representations for common law fraud claims or deceptive trade practices claims.[3] A failure to provide the documents may constitute some sort of omission claim. At a minimum, the HUD-1 and GFE provide a great deal of evidence about the transaction.

[3] In *Cohen v. J.P. Morgan Chase & Co.*, 2006 WL 20596 (E.D.N.Y. Jan. 4, 2006), the plaintiff argued that he should be allowed to base a claim under the NY deceptive trade practices act. The court rejected that argument on the grounds that the fee was disclosed on the HUD-1.

II. ADMINISTRATION OF ESCROW ACCOUNTS.

A. Escrow Account Limitations.

Section 10 of RESPA sets limits on the amounts that a lender may require a borrower to pay into escrow for paying taxes and property insurance premiums. 12 U.S.C. § 2609. Lenders are prohibited from charging more than 1/12 of the total of all annual escrow disbursements, plus a "cushion" of 1/6 of the total disbursements for the year. Lenders must perform a yearly escrow account analysis, notify borrowers of any shortage and refund any excess of $50 or more.

B. Initial and Annual Escrow Statements.

Section 10 of RESPA, 12 U.S.C. § 2609, also requires that any servicer[4] that establishes an escrow account must provide an Initial Escrow Statement itemizing the estimated taxes, insurance premiums and other charges anticipated to be paid from the Escrow Account during the first twelve months of the loan and any required cushion. 12 U.S.C. § 2609(c)(1). The Initial Escrow Statement is supposed to be provided within 45 days after the closing. Section 10 of RESPA also requires that loan servicers provide an Annual Escrow Statement summarizing all escrow account deposits and payments during the prior year. 12 U.S.C. § 2609(c)(2). The annual Escrow Statement also notifies the borrower of any shortages or surpluses in the account and advises the borrower about the course of action being taken.

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[4] As used in 12 U.S.C. § 2605, "servicer" means "the person responsible for servicing of a loan" and "servicing" means "receiving any scheduled periodic payments from a borrower pursuant to the terms of any loan." Id. at 2605(i)(2)-(3).

RESPA authorizes HUD to impose penalties for violating Section 10 of RESPA. 12 U.S.C. § 2609(d). There is no express private cause of action for Section 10 violations, however. The Eleventh, Fifth and Seventh Circuits have refused to imply a private cause of action. *See Hardy v. Regions Mortgage, Inc.*, 449 F.3d 1357 (11th Cir. 2006); *State of La. v. Litton Mortgage Co.*, 50 F.3d 1298, 1301-02 (5th Cir. 1995); *Allison v. Liberty Sav. & Loan Ass'n of Detroit*, 695 F.2d 1086, 1091 (7th Cir. 1982) *Birkholm v. Washington Mutual,* 2006 WL 2104296 (W.D. Wash. July 26, 2006). The Sixth Circuit has held that Congress intended to create a private cause of action for violation of Section 2609. *See Vega v. First Federal Sav. & Loan Assoc.*, 622 F.2d 918, 925, n. 8 (6th Cir. 1980).

Although RESPA does not provide a cause of action for Section 10 violations, many mortgages incorporate by reference RESPA's escrow account provisions. Therefore, if a servicer attempts to collect more than allowed by Reg. X, there may be a breach of contract action that can be brought. With regard to disclosures, although a borrower cannot sue for failing to make the initial or annual escrow account disclosures, RESPA gives borrowers the right to make Qualified Written Requests (QWRs) for information and to sue for failure to provide information in response to a QWR. *See* discussion of QWRs below at 11-15.

C. Timely Payments.

Section 6 of RESPA, 12 U.S.C. § 2605(g), mandates that lenders who set up escrow accounts must make timely payments from the accounts as the payments come

due. As discussed below in connection with the servicing transfer and QWR provisions of RESPA (pp. 11-15), RESPA provides an express cause of action for Section 6 violations. For example, in *Hyderi v. Washington Mutual Bank, F.A.*, 235 F.R.D. 390 (N.D. Ill. 2006), the plaintiff claimed that WaMu failed to make the plaintiff's insurance payment and then forced-placed higher-cost insurance.

Section 6 also provides that whenever servicing rights are transferred, the servicer who transfers the servicing rights must send a Servicing Transfer Statement at least fifteen (15) days prior to the effective date of the transfer showing the name and address of the new servicer, toll-free telephone numbers, and the date the new servicer will begin accepting payments. 12 U.S.C. § 2605(c)(2). *See Salomon Brothers Realty Corp. v. Bourgeois*, 2006 WL 2116591 (E.D. La. July 27, 2006). Borrowers cannot be penalized for payments made to the old servicer within sixty (60) days of the loan transfer. 12 U.S.C. § 2605(e).

III. QUALIFIED WRITTEN REQUESTS.

Section 6(e) of RESPA, 12 U.S.C. 2605(e), imposes requirements on a loan servicer whenever it receives a "qualified written request" (QWR) from the borrower (or the borrower's agent). A QWR must be in writing on something other than a payment coupon or other payment medium supplied by the servicer. It must include the name and account number of the borrower. It must either state the reasons why the borrower believes that the account is in error, or it must set out in sufficient detail the request for

other information sought by the borrower. 12 U.S.C. § 2605(e)(1)(B). A QWR pertaining to a servicing transfer must be delivered within one year after the transfer. 24 C.F.R. § 3500.21(e)(2)(ii). A QWR pertaining to other loan servicing issues must be received within a year after the loan was paid in full. *Id.*

Although the statute is silent as to where and how the QWR should be sent, prudence dictates that it be sent by Certified or Registered mail so that the borrower can prove the QWR was received. Preferably, it should be addressed to whatever address is established by the servicer for similar customer correspondence. In *Griffin v. Citifinancial Mortgage*, 2006 WL 266106 (M.D. Pa. Feb. 1, 2006), the court dismissed the plaintiff's § 6 claim because the borrower's lawyer sent the QWR to the lender's bankruptcy counsel.

The servicer must acknowledge receipt of the QWR within twenty (20) days, unless the servicer takes the action requested by the QWR prior to the expiration of the 20-day period. 12 U.S.C. § 2605(e)(1)(A). Within sixty (60) days of receiving a QWR, the servicer must conduct an investigation and respond to the borrower in one of three ways: (1) by making appropriate corrections to the borrower's account (such as crediting erroneous late charges or penalties) and transmitting to the borrower a written notification of such correction; (2) by providing the borrower with a written explanation of the reasons why the servicer believes that the borrower's account is correct; or (3) by providing a written explanation that either includes information requested by the borrower or an explanation of why the requested information is unavailable or cannot be

obtained by the servicer. *See Collier v. Wells Fargo,* 2006 WL 1464170 (N.D. Tx. May 26, 2006). The response to the QWR must contain the name and telephone number of an individual employed by, or the office or department of, the servicer who can provide assistance to the borrower. 12 U.S.C. § 2605(e)(1)(B)(2). During the sixty (60) day period following the servicer's receipt of a QWR relating to a dispute regarding the borrower's payments, the servicer is prohibited from providing adverse information regarding the disputed payment(s) to any Consumer Reporting Agency.

Section 6 of RESPA contains an express private cause of action. 12 U.S.C. § 2605(f). Individual plaintiffs who prevail are entitled to actual damages plus statutory damages of up to $1,000 in cases where there is a pattern or practice of noncompliance. 12 U.S.C. § 2605(f)(1). In class actions, lenders are liable for an amount equal to actual damages to each class member plus statutory damages of up to $1,000 for each class member in the case of a pattern or practice of noncompliance. Statutory damages in class actions are capped at the lesser of $500,000 or 1% of the defendant's net worth. 12 U.S.C. § 2605(f)(2). Successful plaintiffs are also entitled to an award of attorneys' fees and costs. 12 U.S.C. § 2605(f)(3).

A defendant can avoid liability if, within sixty (60) days after discovering a violation and before the commencement of an action and the receipt of written notice of the error from the borrower, the servicer notifies the person concerned of the error and makes whatever adjustments are necessary to the appropriate account to ensure that the borrower will not be required to pay an amount in excess of any amount that the person

otherwise would have paid. 12 U.S.C. § 2605(f)(4).

Loan servicing problems are very common and courts are generally receptive to QWR claims by borrowers whose accounts have been messed up through no fault of their own. *See, e.g., Holland v. GMAC Mortgage Corp.*, 2006 WL 1133224 (D. Kan. April 26, 2006); *Hutchinson v. Delaware Savings Bank*, 410 F. Supp. 2d 374 (D.N.J. 2006) and *Rawlings v. Dovenmuehle Mortgage, Inc.*, 64 F. Supp. 2d 1156, 1166-67 (M.D. Ala. 1999). In *Holland,* the plaintiff's initial mortgage payment was credited to the wrong account. It took the plaintiff nearly two years of phone calls and letters before the servicer finally straightened out the account. In the meantime, the servicer wrongfully imposed late fees, reported the borrower to the CRAs as being delinquent and so forth. The trial court granted a summary judgment for the plaintiff on his RESPA, Section 6 claim and allowed his state law claim for punitive damages to go to the jury. In a similar case before Ira DeMent, *Rawlings v. Dovenmuehle Mortgage, Inc.,* 64 F. Supp. 2d 1156, 1166-67 (M.D. Ala. 1999), Judge DeMent ruled that "actual damages" provided by Section 6 of RESPA include damages for mental anguish. *See also Johnstone v. Bank of America*, 173 F. Supp. 2d 809, 814-16 (N.D. Ill. 2001) (actual damages may include emotional distress); *Ploog v. HomeSide Lending, Inc.*, 209 F. Supp. 2d 863, 870 (N.D. Ill. 2002) (following *Johnstone*).

Other courts, however, have not allowed mental anguish damages. *Katz v. Dime Savings Bank, FSB*, 992 F. Supp. 250, 255-56 (W.D.N.Y. 1997) (concluding that Congress did not intend actual damages to encompass emotional distress); *In re*

Tomasevic, 273 B.R. 682, 687 (M.D. Fla. 2002) ("actual damages are limited to economic pecuniary injury") (following *Katz*).

Courts have been less receptive to QWR cases involving payoff statements and fax fee charges. In *Watt v. GMAC Mortgage Corp.*, 2006 WL 2192661 (8th Cir. Aug. 4, 2006), the Eight Circuit ruled that the lender did not violate the QWR requirements of Section 6 by charging a $20 payoff statement fee. *See also Curran v. Washington Mutual Bank*, 2006 WL 516846 (W.D. Ark. Mar. 2, 2006) ($60 fee to prepare payoff statement plus a $10 fee did not violate the QWR); *Smith v. Chase Manhattan Mortgage*, 2006 WL 353975 (W.D. Ark. Feb. 16, 2006). While these cases do contain language suggesting that servicers are entitled to be paid for responding to QWRs, it should be noted that all of these decisions arose from pay-off requests in which the borrowers agreed to pay for pay-offs delivered in a much shorter time frame than the sixty (60) days allowed by the statute. I am not aware of any cases in which courts have ruled that a servicer can withhold its 60-day response on the grounds that it is entitled to be paid.

IV. RESPA's KICKBACK AND REFERRAL FEE PROHIBITIONS.

Section 8 of RESPA, 12 U.S.C. § 2607, entitled "prohibition on kickbacks and unearned fees" states in relevant part:

> (a) Business referrals
>
> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

(b) Splitting charges

> No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.

Section 8(c) sets out various examples of payments that do not violate § 8(a) or 8(b), including payments for "bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed ." 12 U.S.C. § 2607(c)(1)(C), § 2607(c)(2) and § 2607(c)(4). Section 8(d) provides for a private cause of action with treble damages and attorneys' fees. 12 U.S.C. § 2607(d). The statute also provides for criminal prosecution.

A. <u>Yield Spread Premiums</u>.

When RESPA was originally enacted (1974), the residential mortgage industry was dominated by savings and loan associations and mortgage bankers who processed loan applications prepared by their own employees. *See* 64 Fed. Reg. 10080. In the wake of the S&L crisis of the 1980s, many lenders discovered that they could save the fixed costs of branch offices and loan officers by outsourcing loan originations to independent mortgage brokers. Loan officers learned that by becoming independent contractors they could make far more money than they were paid as a lender's employee. Thus, the so-called "wholesale" mortgage industry was born.

Today there are about 20,000 mortgage brokers who originate about two-thirds of all residential mortgage loans. A mortgage brokerage is a potentially-lucrative business with few barriers to entry. The primary prerequisites for obtaining a mortgage brokerage

license in Alabama are a $25,000 net worth requirement and the absence of any felony convictions. *See* Ala. Code §§ 5-25-5 and 5-25-6. The mortgage brokerage industry represents a wide swath of American entrepreneurship. The industry includes everything from large, well capitalized and professional organizations to one-person operations consisting of a broker with a magnetic car-door sign and a cell phone who takes loan applications on borrowers' kitchen tables. Mortgage brokers recruit prospective borrowers, prepare loan applications, compile the necessary documentation, and submit loan application packages to lenders. Lenders underwrite the loans and provide the funds to close, a practice known as "table-funding." *See* Reg. X § 3500.2.

The lowest interest rate that a lender is willing to accept for a given loan without requiring the borrower to pay "discount points" is referred to as the "par" rate. When a borrower originates a "below-par" loan, the borrower must pay "discount points" in order to obtain the lower interest rate. If, however, a borrower agrees to accept an "above-par" rate, the lender pays the broker a "yield spread premium" that is based on the present value of the additional future income that is expected from the "above-par" interest rate. *See* "Yield Spread Premiums: A Powerful Incentive for Equity Theft published by the Center for Responsible Lending." http://www.responsiblelending.org/pdfs/ib011-YSP_Equity_Theft-0604.pdf; Howell E. Jackson and Jeremy Berry: "Kickbacks or Compensation: The Case of Yield Spread Premiums," Harvard Law School, http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf.

One of the first cases to challenge the legality of YSPs was *Culpepper v. Inland*

Mortgage Company, 953 F.Supp. 367 (N.D. Ala. 1997). The Eleventh Circuit ruled that the mortgage industry's YSP practices did not fit within either of the 8(c) exceptions advocated by the defendant. *See Culpepper v. Inland Mortg. Corp.*, 132 F.3d 692, 695 (11th Cir. 1998) (*Culpepper I*). In rejecting the defendant's argument that the YSP was payment for the broker's services, the Court reasoned that "the sole determinant of whether a yield spread premium would be paid was the interest rate on the loan." Since the broker "expends the same amount of effort and provides the same quality and quantity of services whether it originates an above par loan, a par loan, or a below par loan...the premium cannot be characterized as payment for originating the loan." *Culpepper I,* 132 F.3d at 696-97.

On rehearing, the defendant and the National Mortgage Bankers Association argued that *Culpepper I* would hurt consumers by eliminating popular "no closing-cost" loans in which brokers receive YSPs in lieu of charging loan origination fees. The Eleventh Circuit refused to reconsider its decision; it did, however, issue an opinion stating that its *Culpepper I* decision should not be read to preclude "buyers from financing closing costs through yield spread premiums." *Culpepper v. Inland Mortg. Corp.*, 144 F.3d 717, 718 (11th Cir. 1998) (*Culpepper II*).

In response to *Culpepper I,* the mortgage industry sought a Congressional moratorium on YSP class actions. Although it refused to outlaw YSP class actions, Congress did direct HUD to "clarify" its position concerning the legality of yield spread premiums. In response, HUD issued its 1999 Policy Statement, 64 Fed. Reg. 10080

(March 1, 1999) setting out a two-pronged test for the legality of YSPs. The first prong was "whether goods or facilities were actually furnished or services were actually performed for the compensation paid." *Id.* at 10084. The second issue was whether the total compensation was "reasonable."

On remand, the trial court granted class certification in *Culpepper* and the defendant filed another appeal. On appeal, the defendant argued that the legality of YSPs was solely a function of whether the broker's total compensation was "reasonable", which it claimed presented individual issues that prevent class certification. In *Culpepper v. Irwin Mortgage Corp.* 253 F.3d 1324 (11th Cir. 2001) (*Culpepper III*), the Eleventh Circuit affirmed the class certification, reasoning that the defendant's interpretation would amount to a *defacto* legalization of "reasonable" referral fees.

By the time *Culpepper III* was decided, a new administration was in place, and the mortgage industry went to HUD's new Secretary for a second bite at the Policy Statement apple. On October 18, 2001, HUD issued its 2001 Policy Statement to "eliminate any ambiguity" concerning the 1999 Policy Statement. Real Estate Settlement Procedures Act 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 Fed. Reg. 53052 (October 18, 2001) (2001 Policy Statement). Although HUD's 1999 Policy Statement had expressly recognized the possibility that class certification might be appropriate, the 2001 Policy Statement stated that an individual investigation of each borrower's loan would be necessary to determine

whether Section 8 had been violated; and it purported to determine that class certification was inappropriate in YSP cases because the legality of the broker's YSP payment was a function of whether its total compensation was "reasonable."

HUD's "reasonableness" rule is based on its contention that a settlement service provider violates Section 8(b) when it charges a fee that exceeds the reasonable value of goods, facilities, or services provided. 2002 Policy Statement, 66 Fed. Reg. at 53059, n. 7. Reg. X states that "If the payment of a thing of value bears no relationship to the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 C.F.R. § 3500.14(g)(2). While courts have consistently rejected "overcharge" claims based on the fact that RESPA does not give HUD the power to cap settlement charges, courts seem to have no trouble accepting the converse argument, that kickbacks are legal so long as the amount is "reasonable."

In *Glover v. Standard Federal Bank,* 283 F.3d 953 (8th Cir. 2002), the court reversed the trial court's certification of a YSP class. The court reached that conclusion despite its tacit recognition that HUD's Policy Statement purports to legalize "reasonable" referral fees. *See Glover,* 283 F.3d at 963 at n. 7. The majority of a Ninth Circuit panel adopted the 2001 Policy Statement test in *Schuetz v. Banc One Mortgage Corp.*, 292 F.3d 1004 (9th Cir. 2002). In a blistering dissent, Judge Kleinfeld compared HUD's reasonableness test to a broken clock. He noted that a yield spread premium calculated purely by the extent to which the borrower's interest rate is above par will sometimes coincide with the worth of the broker's services, but only by chance. "It's like a stopped

clock that shows the right time twice a day, but the clock doesn't measure the time, and the yield spread premium doesn't measure the value of services." *Id.* at 1015. In *Heimmermann v. First Union Corp.*, 305 F.3d 1257 (11th Cir. 2002) the Eleventh Circuit reversed the trial court's class certification. Following the *Heimermann* decision, the trial court again granted summary judgment in *Culpepper.* That case is now on appeal for the third time. Oral argument is scheduled for November.

B. Sham Business Entities.

There have been several class actions and numerous HUD enforcement actions claiming that various title insurance affiliates are nothing more than "sham" businesses set up to funnel referral fees to builders, real estate agents and mortgage brokers in violation of RESPA. *See* HUD settlement agreements for violations of its Sham Controlled Business Arrangements rules at HUD's web site, http://www.hud.gov/offices/hsg/sfh/res/resetagr.cfm; *see also* Reg. X, § 3500.15.

Title insurance is unique among insurance products. Whereas most insurance protects policy holders from losses arising from future events, title insurance protects against title defects stemming from prior events, most of which are discoverable by simply searching courthouse records. The "risk" being insured is minimal as evidenced by the fact that during the past ten years, title insurance companies paid only about 5 cents in claims for every dollar of premiums. *See* Testimony of the National Association of Insurance Commissioners Before the Subcommittee on Housing and Community Opportunity Committee on Financial Services, U.S. House of Representatives, at 5-6

(April 26, 2006), www.naic.org/documents/. For other types of insurance, a much larger percentage of premiums are used to pay claims. Property insurance companies, for example, pay out about 75% of their premiums in claims. *Id.* The potential for abuse becomes obvious when you consider that title insurance companies are almost always chosen not by the borrower, but by one of the real estate professionals involved in the transaction and that 85% to 90% of every premium dollar is retained by the local insurance agency. Only 10% to 15% of every premium dollar goes to the insurance company. *Id.*

Title agencies frequently set up affiliated businesses with builders, real estate agents and mortgage brokers who refer title insurance business. RESPA defines an affiliated relationship as one existing among business entities by virtue of partnership agreements, subsidiary stock ownerships and so forth. *See* 12 U.S.C § 2602. These arrangements do not *per se* violate Section 8 of RESPA if they meet certain statutory conditions. The AfBA owner who refers business to the AfBA must provide a written disclosure on a separate sheet of paper to each consumer who is referred. Borrowers cannot be forced to use the AfBA. No payments, other than a return on ownership interest or payments otherwise permitted under the statute, may be received under the AfBA. Any payments made must be for services rendered or must constitute a return on ownership interest. Additionally, HUD has promulgated a list of criteria regarding net worth, staffing, etc. which are used to determine whether the arrangement is a "sham" that violates Section 8. *See* HUD Policy Statement on Sham Controlled Business

Arrangements, 61 Fed. Reg. 29258-29264 (1996).

Referral fees paid in connection with title insurance was one of the abuses that RESPA was designed to address. Section 9 of RESPA prohibits a seller from requiring a borrower to use a particular title insurance company. 12 U.S.C. § 2608. As a practical matter, this prohibition is not likely to mean anything for Alabamians since Alabama law requires title companies to publish rates and it prohibits them from offering any discounts from published rates. *See* Ala. Code § 27-25-6(a). Therefore, it is unclear whether kickbacks paid in connection with title insurance policies actually cause any increase in premiums. *See* pp. 27-29, infra, Standing; Are Actual Damages Necessary for Section 8 Actions?

C. Mark-ups.

HUD's 2001 Policy Statement also reiterated its long-standing position that RESPA prohibits the "mark up" of settlement services provided by others. Lenders and closing agents typically outsource the work for which they charge courier fees, underwriting fees, tax service fees, document preparation fees, appraisal fees, etc. HUD takes the position that any up-charge of the fees provided by third parties constitutes a violation of RESPA, § 8(b). *See* 2001 Policy Statement at 53058.

There is a split in the circuits over HUD's interpretation of § 8(b), however. The dispute centers on the phrase "No person shall give and no person shall accept...." The Fourth, Seventh, and Eighth Circuits read the above language to require that at least two parties must share a settlement fee in order to violate the statute. *See Haug v. Bank of*

Am., N.A., 317 F.3d 832, 836 (8th Cir.2003); *Boulware v. Crossland Mortgage Corp.*, 291 F.3d 261, 265-66 (4th Cir.2002); *Krzalic v. Republic Title Co.*, 314 F.3d 875, 877-881 (7th Cir. 2002). According to these courts, Section 8(b) is an anti-kickback provision. The Second, Third and Eleventh Circuits have interpreted Section 8(b) as creating two separate prohibitions: (1) giving a portion of charges; and (2) accepting a portion of charges. *See Sosa v. Chase Manhattan Mortgage Corp.*, 348 F.3d 979, 983 (11th Cir. 2003); *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3rd Cir. 2005); *Kruse, et al. v. Wells Fargo Home Mortgage, Inc., et al.*, 383 F.3d 49 (2nd Cir. 2004). These courts have held that an 8(b) violation may be predicated on a lender or closing agent marking up a third-party's fee and pocketing the excess.[5]

Defendants in mark-up cases typically argue that the up-charge was compensation for services within the meaning of RESPA, § 8(c). For example, the plaintiff in *Price v. Countrywide Home Loans,* 2005 WL 2354348 (S.D. Ga. 2005), claimed that the defendant violated Section 8(b) by charging borrowers $35 for $18 credit reports. The court rejected the defendant's argument that the mark-up was a legitimate charge for ordering and reviewing the credit report, in part, because HUD's 2001 Policy Statement provides that "reviewing" the work of another settlement service provider is not a service for which a fee can be charged. *See* 66 Fed. Reg. at 53,059 n. 7; *see also* 24 C.F.R.

[5] The Second Circuit's rationale was slightly different than the Third and Eleventh Circuits' rationales. In *Kruse, et al. v. Wells Fargo Home Mortgage, Inc., et al.*, 383 F.3d 49 (2nd Cir. 2004), the court held that the language of Section 8(b) was ambiguous, but that *Chevron*'s deference to HUD's 2001 SOP was warranted. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

3500.14 (c) ("[a] charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates [Section 8(b)]").

The "services" argument also presents at least two additional hurdles for defendants. Each service provider's "services" are supposed to be listed separately on the HUD-1. *See* 12 U.S.C. § 2603(a); 24 C.F.R. § 3500, Appendix A. While failure to list the up-charge as a separate fee is not actionable under RESPA, the failure to list it as a separate charge is evidence supporting the plaintiff's claim that it is not a fee for a service. Moreover, the alleged service provided in exchange for the up-charge may have already been paid for. For example, if the plaintiff in *Price* paid a loan origination fee and/or an underwriting fee, it would seem that he had already paid the lender to order and review the credit report.

The other problem for the *Price* defendant is that credit report fees are not included in the "finance charge" for purposes of the TILA APR calculation; whereas, the lender's services are considered part of the finance charge. Therefore, re-categorizing a portion of the credit report charge as a fee for services will change the APR calculation which could trigger a TILA violation.

Courts have been more receptive to the "services" argument in mark-up cases than one might have expected. For example, in *Sosa v. Chase Manhattan Mortg. Corp.*, 348 F.3d 979 (11th Cir. 2003), the plaintiffs alleged that the defendant violated Section 8(b) by charging borrowers $50 for courier or messenger fees of which only a portion was paid to third-party contractors. Although the court agreed with the plaintiff's

interpretation of the law, it affirmed the dismissal of the complaint on the ground that the plaintiffs failed to allege that the charge the defendant retained was accepted "other than for services actually performed," i.e., that the defendant performed no services that would justify its retention of a portion of the fee. The court, however, went on to state:

> Not only does the complaint fail to allege that Chase did not perform any services, we do not believe that the borrowers could credibly make such an allegation. It is undisputed that the charges were paid to Chase and that Chase arranged to have items delivered to complete the closing. Through its agents, therefore, Chase performed the deliveries that were the subject of the charges. Moreover, even if Chase could not be credited with the actual delivery, Chase benefited the borrowers by arranging for third party contractors to perform the deliveries. Under these circumstances, we find it impossible to say that Chase performed no services for which its retention of a portion of the fees at issue was justified.

Sosa, 348 F.3d at 983-984. This is an astounding assertion when you consider the huge disparity between FedEx's charges and Sosa's payment. Moreover, it ignores the fact that the borrower probably paid a myriad of other fees (origination fees, document preparation fees, etc.) that one might ordinarily expect to have covered the cost of filling out a label. With all due respect to the Eleventh Circuit panel that decided *Sosa*, it appears that the complaint raised the question whether the alleged "ancillary services" were reasonable in light of the additional services provided, or whether these extra services were already included in some other settlement service charge paid by the borrower. *See* Reg. X, 24 C.F.R. § 3500.14(c). That issue ought to present a jury question. *See Santiago*, 417 F.3d at 389.

D. Overcharges.

An overcharge is a lender's provision of services to a borrower at an unreasonably high price. Whereas courts have struggled with the question whether a settlement service provider can mark up charges for services provided by third parties, they seem to have had less trouble disposing of "overcharge" claims despite HUD's interpretation of RESPA as creating a violation where, "one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done." 66 Fed. Reg. 53053, 53057. The Second Circuit in *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2nd Cir. 2004), and the Third Circuit in *Santiago v. GMAC Mortgage Group, Inc.*,417 F.3d 384 (3rd Cir. 2005), held that Section 8 does not apply to "overcharges." The Eastern District of New York took that rationale one step further in ruling that RESPA does not prohibit a charge for which no services whatsoever were rendered to the borrower. *See Cohen v. J.P. Morgan Chase and Co.*, 2006 WL 20596 (E.D.N.Y. Jan. 4, 2006), in which the court ruled that no RESPA violation occurred where the lender was sued for charging a "post-closing fee" of $225 for which no services were rendered to the borrower.

E. Standing: Are Actual Damages Necessary for Section 8 Actions?

Courts are split on the question whether borrowers must demonstrate actual damages to bring a Section 8 claim. There are many circumstances where lenders pay kickbacks or charge mark-ups that do not directly result in higher prices. For example, lenders sometimes enter into agreements with local appraisers whereby the lender promises the appraiser all its considerable volume of appraisal work in exchange for a

discount, which is not passed along to the borrowers. But if the borrower is charged no more than the "going rate," then is there a RESPA violation?

Even in cases of clear and obvious Section 8 violations – violations which technically could result in criminal prosecutions - many courts are reluctant to enforce RESPA's statutory treble damages provisions unless the plaintiff can prove that he suffered actual damages. The leading case espousing this "no harm no foul" viewpoint is *Morales v. Attorneys' Title Ins. Fund*, 983 F.Supp. 1418 (S.D. Fla. 1997), in which the court dismissed a RESPA claim on standing grounds when plaintiffs paid nothing more than a filed rate for title insurance. *See also Binney v. ABN Amro*, 2006 WL 2310264 (E.D. Mich. Aug. 9, 2006) (granting motion to dismiss for claim that lender paid kickback to broker where plaintiff could not demonstrate that the alleged kickback resulted in higher settlement costs); *Moore v. Radian Group, Inc.*, 233 F. Supp. 2d 819 (E.D. Tx. 2002); *Mullinax v. Radian Guar., Inc.*, 311 F. Supp. 2d 474 (M.D.N.C. 2004) (holding that plaintiffs lacked standing to bring claims for alleged Section 8 violations arising out of the lenders' arrangements with PMI insurers where the arrangement in question did not increase the plaintiffs' PMI premiums).

The contrary point of view is set out in *Kahrer v. Ameriquest Mortg. Co.,* 418 F. Supp. 2d 748 (W.D. Pa. 2006), in which the court set out in detail why it believed that *Morales* and its progeny were wrongly decided. That court ruled that the plaintiff stated a claim for a Section 8 violation where Sears referred the borrower to a mortgage lender who insisted that the borrower pay off Sears with a portion of the loan proceeds. *See also*

Boulware v. Crossland Mortgage Corp., 291 F.3d 261, 266 (4th Cir. 2002) (stating in dicta that Section 8(a) prohibits kickbacks or referral fees and does not require an overcharge to a consumer.)

V. MISCELLANEOUS ISSUES.

A. Statutes of Limitations.

The statute of limitations for private actions under Sections 8 or 9 is one (1) year. Section 6 has a three (3) year statute of limitations. HUD, a State Attorney General or State Insurance Commissioner may bring an injunctive action to enforce violations of Section 6, 8 or 9 of RESPA within three (3) years.

B. Standing.

To have standing to bring a RESPA claim, the plaintiff must be a borrower. *See Cahalan v. Ameriquest Mortgage Co.*, 2006 WL 1312961 (W.D Pa. May 10, 2006). (A plaintiff claiming that his name was forged by his ex-wife on a note and mortgage does not have standing to bring a RESPA claim against the ex-wife's lender.)

C. Jurisdiction/Venue.

Venue is proper under RESPA "in the United States district court or in any other court of competent jurisdiction, for the district in which the property involved is located, or where the violation is alleged to have occurred." 12 U.S.C.A. § 2614 (2001).