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MEMORANDUM

To: Dallas/Fort Worth Association of Mortgage Brokers

From: Robert A. Long, Jr. & Richard L. Fruehauf

Re: Legal Challenges to RESPA Rules

This memorandum identifies and analyzes potential legal challenges to federal regulations governing the process of applying for and obtaining home mortgages. The U.S. Department of Housing and Urban Development ("HUD") has published a proposal to amend its regulations, known as the "RESPA Rules" or "Regulation X," governing the mortgage process.[1] Regulation X is supposed to implement the provisions of the Real Estate Settlement Procedures Act, Pub. L. No. 93-533, 88 Stat. 1724, 12 U.S.C. § 2601 *et seq*. 1974) ("RESPA"). HUD's proposal to amend Regulation X is subject to legal challenge. The proposed amendments would, among other things: (1) discriminate unfairly against mortgage brokers; (2) harm competition between mortgage brokers and lenders, to the detriment of borrowers; and (3) confuse and mislead borrowers concerning the relative costs of services provided by mortgage brokers and lenders. Indeed, HUD's *current* regulations are vulnerable to challenge on similar grounds. In addition, HUD's proposal appears to exceed its authority under RESPA.

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1 *See* Department of Housing and Urban Development, Proposed Rule, "Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages To Reduce Settlement Costs to Consumers," 67 *Fed. Reg.* 49134 (July 29, 2002) (amending 24 C.F.R. Part 3500).

DISCUSSION

I. Background

A. The Role of Mortgage Brokers

Mortgage brokers play an increasingly vital role in the residential real estate financing system in the United States. When Congress enacted RESPA in 1974, most mortgages for single family residential real estate were originated and held by savings and loan institutions, commercial banks, and mortgage bankers. Since 1974, use of mortgage bankers in home mortgage transactions has increased dramatically, so that today they account for approximately 60% of all mortgages originated in the United States.[2]

Mortgage brokers have enjoyed dramatic gains in popularity because they provide valuable services and products. These services include "counseling borrowers on loan products, collecting application information, ordering required reports and documents," "gathering data required to complete the loan package and mortgage transaction," and participating in the loan closing.[3] In addition, mortgage brokers may offer "goods and facilities, such as reports, equipment, and office space to carry out their functions."[4]

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[2] HUD estimates that mortgage brokers account for roughly 60% of all mortgages originated in the U.S. today. 67 Fed. Reg. at 49140.

[3] 67 Fed. Reg. at 49140; *see also* HUD, "Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers," 64 Fed. Reg. 10080, 10081 (March 1, 1999).

[4] 67 Fed. Reg. at 49140.

Mortgage brokers compete with direct lenders in providing origination services and products to borrowers.[5] The increasing popularity of mortgage brokers indicates that borrowers often find their services and products more attractive than competing offerings from direct lenders.

As HUD recognizes, the services provided by a mortgage broker may vary significantly from one transaction to another because mortgage applicants may have:

> "[d]ifferences in credit ratings, employment status, levels of debt, assets, and experience [that] frequently translate into varying degrees of effort required to originate a loan. Also, mortgage brokers may be required to perform different components of origination (i.e., underwriting) pursuant to specific agreements with individual wholesale lenders."[6]

B. Compensation of Mortgage Brokers

Mortgage brokers generally occupy an intermediary position between borrower and lender.[7] Mortgage brokers may be compensated for their services in several ways. *First*,

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5 *Id.*

6 *Id*.

7 Most mortgage brokers do not fund mortgages, or if they do, it is only in the limited sense of "table funding," *i.e.*, the mortgage may be closed in the name of the mortgage broker but it is transferred at the time of settlement to a lender advancing funds for the loan. In a "table funding" transaction, the mortgage broker delivers the loan package, including the promissory note, mortgage, evidence of insurance, and all rights in the loan held by the mortgage broker, to the lender immediately after the loan is consummated. It appears that HUD's proposed amendments would apply to transactions in which a mortgage broker acts purely as an intermediary or "table funds" the loan. *See* 67 *Fed. Reg*. at 49140. If a mortgage broker originates, closes in its own name, temporarily funds the loan using its own funds or a warehouse line of credit, and then sells the loan after settlement, the transaction is treated exempt from Section 8 of RESPA as a "secondary market transaction." 24 C.F.R. § 3500.5(b)(7). *See also* 67 *Fed. Reg.* at 49159 (proposed definition in 24 C.F.R. § 3500.2 of a mortgage broker as "a person or entity that renders origination services in a table funding or intermediary transaction. Where a mortgage broker is the source of funds for a transaction, the mortgage broker is a 'lender' for purposes of this part.").

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they may receive their compensation as a direct payment from the borrower in the form of "origination" or other fees. *Second*, mortgage brokers may be compensated through a payment from a lender or other third party as so-called "indirect compensation." *Third*, brokers may receive a combination of direct and indirect compensation.

One common form of "indirect compensation" is known as a "yield spread premium." A yield spread premium is typically used by the mortgage broker to lower the up-front settlement costs of a loan by charging a somewhat higher interest rate for the loan. The "premium" refers to the difference between the interest rate on the loan and the interest rate that the borrower would pay if he or she qualified for the loan and were able (or chose) to pay all of the closing costs from out-of-pocket funds.[8]

Yield spread premiums enable borrowers to complete mortgage transactions even if they do not have sufficient funds available to pay all the settlement costs immediately, or prefer to use those funds for other purposes. Both Congress and HUD have recognized the utility of yield spread premiums. Congress, for example, stated in the Conference Report to the 1999 Appropriations Act for HUD, that it "never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be

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[8] Lender compensation for loan origination services is quite similar to broker compensation. Lenders may be compensated in the form of direct payments from the borrower, or indirectly in the form of "[t]he functional equivalent of a yield spread premium." 67 Fed. Reg. at 49141. As HUD explains: "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." *Id.*

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violations of" RESPA's unearned fee and anti-kickback proscriptions.[9] In response to that congressional statement, HUD has issued several policy statements in which it noted that yield spread premiums should be retained as an option for borrowers.[10]

C. Current Regulation of Mortgage Broker Compensation Under RESPA and Regulation X

Congress enacted RESPA in 1974 to further several purposes: (1) to provide buyers and sellers of residential real estate with more effective advance disclosure of settlement costs; (2) to eliminate "kickbacks" or referral fees that tend to increase unnecessarily the costs of certain settlement services; (3) to reduce required escrow accounts; and (4) to reform and modernize local land title information recordkeeping.[11] RESPA applies to transactions involving "settlement services" for "federally related mortgage loans." "Settlement services" are defined as any service provided in connection with a real estate settlement, and include origination of a federally related mortgage loan (*e.g.*, taking loan applications, loan processing, underwriting and funding of loans), and the handling of the processing and closing of

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[9] H. Rep. 105-769 at 260.

[10] *See, e.g.*, HUD, 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 (Oct. 18, 2001); HUD, Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 *Fed. Reg*. 10080 (March 1, 1999).

[11] 12 U.S.C. § 2601(b).

settlement.[12] Federally related mortgage loans are broadly defined to include most residential real estate mortgages.[13]

HUD has implemented the requirements of RESPA through Regulation X and two principal forms to provide the disclosures required under RESPA: the "good faith estimate" ("GFE") of settlement costs provided in advance of the closing and the "HUD-1" form (or HUD-1A for refinancings) to be provided at closing of the mortgage loan. HUD's 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. HUD's suggested format for the GFE 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. A 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 is received or prepared.

The HUD–1, as described in Appendix A of HUD's RESPA rules, discloses the charges at settlement in major groupings or series. It includes a summary of 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, and includes credits to the borrower as well as the total settlement charges due. The HUD-1 also 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

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[12] 12 U.S.C. § 2602(3).

[13] *See* 12 U.S.C. § 2602(1).

mortgages, and any other items due from seller (such as taxes), to arrive at a total amount due seller. Included on the HUD-1 are such costs as real estate broker commissions, origination fees and certain third party settlement services payable in connection with the loan, and other settlement related costs.

Mortgage brokers, like other loan originators are subject to RESPA's GFE and HUD-1 disclosure requirements, as well as its prohibitions on unearned fees and kickbacks.[14] As HUD describes the current disclosure requirements for mortgage brokers with respect to yield spread premiums:

> 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).[15]

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[14] Currently, Regulation X defines a mortgage broker as "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 … 'settlement services'." *See* 24 C.F.R. § 3500.2(b)).

[15] 67 Fed. Reg. at 49141. In a footnote, HUD acknowledges that its "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. …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." *Id.* at 49147 n. 36.

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D. HUD's Proposal to Require New Yield Spread Premium Disclosures and Permit Packaging of Settlement Services

HUD's proposal to amend Regulation X includes three basic elements. *First*, it changes the reporting requirements for mortgage broker compensation 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 of the loan, including payments based upon an above-par interest rate on the loan (*i.e.*, ''yield spread premiums''), be reported on the GFE and the HUD–1/1A as a lender payment to the borrower. Additionally, in brokered loans, any borrower payments to reduce the interest rate (''discount points'') must 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.

Second, the proposed rule would establish a new required GFE format, which would include mandatory statements 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, and that the borrower has 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. The proposed GFE format would also require disclosures of the loan originators' fees, including the mortgage broker's and lender's total charges to borrowers. In transactions originated by mortgage brokers, HUD's proposal would require that all payments from a lender other than for the par value for the loan (including ''yield spread premiums'' and servicing release premiums) be reported on the GFE and the HUD–1 as a lender payment to the borrower. Under HUD's proposal, any discount points charged to the

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borrower must equal the discount in the price of the loan paid by the lender and must be reported on the GFE and the HUD–1 as borrower payments to the lender.

Third, the proposed rule would permit packages of settlement services and mortgage loans to be made available to borrowers. HUD would establish a "safe harbor" under RESPA for ''Guaranteed Mortgage Package'' (GMP) transactions. 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 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. The HUD–1 would list the services ultimately provided, but not the charges for specific services.

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II. Legal Analysis

A. Discriminatory Treatment of Mortgage Brokers Is Arbitrary and Capricious.

The Administrative Procedure Act ("APA") provides that any person "adversely affected or aggrieved by agency action . . . is entitled to judicial review thereof."[16] Under the APA, a reviewing court "shall . . . hold unlawful and set aside agency action . . . found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," "in excess of statutory jurisdiction, authority or limitations," or "contrary to constitutional right, power privilege or immunity."[17]

HUD's RESPA rules, including its proposed amendments to those rules, are subject to judicial review under the APA. As explained below, mortgage brokers are "adversely affected or aggrieved" by the proposed amendments, and thus they will be entitled to seek judicial review of the amendments if they are adopted by HUD. In addition, an association of mortgage brokers would have standing to seek judicial review of the rules on behalf of its members.[18]

A court may find agency action to be "arbitrary and capricious" for a variety of reasons.[19] As summarized by the Supreme Court, an agency rule is arbitrary and capricious "if the agency has relied on factors which Congress has not intended for it to consider, entirely

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[16] 5 U.S.C. § 702.

[17] 5 U.S.C. § 706.

[18] *See National Lime Ass'n v. EPA*, 233 F.3d 625, 637 (D.C. Cir. 2000) (association has standing if issues are germane to association's purpose and at least one member of the association could have pressed the same claims in its own right).

[19] *See Animal Legal Defense Fund v. Glickman*, 204 F.3d 229, 234 (D.C. Cir. 2000).

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failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[20] Courts may find an agency action arbitrary and capricious if the action is too wooden and fails to balance equitable considerations,[21] or if it rests on grounds that fail to justify the result.[22] Agency action is likely to be held arbitrary and capricious if it imposes costs that "far outweigh any benefits."[23] Similarly, an agency rule is arbitrary and capricious where the agency relies on "pure speculation" in the absence of any information to support its findings.[24]

HUD's proposed rules -- and, indeed, its current rules -- are open to attack as arbitrary and capricious agency action. The rules plainly discriminate against mortgage brokers and in favor of direct lenders. Mortgage brokers are required to disclose indirect compensation received in the form of yield spread premiums; lenders are not required to make any equivalent disclosure, even though they receive the same type of compensation for the same services. As HUD recognizes, mortgage brokers and lenders are competitors in the marketplace for mortgage origination goods and services. By discriminating against one group of competitors and in favor of another, HUD places mortgage brokers at a distinct competitive disadvantage. HUD's

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[20] *Motor Vehicle Manufacturers Assn. v. State Farm Automobile Insurance Co.*, 463 U.S. 29, 43 (1983).

[21] *Gulf Power Co. v. FERC*, 983 F.2d 1095, 1101 (D.C. Cir. 1993).

[22] *MCI Telecommunications Corp. v. FCC*, 10 F.3d 842, 846 (D.C. Cir. 1993).

[23] *City of Centralia, Wash. v. F.E.R.C.,* 213 F.3d 742, 749 (D.C. Cir. 2000) (where agency's action imposes costs that "far outweigh any benefits" its action is "arbitrary and capricious for want of reasoned decisionmaking").

[24] *Horsehead Resource Development Co. v. Browner*, 16 F.3d 1246, 1269 (D.C. Cir. 1994).

discriminatory regulations harm not only brokers but also consumers, who benefit from vigorous competition on a level playing field.

In addition to discriminating against some competitors and favoring others, HUD's proposed rules will confuse and mislead consumers. Under HUD's rules, borrowers will be told that they are paying for the broker's services in the form of a yield spread premium, but they will not be told that they are paying anything for similar services provided by a lender, even though the lender is being compensated for its services in just the same way as the broker is compensated. At best, borrowers will be confused. At worst, they will draw the erroneous conclusion that the services of brokers cost more than the services of lenders, when in fact the undisclosed costs of the lender's services may equal or exceed those of the broker's services.[25]

HUD acknowledges that "the proposed rule results in different treatment of compensation in loans originated by lenders and those originated by mortgage brokers."[26] It also acknowledges that the difference in treatment "is not because the Department believes that the latter are necessarily more suspect or susceptible of abuse than the former."[27] And it recognizes that when lenders originate loans themselves, they routinely obtain "[t]he functional equivalent

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25 Discriminatory treatment by a government agency may, in extreme cases, violate constitutional principles of equal protection that are binding on the federal government under the Due Process Clause of the Fifth Amendment. *See Bolling v. Sharpe*, 347 U.S. 497 (1954). To survive equal protection scrutiny, HUD's disparate treatment of mortgage brokers in comparison to their acknowledged competitors such as mortgage bankers must be based on a "reasonably conceivable state of facts that could provide a rational basis for the classification." *Federal Communications Comm'n v. Beach Communications, Inc.*, 508 U.S. 307, 313 (1993). Accordingly, irrational discrimination against mortgage brokers is unconstitutional, as well as unlawful under the APA.

26 67 Fed. Reg. at 49148

27 *Id.*

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of a yield spread premium," "just like brokers do," by lowering up front costs and "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."[28]

Despite its recognition of each of these points, HUD's proposal discriminates against mortgage brokers by requiring them to disclose yield spread premiums on the GFE and HUD-1 as a lender payment to the borrower, while not requiring any equivalent disclosure from direct lenders. The purpose of the required disclosures is ostensibly to permit borrowers to engage in more informed and effective comparison shopping for settlement services. But "comparison shopping" will be ineffective if borrowers are unable to compare mortgage broker transactions with direct lender transactions on a straightforward apples-to-apples basis. HUD's proposed disclosures would prevent apples-to-apples comparisons, and this would impede effective comparison shopping. As noted above, HUD's proposed treatment of mortgage broker yield spread premiums would convey to consumers a misleading impression that a comparable transaction with a direct lender costs less, when in fact, the only difference is that the direct lender is not required to disclose mortgage origination costs in a comparable manner.

HUD asserts that the new disclosure requirements "will allow borrowers to focus on the total origination costs for shopping purposes," and thus the required disclosures "will not

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[28] *Id.* at 49141.

disadvantage brokers in competition with lenders."[29] This makes no sense. If borrowers are told that they will be charged $ x for the broker's services, and are not told that they will be charged *anything* for similar services provided by a lender, they will naturally assume that the lender is providing the services for free, and therefore they are better off using the lender. If, on the other hand, HUD is right that it is only total "bottom line" costs that matter (including both up front fees and interest rates), then the required disclosures should focus on the "bottom line" rather than on requiring some competitors, but not others, to break out the cost of loan origination services.

HUD's reasons for discriminating against mortgage brokers are unpersuasive. HUD does not take the position that transactions involving mortgage broker present special risks or dangers to borrowers that justify additional disclosures, or that yield spread premiums received by brokers are fundamentally different from indirect compensation received by direct lenders. To the contrary, HUD states that it does not believe that transactions originated by mortgage brokers are more suspect or susceptible of abuse than transactions originated by

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[29] *Id.* at 49136. HUD asserts that "the [revised GFE] 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 borrowers' 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." 67 *Fed. Reg*. at 49148.

lenders, and that lenders routinely receive the functional equivalent of yield spread premiums.[30] Instead, the agency takes the position that "reporting of total lender compensation cannot be meaningfully regulated under RESPA, while total broker compensation can be regulated."[31] There are multiple objections to HUD's rationale.

First, HUD asserts that it cannot treat lenders the same as mortgage brokers because of the so-called "secondary market exemption," which exempts from Section 8 scrutiny compensation received by a lender from the sale of a loan in the secondary market. HUD simply accepts the secondary market exemption as a fixed and immovable legal obstacle to even-handed treatment of mortgage brokers and direct lenders. HUD fails to acknowledge that it created the "secondary market exemption" by regulation, and therefore it can modify the exemption to avoid unwarranted discrimination and borrower confusion. A variety of options are open to HUD. For example, it could modify the secondary market exemption to require direct lenders to make disclosures equivalent to those required of mortgage brokers. Alternatively, HUD could expand the exemption to "table funded" transactions, thus reliving mortgage brokers of additional disclosure obligations for many transactions.

Second, HUD asserts that measuring indirect lender compensation would be "very difficult," because "a lender may retain the loan in its portfolio for the life of the loan, or sell it long after the settlement."[32] Like HUD's invocation of the secondary market exemption, this is a

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30 *Id.* at 49141,49148.

31 *Id.* at 49148.

32 *Id.*

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completely unsatisfactory justification for the agency's proposed action. Even if the determination of lender compensation were "difficult," that would hardly be an adequate reason for imposing discriminatory requirements that confuse and mislead borrowers and harm competition. Moreover, HUD greatly overstates the "difficulty" of such a determination. HUD refers only to loans that the lender retains the loan in its portfolio, completely ignoring the the huge numbers of loans that lenders sell immediately upon closing in the secondary market immediately. Where there is an immediate sale, it should not be difficult to determine the amount of indirect lender compensation. As HUD itself recognizes elsewhere in its Notice of Proposed Rulemaking, the lender's premium on such a transaction "represent[s] the difference between the interest rate on the loan and the par, or wholesale market interest rate."[33] Nor would it be terribly difficult to determine the amount of indirect lender compensation if the lender chooses to retain the loan in its portfolio for a period of time. In such cases, the lender could simply disclose the difference between the interest rate on the loan and the wholesale market interest rate. This disclosure could be coupled with a statement that the lender will not realize this gain immediately if it holds the loan in its own portfolio, and if it sells the loan at a later date the amount it ultimately realizes will be affected by intervening changes in interest rates.[34]

HUD's proposal is objectionable on another ground as well: Having concluded that additional disclosures by mortgage brokers and lenders are desirable, but disclosures by

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[33] *Id.* at 49141.

[34] The discussion in the proposed rule's Regulatory Flexibility Analysis and Economic Impact Analysis of the measure HUD has taken to "reduce[] any anti-competitive effects between brokers and lenders" does not save the regulation. *See* 67 Fed Reg. at 49171 (citing relevant portions of Economic Impact Analysis).

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lenders are not practical, HUD proceeds directly to the conclusion that requiring additional disclosures from mortgage brokers is desirable.[35] This is a classic example of arbitrary and capricious agency action. In deciding upon a course of action, the agency is not permitted to consider only the expected benefits of that action. Instead, it must weigh the expected benefits against expected costs, and compare net benefits against those of other possible courses of action. As noted above, HUD's proposed disclosures would impose significant costs, in the form of discrimination against mortgage brokers, regulatory interference in a competitive marketplace, and consumer confusion and mistake. Those costs easily outweigh any expected benefits, particularly when HUD could reduce the costs by requiring equivalent disclosures from mortgage brokers and lenders.

In addition to its other deficiencies, HUD's proposal contravenes the intent of Congress. Congress has explained its reasons for requiring advance disclosure of estimated settlement costst:

> "[a]rmed with the special information booklet, at an early stage, as expanded by the committee bill to include estimates of settlement costs, the prospective borrower is adequately equipped to shop, or not to shop if he so wishes, for settlement services, or to question or not to question the reasonableness of a settlement charge. No amount of federal requirements and red tape can substitute for an informed consumer who can insist on fair dealings and say 'no' to unreasonable charges. Accordingly, the committee bill . . . [contains] provisions designed to provide early and meaningful information to consumers in a manner that is not burdensome to the parties involved in the real estate transaction."[36]

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[35] *See* 67 Fed. Reg. 49148 (differential treatment "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.")

[36] H. Rep. No. 94-667 (Dec. 19, 1975), at 5.

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For the reasons explained above, HUD's proposal would not "adequately equip[]" prospective borrowers to shop for settlement services, nor would it create "informed" consumers supplied with "meaningful" information. To the contrary, prospective borrowers would not be in a position to directly compare the costs of mortgage brokers and lenders, and might well be misled by asymmetrical disclosures into erroneous conclusions that services provided by direct lenders are free, or at least a better bargain than services provided by mortgage brokers.[37]

B. HUD's "Safe Harbor" Proposal Exceeds Its Authority

Under HUD's proposal, a "Guaranteed Mortgage Package" ("GMP") of settlement services would qualify for "safe harbor" treatment, including exemption from the requirements of Sections 4, 5 and 8 of RESPA. As HUD acknowledges, the GMP proposal was challenged by some settlement service providers on the ground that it would "legalize kickbacks and referral fees" that are prohibited under Section 8 of RESPA.[38] In its Notice of Proposed Rulemaking, HUD does not deny the essence of this charge: the GMP proposal *would* authorize kickbacks that are prohibited under RESPA. HUD asserts, however, that "[d]eregulation,

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[37] HUD's *current* regulations are subject to many of the same objections set out above. Under the current rules, as described by HUD, mortgage brokers "are required to disclose their direct charges and any indirect payments to be made to them on the GFE. 67 Fed. Reg. 49141. Lenders are subject to no equivalent disclosure requirement. The current rules differ from the proposed rules in that yield spread premiums are "shown as 'Paid Outside of Closing' (P.O.C.), listed outside the columns, and excluded from the computation of borrower's total settlement costs." *Id.* (citing 24 C.F.R. 3500.7(a)(2)). HUD's proposal would make a bad situation even worse by including indirect compensation to brokers -- but not indirect compensation to lenders -- in the borrower's total settlement costs.

[38] 67 Fed. Reg. 49135.

transparency and a free market will wring out kickbacks, referral fees and other excesses."[39]

HUD also asserts effectively unlimited authority to grant exemptions from RESPA under Sections 8(c)(5) and 19 of the statute.[40]

> According to HUD's proposal:
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> "[t]he 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 theses 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 [sic] 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."[41]

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[39] *Id.*

[40] HUD asserts authority to require disclosure of yield spread premiums under Section 19(a) of RESPA, 12 U.S.C. § 2617(a), which authorizes HUD to promulgate "rules and regulations…and … *reasonable* exemptions for classes of transactions, as may be necessary to achieve the purposes of [RESPA]." (emphasis added). Section 8(c)(5) authorizes HUD to exempt "such other payments or classes of payments or other transfers as are specified in regulations prescribed by" the agency from Section 8's prohibitions on kickbacks, unearned fees and fee splitting

[41] 67 Fed Reg. at 49137.

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Notwithstanding HUD's attempt at justification, the fact remains that the agency is proposing to authorize kickbacks and referral fees -- the very type of payments that Congress wished to prohibit. HUD's statement that it is not proposing to authorize kickbacks in *all* circumstances does not alter the fact that *is* proposing to authorize kickbacks in *some* circumstances. HUD relies on its authority to grant exemptions from Section 8, but that authority is not without limits. In particular, HUD may not grant exemptions that frustrate rather than further congressional intent

HUD asserts that deregulation and the free market will wring out kickbacks, but if Congress had agreed with HUD it would not have enacted legislation prohibiting kickbacks in the first place. Moreover, as noted below, HUD's proposal would excuse lenders from itemizing settlement charges. In the absence of an itemization, it is difficult to see how HUD can rely on "transparency" and free markets to take the place of a statutory prohibition on kickbacks.

HUD's proposal also contravenes clear congressional intent with respect to itemization of settlement charges. In Section 4 of RESPA, Congress provided that HUD shall develop a "uniform settlement statement" that "conspicuously and clearly itemizes all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement."[42] While HUD has discretion to develop the uniform settlement statement, Congress itself specified the circumstances in which itemization was not required, by providing that "[t]he

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[42] 12 U.S.C. § 2603(a).

Secretary [of HUD] may, by regulation, permit the deletion from the form prescribed under this section of items which items are not under local laws or customs, applicable in a locality…."[43]

HUD's proposal disregards this clear congressional mandate to require itemization of all expenses on the HUD-1. In these circumstances, a court might well hold that HUD has exceeded its Section 19 authority. Under *Chevron v. Natural Resources Defense Council,*[44] when a court is confronted with a question of statutory interpretation, it first asks "whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[45] Where, as here, Congress has addressed the precise question of what costs must be itemized on the HUD-1, it is doubtful -- to say the least -- whether HUD's general rulemaking and interpretive authority under Section 19 permits it to give a different answer to that question.[46]

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43 *Id*.

44 467 U.S. 837 (1984).

45 *Id*. at 842.

46 Cf. *Sierra Club v. EPA*, 129 F.3d 137 (D.C. Cir. 1997) (EPA's creation of a "grace period" for enforcement rejected as contrary to "plain meaning" when statute made no provision for it).