

# **MORTGAGE BANKERS ASSOCIATION**

## **REGULATORY COMPLIANCE CONFERENCE**

### **ROUNDTABLE DISCUSSION**

#### **NUTS AND BOLTS OF RESPA, TILA AND CANSPPAM COMPLIANCE**

**SEPTEMBER 8, 2006  
9:30 AM TO 10:45 AM**

**RICHARD ANDREANO, JR.  
WEINER BRODSKY SIDMAN KIDER PC  
1300 NINETEENTH STREET, NW  
WASHINGTON, DC  
(202) 628-2000  
ANDREANO@WBSK.COM  
[WWW.WBSK.COM](http://WWW.WBSK.COM)**

#### **I. TRUTH IN LENDING ACT (TILA)**

##### **A. TILA SCOPE**

###### **1. General Application**

Four conditions must be met for an offer or extension of credit to be subject to TILA:

- a. The credit is offered or extended to consumers.
- b. The offering or extension of credit is done regularly.
  - i. More than 25 extensions of any credit during the preceding or current calendar year.
  - ii. More than 5 dwelling-secured extensions of credit during the preceding or current calendar year.

- iii. More than 1 extension of credit subject to the Home Ownership Equity Protection Act (HOEPA) in any 12-month period.
- iv. 1 or more extensions of credit subject to HOEPA through a mortgage broker in any 12-month period.
- c. The credit is subject to a finance charge or payable by a written agreement in more than 4 installments.
- d. The credit is primarily for personal, family, or household purposes.

2. Certain Exemption:

- a. An extension of credit primarily for a business, commercial or agricultural purpose.
  - i. Loan for an owner-occupied single unit second home is not for business purposes.
  - ii. Loan for a non-owner occupied rental property is for business purposes.

**B. PRACTICE POINTS**

1 Finance Charge

- a. Exclusion For Real Estate-Related Fees—226.4(c)(7).
  - i. Noted fees must be bona fide and reasonable in amount.
  - ii. TILA mark-up issue.
  - iii. Duplicate fee issue.

2. Rescission

- a. Rescission rights applies to a consumer if the consumer's ownership interest in his or her principal dwelling will be subject to the security interest.
  - i. Thus, non-borrowers may have a rescission right.
- b. Two key exemptions:
  - i. Residential mortgage transaction (a loan for the acquisition or initial construction of a consumer's principal dwelling).
  - ii. Refinancings by the original creditor with no new money.
    - The original creditor is the creditor to whom the obligation is originally payable.
    - No new money means that the new amount financed may not exceed the sum of the unpaid principal balance of the existing debt, any earned but unpaid finance charge on the existing debt, and the costs of the refinancing.
    - If there is new money, the rescission right only applies to the new money.
    - Exemption only applies to closed-end transactions.
- c. Two model rescission forms for closed-end transactions.
  - i. H-8, general form.
  - ii. H-9, refinancings by original creditor.

- d. Two copies of the notice of right to cancel must be provided to each consumer with a right to rescind.
  - i. One copy permitted if delivering pursuant to electronic communication provisions.

### 3. Advertising—Closed End Credit

- a. If an advertisement states a finance charge rate, the rate must be stated as an annual percentage rate or APR.
  - i. May also disclose simple interest rate in conjunction with the APR, but not more conspicuously than the APR.
  - ii. In electronic advertisements, if simple interest rate is provided in addition to the APR, the consumer must be able to view APR and simple interest rate simultaneously.
  - iii. If APR may increase after consummation, must state that.
  - iv. For discounted variable rate transactions, must use APR computation rules to determine APR that is disclosed.
  - v. If discounted initial rate is included, advertisement must provide the limited term during which the rate applies.
- b. If an advertisement includes any “trigger terms,” then additional information is required. The “trigger terms” are:
  - i. The number of payments or period of repayment.
  - ii. The amount of any payment.
  - iii. The amount of any finance charge.
- c. The down payment is an additional “trigger term” for credit sales.
- d. If “trigger terms” are present, the advertisement must include:
  - i. The amount or percentage of the down payment.
  - ii. The terms of repayment.
  - iii. The annual percentage rate or APR and, if applicable, that the APR is subject to increase after consummation.
- e. Exception for discounted variable rate transactions.
  - i. The effect of the discount on the initial payments may be shown without triggering additional disclosures.
- f. Because of the range of credit terms that typically apply to mortgage transactions, advertisements typically will need to rely on the ability to present one or more examples of typical transactions.
  - i. When examples are used, they must be labeled as examples, and must be representative of actual terms offered.

### 4. Advertising—Home Equity Lines of Credit (HELOCs)

- a. If an advertisement states a periodic rate, the rate must be stated as an annual percentage rate or APR.
  - i. If the HELOC provides for a variable rate, this must be stated.
  - ii. If a variable rate HELOC provides for a discounted initial rate, the discounted APR and period that the discounted APR is in effect must be

- stated. Additionally, the advertisement must disclose, with equal prominence to the discounted rate, a reasonably current APR that would have been in effect using the index and margin, along with the statement that this rate may vary.
- b. If an advertisement includes any “trigger terms,” either affirmatively or negatively, then additional information is required. The “trigger terms” are:
    - i. Any APR that may be applied.
      - The APR is not a trigger term for closed-end credit advertisements, but is for HELOC advertisements.
    - ii. When the finance charge begins to accrue, or a statement of any period within which any credit may be repaid without a finance charge being incurred.
    - iii. The method of determining the balance on which the finance charge may be imposed.
    - iv. The method of determining the finance charge, including a description of how any finance charge other than the periodic rate will be determined.
    - v. The amount of any charge, other than the finance charge, that may be imposed as part of the HELOC.
    - vi. The payment terms of the HELOC, which are the draw period, any repayment period, the length of the HELOC, how the minimum payments are determined and the timing of the minimum payments.
  - c. If “trigger terms” are present, the advertisement must include:
    - i. Any minimum, fixed, transaction, activity or similar charge.
    - ii. Any periodic rate that may be applied, expressed as an APR.
    - iii. If the HELOC provides for a variable periodic rate, this must be stated, as well as the maximum rate that may be imposed.
    - iv. Any loan fee that is a percentage of the credit limit under the HELOC.
    - v. An estimate of any other fees imposed for opening the HELOC, stated as a single dollar amount or a reasonable range.
  - d. With regard to the disclosure of a variable APR:
    - i. An advertisement may include an insert to show the current rate, disclose the applicable rate as of a specified recent date, or disclose an estimated rate.
    - ii. If an estimated rate is disclosed, that fact must be stated and the estimate must be based on the best information that is reasonably available.
    - iii. See a. above regarding a discounted variable rate.
  - e. With regard to the estimate of fees for opening the HELOC:
    - i. Both lender and third party fees must be disclosed.
    - ii. If fees to open a plan will be imposed, but may be rebated, the fees still need to be disclosed.
    - iii. If property insurance is required, the premium cost may be estimated or the requirement for insurance must be stated.
  - f. If an advertisement contains a statement about any minimum periodic payment:
    - i. If there is a potential for a balloon payment, the advertisement must state that a balloon payment may result.

- ii. If a balloon payment would result if only the minimum required payments are made, the advertisement must state that a balloon will result if only the minimum payments are made.
- iii. The term “balloon payment” does not have to be used. The requirements apply only if the balloon payment could exceed twice the amount of the other minimum payments.
- g. If an advertisement states that the interest is or may be tax deductible, the statement may not be misleading. A reference to tax deductibility is not misleading if the advertisement includes a statement such as “consult a tax advisor regarding the deductibility of interest.”
- h. Misleading terms are not permitted. For example, an advertisement may not:
  - i. Refer to a HELOC as “free money” or contain a similar misleading statement.
  - ii. State “no closing costs” or “we waive closing costs” if the consumer may be required to pay any fees, such as recording fees. (A “no closing cost” statement may be included if the consumer will pay no closing costs, even though property insurance is required, if the advertisement reflects that property insurance is required.)

## C. MORTGAGE LOAN TOLERANCES

### 1. Finance Charge (see also the Annual Percentage Rate section below)

#### a. For general purposes:

The finance charge and other disclosures affected by the finance charge will be deemed to be accurate if:

- i. The amount disclosed as the finance charge exceeds the actual finance charge.
- ii. The amount disclosed as the finance charge is not understated by more than \$100 (i.e., the disclosed finance charge is not more than \$100 less than the actual finance charge).

#### b. For rescission purposes:

i. *General Rule.* Except as provided in ii. and iii. below, the finance charge and other disclosures affected by the finance charge will be deemed to be accurate if:

- The amount disclosed as the finance charge exceeds the actual finance charge.
- The amount disclosed as the finance charge is not understated by more than 1/2 of 1 percent of the face amount of the note or \$100, whichever is greater (i.e., the disclosed finance charge is not more

than 1/2 of 1 percent of the face amount of the note or \$100, whichever is greater, less than the actual finance charge).

ii. *1% For Certain Refinancings.* Except as provided in iii. below, for a refinancing of a residential mortgage transaction, provided that the refinancing is not subject to Home Ownership Equity Protection Act and there is no new advance and no consolidation of existing loans, the finance charge and other disclosures affected by the finance charge will be deemed to be accurate if:

- The amount disclosed as the finance charge exceeds the actual finance charge.
- The amount disclosed as the finance charge is not understated by more than 1 percent of the face amount of the note or \$100, whichever is greater (i.e., the disclosed finance charge is not more than 1 percent of the face amount of the note or \$100, whichever is greater, less than the actual finance charge).

iii. *Special Foreclosure Rules.* After the initiation of foreclosure on the consumer's principal dwelling that secures the obligation, the finance charge and other disclosures affected by the finance charge will be deemed to be accurate if:

- The amount disclosed as the finance charge exceeds the actual finance charge.
- The amount disclosed as the finance charge is not understated by more than \$35 (i.e., the disclosed finance charge is not more than \$35 less than the actual finance charge).

Additionally, the consumer has the right to rescind if the mortgage broker fee that should have been included in the finance charge was not included.

## 2. Annual Percentage Rate (APR)

a. *APR-Specific Tolerances.* For general purposes and rescission purposes, the annual percentage rate will be deemed to be accurate if:

- i. For regular transactions, the amount disclosed as the annual percentage rate is not understated or overstated by more than 1/8 of 1 percent of the actual annual percentage rate (i.e., the disclosed annual percentage rate is not more than 0.125 percentage points higher or lower than the actual annual percentage rate).
- ii. For irregular transactions, the amount disclosed as the annual percentage rate is not understated or overstated by more than 1/4 of 1 percent of the actual annual percentage rate (i.e., the disclosed annual percentage rate is

not more than 0.250 percentage points higher or lower than the actual annual percentage rate).

An irregular transaction is one that includes one or more of the following features: multiple advances, irregular payment periods, or irregular payment amounts (other than an irregular first period or an irregular first or final payment).

b. *Finance Charge-Based Tolerances.* The following tolerances are in addition to the APR-specific tolerances.

i. *APR Reflects Finance Charge.*

- For general purposes, the disclosed annual percentage rate will be deemed to be accurate if the disclosed annual percentage rate results from the disclosed finance charge, and the disclosed finance charge is deemed accurate under the tolerance for general purposes set forth in paragraph 1.a. of the Finance Charge section above. (That is, for example, if the disclosed finance charge is overstated by \$1,000 and the disclosed annual percentage rate reflects a finance charge that is overstated by \$1,000, the disclosed annual percentage rate will be deemed to be accurate.)
- For rescission purposes, the disclosed annual percentage rate will be deemed to be accurate if the disclosed annual percentage rate results from the disclosed finance charge, and the disclosed finance charge is deemed accurate under the tolerance for rescission purposes set forth in paragraph 1.b. of the Finance Charge section above. (That is, for example, if the disclosed finance charge is overstated by \$1,000 and the disclosed annual percentage rate reflects a finance charge that is overstated by \$1,000, the disclosed annual percentage rate will be deemed to be accurate.)

ii. *APR Within Range of Finance Charge Error.*

- For general purposes, the disclosed annual percentage rate will be deemed to be accurate if the disclosed finance charge is deemed accurate under the tolerance for general purposes set forth in paragraph 1.a. of the Finance Charge section above and:
  - If the disclosed finance charge is understated, the disclosed annual percentage also is understated, but by a lower amount. (That is, for example, if the disclosed finance charge is understated by \$100 and the disclosed annual percentage rate reflects a finance charge that is understated by \$50, the disclosed annual percentage rate will be deemed to be accurate.)
  - If the disclosed finance charge is overstated, the disclosed annual percentage reflects a finance charge that is overstated, but by a lower amount. (That is, for example, if the disclosed finance

charge is overstated by \$1,000 and the disclosed annual percentage rate reflects a finance charge that is overstated by \$500, the disclosed annual percentage rate will be deemed to be accurate.)

- For rescission purposes, the disclosed annual percentage rate will be deemed to be accurate if the disclosed finance charge is deemed accurate under the tolerance for rescission purposes set forth in paragraph 1.b. of the Finance Charge section above and:
  - If the disclosed finance charge is understated, the disclosed annual percentage also is understated, but by a lower amount. (That is, for example, in a transaction subject to the tolerance rule set forth in paragraph 1.b.ii. of the Finance Charge section above, if the disclosed finance charge is understated by 1% of the face amount of the note and the disclosed annual percentage rate reflects a finance charge that is understated by 1/2 of 1% of the face amount of the note, the disclosed annual percentage rate will be deemed to be accurate.)
  - If the disclosed finance charge is overstated, the disclosed annual percentage reflects a finance charge that is overstated, but by a lower amount. (That is, for example, if the disclosed finance charge is overstated by \$1,000 and the disclosed annual percentage rate reflects a finance charge that is overstated by \$500, the disclosed annual percentage rate will be deemed to be accurate.)

## **II. REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)**

### **A. RESPA SCOPE**

#### 1. Federally Related Mortgage Loans:

- a. Broadly defined to cover most residential mortgage loans.
- b. Includes:
  - i. First lien purchase money loans.
  - ii. First lien refinance loans.
  - iii. Second lien loans, including home equity credit lines.
  - iv. Primary residence or second home.

#### 2. Certain Exemptions:

- a. Loans primarily for business, commercial or agricultural purposes.
  - i. Follow TILA/Regulation Z guidance to determine if exemption applies.
- b. Temporary financings, such as construction loans (must be less than 2 years).
- c. Loans on vacant land, unless a home is built or placed on the land in 2 years.

**B. RESPA SECTION 8 PROHIBITIONS:**

1. Referral Fee Prohibition:

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.

*Referral:* Broadly defined to include:

- a. Any oral or written action directed to a person that has the effect of affirmatively influencing the selection by a person of a particular settlement service provider when the person will pay for the settlement service or a charge attributable in whole or part to the settlement service.
- b. When a person paying for a settlement service is required to use a particular settlement service provider.

*Thing of value:* Broadly defined to include various items, such as money, things, discounts, salaries, commissions, services at special prices or rates, and sales or rentals at special prices or rates.

2. Fee Splitting Prohibition:

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.

3. Penalties:

- a. Fine up to \$10,000, prison term up to 1 year, or both.
- b. Joint and several liability to the consumer for three times the amount of any charge paid by the consumer for the applicable settlement service.
- c. Court costs and reasonable attorneys' fees may be awarded.

4. Exceptions:

- a. Payments to attorneys for services rendered.
- b. Payments by title companies to duly appointed agents for services performed in the issuance of a title policy.
- c. Payments by lenders to duly appointed agents or contractors for services performed in the origination, processing or funding of a loan.
- d. Payments to persons of bona fide salaries or compensation, or other payments for services, goods or facilities provided.

- e. Payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers (applies only to real estate brokerage activity).
- f. Normal promotional and educational activities that are not conditioned on the referral of business and do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement service business.

#### HUD FAQ:

Can a lender give a real estate agent note pads with the lender's name on it?

Answer: Yes. Such note pads with the lender's name on it would be allowable as normal promotional items. However, if the lender gives the real estate agent note pads with the real estate agent's name on it for the agent to use to market clients for its real estate business, then the note pads could be a thing of value given for referral of loan business, because it defrays a marketing expense that the real estate agent would otherwise incur.

- g. Payments by employers to their own employees for any referral activities.
- h. Affiliated business arrangements.

### **C. LENDER PAYMENTS TO MORTGAGE BROKERS**

#### 1. Two Basic Principles:

HUD has established two basic principles regarding the payment of compensation by lenders to mortgage brokers:

- a. A lender may compensate a mortgage broker for services, goods and facilities provided by the broker, as long as the total compensation received by the broker from the lender, the consumer and any other party is within the range of the market value of the services, goods and facilities provided the broker.
- b. For a lender to pay any compensation to a mortgage broker, the broker must provide at least a minimum level of services, goods and facilities (services).

#### 2. Minimum Level of Services:

- a. Background: HUD first provided guidance on the minimum level of services in two informal interpretations (February 14 and June 20, 1995 letters by Nicolas Retsinas). HUD then formalized the guidance in Statement of Policy 1999-1. HUD identifies specific services, and then addresses the minimum number of services that must be performed to justify the payment of any compensation by a lender to a mortgage broker.

b. Identified Services:

- i. Taking information from the borrower and filling out the application, or performing a comparable activity, such as filling out a worksheet.
- ii. Analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford.
- iii. Educating the prospective borrower in the home buying and financing process, advising the borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product.
- iv. Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process.
- v. Assisting the borrower in understanding and clearing credit problems.
- vi. Maintaining regular contact with the borrower, real estate broker/agent and lender between application and closing to apprise them of the status of the application and gathering any additional information as needed.
- vii. Initiating/ordering verifications of employment and verifications of deposit.
- viii. Initiating/ordering requests for mortgage and other loan verifications.
- ix. Initiating/ordering appraisals.
- x. Initiating/ordering inspections or engineering reports.
- xi. Providing disclosures (truth in lending, good faith estimate and others) to the borrower.
- xii. Ordering legal documents.
- xiii. Determining whether the property is located in a flood zone or ordering such service.
- xiv. Participating in the loan closing.

HUD advises that if a mortgage broker takes the loan application information or performs a comparable function, and in addition performs at least five of the listed services, with at least one of the additional services not being a service listed in ii. through vi., then HUD generally will be satisfied that sufficient origination work was performed by the broker to justify compensation.

HUD refers to the services listed in ii. through vi. as "counseling type" services. If the only services rendered by a broker, other than taking the application or performing a comparable function, are counseling services, additional requirements apply to address the concern of HUD that meaningful counseling, and not steering, be performed. The additional requirements are that (a) the borrower has the opportunity to consider products from at least three different lenders, (b) the broker receives the same compensation regardless of which lender's products are selected, and (c) the payment to the broker must be based on the counseling services and may not be based on the amount of loan business referred to a particular lender.

3. Yield Spread Premiums—Statement of Policy 2001-1:

- a. Background: HUD restates and clarifies its position set forth in Statement of Policy 1999-1 regarding yield spread premium payments by lenders to mortgage brokers. HUD took this action to respond to a decision by the 11<sup>th</sup> Circuit Court of Appeals in the *Culpepper v. Irwin Mortgage* case that determined the case could proceed as a class action. To reach this conclusion, the court had to conclude that an inquiry into the facts regarding each class member, particularly the services rendered by the broker in connection with each class member's loan, was not necessary.
- b. Two Part Test: HUD advises that when a broker provides compensable services, both parts of a two part test established by HUD in Statement of Policy 1999-1 must be applied to determine the permissibility under RESPA Section 8 of yield spread premium payments by lenders to mortgage brokers:
  - i. First Part: The total compensation to a mortgage broker, of which a yield spread premium may be a component or the entire amount, must be for goods or facilities provided or services performed. In order to discern whether a yield spread premium is for goods, facilities or services, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed by the broker in the transaction, whether the goods, facilities or services are paid for by the borrower, the lender, or partly by both.
  - ii. Second Part: Whether the total compensation received by the broker for the goods, facilities and services is reasonable must be determined. Total compensation includes fees paid by a borrower and any yield spread premium paid by a lender, not simply the yield spread premium alone. Yield spread premiums serve to allow the borrower a lower up front cash payment in return for a higher interest rate, while allowing the broker to recoup the total costs of originating the loan. The total compensation to the broker must be reasonably related to the total value of goods or facilities provided or services performed by the broker. Simply delivering a loan with a higher interest rate is not a compensable service.

**D. AFFILIATED BUSINESS ARRANGEMENTS**

1. Definition:

An affiliated business arrangement exists when:

- a. A person who is in a position to refer settlement service business involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and
- b. Either of such persons directly or indirectly refers settlement service business to the provider or affirmatively influences the selection of the provider.

*Associate:* A party who has one or more of the following relationships with a person in a position to refer settlement service business:

- a. A spouse, parent or child of such person.
- b. A corporation or business entity that controls, is controlled by, or is under common control with such person.
- c. An employer, officer, director, partner, franchisor, or franchisee of such person.
- d. Anyone who has an agreement, arrangement, or understanding with such person, the purpose or substantial effect of which is to enable the person in a position to refer settlement business to benefit financially from the referrals of such business.

*Affiliate Relationship:* The relationship among business entities in which one effectively has control over the other by virtue of a partnership or other agreement or is under common control with the other by a third entity or when an entity is a corporation related to another corporation as a parent to a subsidiary by an identity of stock ownership.

*Control:* For purposes of “associate” and “affiliate relationship” means that a person:

- a. Is a general partner, officer, director, or employer of another person;
  - b. Directly or indirectly or acting in concert with others, or through one or more subsidiaries, owns, holds with power to vote, or holds proxies representing, more than 20 percent of the voting interests of another person;
  - c. Affirmatively influences in any manner the election of a majority of the directors of another person; or
  - d. Has contributed more than 20 percent of the capital of the other person.
2. Three Conditions: An affiliated business arrangement does not violate RESPA Section 8 if three conditions are satisfied—a disclosure condition, a no required use condition and a no thing of value condition:
- a. Disclosure Condition: The referring party provides the consumer with a written affiliated business arrangement disclosure in the format specified by HUD.

*Contents:* The disclosure sets forth:

- i. The relationship between the referring party and the settlement service provider.
- ii. The estimated charges or range of charges of the settlement service provider.

*Format:* A separate piece of paper in the format specified by HUD.

*Delivery Requirements:* There are general delivery requirements, requirements for lenders and attorneys, and special requirements for telephone referrals:

- i. Generally the disclosure must be given at or before the time of the referral.
  - ii. For lenders, when the use of a particular affiliated provider is required, the disclosure must be given at the time of loan application. Otherwise the disclosure may be given at the time the Good Faith Estimate is provided.
  - iii. When an attorney or law firm requires a client to use a particular title agent, the disclosure must be provided no later than the time that the attorney or law firm is engaged by the client.
  - iv. For referrals by telephone, the referring party must (A) make an abbreviated verbal disclosure of the arrangement by phone, (B) advise that a written disclosure will be provided within 3 business days and (C) provide the written disclosure within 3 business days.
- b. No Required Use Condition: Subject to exceptions, the referring party may not require the consumer to use a particular settlement service provider.

*Definition:* Required use means a situation in which a person must use a particular settlement service provider in order to have access to some distinct service or property, and the person will pay for the settlement service of the provider or pay a charge attributable in whole or in part to the service. The offering of a package (or combination of settlement services) or the offering of discounts or rebates to consumers for the purchase of multiple settlement services does not constitute a required use. Any package or discount must be optional to the purchaser. The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process.

*Exceptions:*

- i. A lender may require a consumer to use and pay for an affiliated attorney, credit reporting agency or appraiser.
  - ii. An attorney or law firm may arrange a title insurance policy for a client directly as a title agent or through a separate, related corporate title agency, as part of the representation of the client.
- c. No Thing of Value Condition: No thing of value may be received from the arrangement, other than a return on an ownership interest or other RESPA permitted compensation.

### 3. Statement of Policy 1996-2—Regarding Sham Affiliated Business Arrangements

a. Background:

To address issues presented by the growing number of affiliated business arrangements, in 1996 HUD issued a Statement of Policy to provide guidance regarding whether it would view an affiliated business arrangement to be a bona fide arrangement or merely a sham designed to avoid the RESPA Section 8

prohibitions. (At the time, affiliated business arrangements were called “controlled business arrangements”.)

HUD set forth a list of factors that it will consider in assessing if an entity created as part of an affiliated business arrangement is a bona fide provider of settlement services. HUD also set forth factors that it will consider in assessing if distributions made by the entity are bona fide returns on ownership interests, or payments that violate RESPA Section 8.

b. Bona Fide Settlement Service Provider Factors:

- i. Does the new entity have sufficient initial capital and net worth, typical in the industry, to conduct the settlement service business for which it was created? Or is it undercapitalized to do the work it purports to provide?
- ii. Is the new entity staffed with its own employees to perform the services it provides? Or does the new entity have “loaned” employees of one of the parent providers?
- iii. Does the new entity manage its own business affairs? Or is an entity that helped create the new entity running the new entity for the parent provider making the referrals?
- iv. Does the new entity have an office for business that is separate from one of the parent providers? If the new entity is located at the same business address as one of the parent providers, does the new entity pay a general market value rent for the facilities actually furnished?
- v. Is the new entity providing substantial services, *i.e.*, the essential functions of the real estate settlement service, for which the entity receives a fee? Does it incur the risks and receive the rewards of any comparable enterprise operating in the market place?
- vi. Does the new entity perform all of the substantial services itself? Or does it contract out part of the work? If so, how much of the work is contracted out?
- vii. If the new entity contracts out some of its essential functions, does it contract services from an independent third party? Or are the services contracted from a parent, affiliated provider or an entity that helped create the controlled entity? If the new entity contracts out work to a parent, affiliated provider or an entity that helped create it, does the new entity provide any functions that are of value to the settlement process?
- viii. If the new entity contracts out work to another party, is the party performing any contracted services receiving a payment for services or facilities provided that bears a reasonable relationship to the value of the services or goods received? Or is the contractor providing services or goods at a charge such that the new entity is receiving a “thing of value” for referring settlement service business to the party performing the service?
- ix. Is the new entity actively competing in the market place for business? Does the new entity receive or attempt to obtain business from settlement

service providers other than one of the settlement service providers that created the new entity?

- x. Is the new entity sending business exclusively to one of the settlement service providers that created it (such as the title application for a title policy to a title insurance underwriter or a loan package to a lender)? Or does the new entity send business to a number of entities, that may include one of the providers that created it?

HUD advises in the Statement of Policy that the responses to the questions listed above will be considered together in determining whether a settlement service provider is bona fide, and that a response to any one question by itself may not be determinative of a sham affiliated business arrangement.

c. Bona Fide Returns On Ownership Factors:

HUD advises in the Statement of Policy that it will examine the following factors in deciding whether a payment is a return on an ownership interest or an impermissible payment for referrals of business:

- i. Has each owner or participant in the new entity made an investment of its own capital, as compared to a “loan” from an entity that receives the benefits of referrals?
- ii. Have the owners or participants of the new entity received an ownership or participant’s interest based on a fair value contribution? Or is it based on the expected referrals to be provided by the referring owner or participant to a particular cell or division within the entity?
- iii. Are the dividends, partnership distributions, or other payments made in proportion to the ownership interest (proportional to the investment in the entity as a whole)? Or does the payment vary to reflect the amount of business referred to the new entity or a unit of the new entity?
- iv. Are the ownership interests in the new entity free from tie-ins to referrals of business? Or have there been any adjustments to the ownership interests in the new entity based on the amount of business referred?

**E. MARK UPS AND DIRECT FEES**

- 1. Background: In addition to addressing yield spread premiums in Statement of Policy 2001-1, HUD also set forth its interpretation of the fee splitting prohibition under RESPA Section 8(b). This was prompted largely by a decision of the 7<sup>th</sup> United States Circuit Court of Appeals in *Echevarria v. Chicago Title and Trust* in which the court determined that Section 8(b) was not violated when a title company collected recording fees that exceeded the fees paid to the recording office and retained the difference.

*RESPA Section 8(b)—The Fee Splitting Prohibition:*

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.

2. HUD Interpretation: HUD advises that it disagrees with the court's decision, and interprets RESPA Section 8(b) to prohibit all unearned fees, including but not limited to cases in which:
  - a. Two or more persons split a fee for settlement services, any portion of which is unearned.
  - b. One settlement service provider marks-up the cost of services performed or goods provided by another settlement service provider without providing additional actual, necessary and distinct services, goods or facilities to justify the additional charge.
    - i. Courts are divided on this position.
    - ii. The 2nd, 3rd and 11th United States Circuit Courts of Appeals concur that marking up a third party fee may violate RESPA Section 8(b).
    - iii. The 4th, 7th and 8th United States Circuit Courts of Appeals disagree and believe that marking up a third party fee does not violate RESPA Section 8(b).
  - c. One service provider charges the consumer a fee where no, nominal or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.
    - i. The United States Circuit Courts of Appeals that have considered this position have rejected it.

## **F. RESPA SECTION 9 PROHIBITION**

No seller of property that will be purchased with the assistance of a federally related mortgage loan shall require directly or indirectly, as a condition to selling the property, that title insurance covering the property be purchased by the buyer from any particular title company.

Any seller who violates the prohibition is liable to the buyer in an amount equal to three times all charges made for the title insurance.

*Required use:* The definition of "required use" for an affiliated business arrangement also applies to Section 9.

## **G. OTHER MATTERS**

1. Cost Disclosures:
  - a. Good Faith Estimate

- b. Settlement Statement
- 2. Escrow Accounts:
  - a. Accounting requirements and escrow deposit limits
  - b. Initial and annual escrow disclosure statements
  - c. Account surplus, shortage and deficiency rules
  - d. Timely payment of taxes, insurance, etc. required
- 3. Servicing:
  - a. Up front disclosure regarding servicing transfer potential
  - b. Time of servicing transfer disclosure
  - c. Requirement to respond to borrower inquiries and complaints

**H. HUD RESPA WEBSITE**

- 1. The URL of the website is:  
  
[http://www.hud.gov/offices/hsg/sfh/res/respa\\_hm.cfm](http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm)

**III. CONTROLLING THE ASSAULT OF NON-SOLICITED PORNOGRAPHY AND MARKETING ACT (CANSPAM)**

**A. COVERED AND EXCEPTED EMAIL** – The Act generally applies to commercial electronic mail messages (“commercial email”), but does not apply to transactional or relationship messages.

- 1. Covered Email
  - a. “Commercial electronic mail message” is defined as any email message the *primary purpose* of which is the commercial advertisement or promotion of a commercial product or service (including content on an Internet website operated for commercial purposes).
  - b. Primary Purpose:
    - i. Messages that contain only commercial content (“single purpose messages”) are clearly classified as commercial emails and are subject to the Act.
    - ii. If a message contains both commercial advertisement or promotion of a commercial product or service as well as transactional or relationship content (“dual purpose messages”), then the “primary purpose” of the message shall be deemed to be commercial if:
      - A recipient reasonably interpreting the subject line of the email message would likely conclude that the message contains the commercial advertisement or promotion of a commercial product or service; or

- The email message's transactional or relationship content does not appear, in whole or in substantial part, at the beginning of the body of the message.
- iii. If a message contains both the commercial advertisement or promotion of a commercial product or service as well as other content that is not transactional or relationship content (also a form of “dual purpose message”), then the “primary purpose” of the message shall be deemed to be commercial if:
  - A recipient reasonably interpreting the subject line of the email message would likely conclude that the message contains the commercial advertisement or promotion of a commercial product or service; or
  - A recipient reasonably interpreting the body of the message would likely conclude that the primary purpose of the message is the commercial advertisement or promotion of a commercial product or service. (Factors to be considered include the placement of content that is the commercial advertisement or promotion of a commercial product or service, in whole or in substantial part, at the beginning of the body of the message; the proportion of the message dedicated to such content; and how color, graphics, type size, and style are used to highlight commercial content.)
- iv. Messages that contain only transactional or relationship content are generally not subject to the Act’s restrictions on commercial email.

## 2. Excepted Email

The Act’s prohibitions, except for the ban on the use of false or misleading transmission information, do not apply to a “transactional or relationship message.”

- a. “Transactional or relationship message” is defined as an email message the primary purpose of which is to:
  - i. Facilitate, complete, or confirm a commercial transaction that the recipient has previously agreed to enter into with the sender.
  - ii. Provide warranty information, product recall information, or safety or security information with respect to a commercial product or service used or purchased by the recipient.
  - iii. With respect to a subscription, membership, account, loan, or comparable ongoing commercial relationship involving the ongoing purchase or use by the recipient of products or services offered by the sender, provide:
    - Notification concerning a change in the terms or features;
    - Notification of a change in the recipient's standing or status; or
    - At regular periodic intervals, account balance information or other type of account statement.

- iv. Provide information directly related to an employment relationship or related benefit plan in which the recipient is currently involved, participating, or enrolled.
- v. Deliver goods or services, including product updates or upgrades, that the recipient is entitled to receive under the terms of a transaction that the recipient has previously agreed to enter into with the sender.

**B. PROHIBITIONS APPLICABLE TO SENDERS OF COMMERCIAL EMAILS**

1. Using false or misleading headers.
  - a. “Header” is defined as the source, destination, and routing information attached to an electronic mail message, including the originating domain name and originating electronic mail address, and any other information that appears in the line identifying, or purporting to identify, a person initiating the message.
  - b. An accurate “from line” would not be considered materially false or materially misleading.
  - c. This prohibition also applies to transactional and relationship messages.
2. Using false and misleading subject lines.
3. Failing to provide a functioning return email address or similar Internet-based functionality for recipients to opt out of receiving future email messages.
4. Sending a commercial email to a recipient more than 10 business days after the recipient has opted-out of receiving commercial emails.
5. Selling, leasing, exchanging, or otherwise transferring or releasing the email address of a person that has opted out of the receipt of commercial emails for any purpose other than compliance with the Act or other provision of law.
6. Failing to provide the requisite disclosures.

**C. DISCLOSURE REQUIREMENTS**– Senders of commercial email messages must:

1. Identify clearly and conspicuously that the email is an advertisement or solicitation.
2. Provide a clear and conspicuous notice of opportunity to decline from receiving future messages (“opt-out” notice).
3. Provide a valid physical postal address of the sender.

**D. AGGRAVATED VIOLATIONS** – Aggravated violations are subject to additional penalties under the Act.

1. An aggravated violation occurs when a person initiates a commercial email (or assists in the origination of such message through the provision or selection of addresses to which the email will be sent), if such person had actual knowledge, or knowledge fairly implied on the basis of objective circumstances that:
  - a. The email addresses of the recipients were obtained using an automated means from a website or proprietary online service operated by another person that stated that the operator of the website or online service would not transfer email addresses to any other party for the purpose of initiating or enabling others to initiate email messages (“address harvesting”).
  - b. The email addresses of the recipients were obtained using an automated system that generates possible email addresses by combining letters, names or numbers into numerous permutations (“dictionary attacks”).
2. The following are also considered aggravated violations:
  - a. Using scripts or other automated means to register for multiple electronic mail accounts or online user accounts from which to transmit, or enable another person to transmit, commercial email messages that are unlawful.
  - b. Knowingly relaying or retransmitting commercial email messages that are unlawful from a computer or computer network that the sender accessed without authorization.

## **E. ENFORCEMENT & PENALTIES**

1. Enforcement By Federal Agencies
  - a. The Federal Trade Commission (“FTC”) may enforce violations of the Act as unfair and deceptive acts or practices under the Federal Trade Commission Act and may seek civil penalties of up to \$11,000 per violation.
  - b. Other federal agencies are also charged with enforcement of the Act, including: the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, and the Securities and Exchange Commission. The agencies have enforcement powers under their respective statutes. For purposes of enforcement by the agencies, pursuant to their respective statutes, any violation of the Act is considered to be a violation of a FTC trade regulation rule. The agencies may exercise, for the purpose of enforcing compliance with the Act, any other authority conferred on them by law.
2. Enforcement By States - State attorneys general may bring a civil action seeking injunctive relief, actual damages suffered by state residents or statutory damages.
  - a. State attorneys general may obtain statutory damages on behalf of residents of the state in an amount of \$250 per violation. Each separately addressed unlawful

- message received by or addressed to a state resident is considered a separate violation.
- b. For violations identified in Section B above, excluding violations pertaining to the prohibition against using false or misleading header information, statutory damages may not exceed \$2 million.
  - c. A court may increase a damage award to three times the amount of the award if:
    - i. The court determines that the defendant committed the violation willfully and knowingly.
    - ii. The defendant's unlawful activity included one or more aggravated violations (described above in Section D).
3. Providers of Internet Access Services may bring a civil action seeking injunctive relief, actual damages or statutory damages.
- a. Providers of Internet Access Services may seek statutory damages in an amount of \$100 per violation in the case of a violation for using false or misleading header information and up to \$25 per violation in the case of any other violation described in Section B above. Each separately addressed unlawful message that is transmitted or attempted to be transmitted, over the facilities of the provider, or that is transmitted or attempted to be transmitted to an email address obtained from the provider by unlawful address harvesting (as described in Section D.1.a. above) is considered a separate violation.
  - b. For violations identified in Section B above, excluding violations pertaining to the prohibition against using false or misleading header information, statutory damages may not exceed \$1 million.
  - c. A court may increase a damage award to three times the amount of the award if:
    - i. The court determines that the defendant committed the violation willfully and knowingly.
    - ii. The defendant's unlawful activity included one or more aggravated violations (described above in Section D).
4. The Department of Justice is authorized to investigate and prosecute certain violations of the Act and seek criminal penalties.
5. Individuals that receive commercial email messages in violation of the Act are not authorized to bring a civil action.

## **F. FTC RULEMAKING & DEVELOPMENTS**

1. Notice of Proposed Rulemaking - On May 12, 2005, the FTC issued a notice of proposed rulemaking (NPRM) with regard to five items under the Act:
  - a. Defining the term "person".
  - b. Defining the term "sender" for those instances where an email contains more than one sender.

- c. Clarifying the use of (i) a P.O. box, which the sender has registered with the United States Postal Service, or (ii) a private mailbox, which the sender has registered with a commercial mail receiving agency that is established pursuant to United States Postal Service regulations, as a physical postal address.
  - d. Shortening the time a sender has to honor an opt-out request from ten to three business days.
  - e. Clarifying that a recipient may not be required to pay a fee, provide information other than an email address and opt out preferences, or take steps other than replying to an email message or visiting a single website, in order to submit a valid opt out request.
2. To date final rules have not been issued addressing the items in the NPRM discussed above.

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