DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR 3780–P–08]

RIN 2502–AG40

Real Estate Settlement Procedures Act (RESPA) Disclosure of Fees Paid to Mortgage Brokers; Proposed Rule and Notice of Proposed Information Collection Requirements

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: This proposed rule would provide consumers with more meaningful disclosures concerning the functions and fees of mortgage brokers while protecting consumers from fees which are illegal under the Real Estate Settlement Procedures Act (RESPA). At the same time, the rule would provide mortgage brokers with greater clarity regarding the application of RESPA to their fees. Under this rule, mortgage brokers who seek clarity regarding RESPA's applicability to their fees would enter into binding contracts with borrowers prior to the borrowers' applications for mortgage loans. For each particular loan transaction the broker would explain in the contract the services the broker would provide and the broker's duties to the borrower, how the broker's compensation is derived, and the maximum amount of compensation the broker would earn (based on the loan's interest rate and points). Under the contract, the broker would also disclose the components of its compensation including the direct fees to be paid to the broker by the borrower and the potential maximum amount of indirect compensation to be received by the broker from a lender providing mortgage loan funds.

Because compensation to the broker may differ under various combinations of rates and points, the contract would also advise the borrower that the broker has information on other loans with different combinations of rates and points which the broker will display for the borrower. (HUD will facilitate the development of software to help brokers provide this information.) The broker will give the borrower a contract or a contract amendment covering each type of loan product for which the borrower may apply. The contract also requires that the broker provide its State license or other identification number in those States that require licenses.

For those transactions in which mortgage broker contracts are entered into and adhered to, and other requirements of the rule are satisfied, the direct fees received from the borrower, as well as the indirect fees paid to the broker from a lender for the transaction, will be covered by a ''qualified safe harbor'' and presumed to be legal and permissible under section 8 of RESPA. The presumption of permissibility and legality would not apply, however, if one or more of the requirements for the safe harbor is not met. Moreover, even if all of the requirements for the safe harbor are met, the presumption may be rebutted if the total compensation does not pass a test that will be established by HUD through this rulemaking and incorporated into the final rule. There are numerous possibilities for such a test that could result from this rulemaking, including defining the outer boundaries of permissible or legal total compensation in terms of ranges or amounts of dollars that could vary based on the size of a loan or other factors; a test comparing the total compensation for a loan to the total compensation for similar loans by mortgage brokers and lenders; a test establishing the parameters of permissible and impermissible compensation based upon plain and straightforward criteria; or such other test or tests that would provide a clear line between compensation presumed legal and compensation that would not enjoy such presumption. Any test established through this rulemaking will allow brokers, lenders, and consumers alike to determine with certainty whether the total compensation to a broker is or is not legal. HUD is requesting comments from the public on an appropriate test or tests. Mortgage brokers that fail to enter into and adhere to the contract, and fail to meet the other requirements in the rule, will be presumed to be in violation of section 8 of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided.

DATES: Comment Due Date: Deadline for comments on this proposed rule, including comments on the proposed information collection requirements: December 15, 1997.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410–0500. Communications should refer to the above docket number and title. Facsimile (FAX) comments are *not* acceptable. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

HUD also invites interested persons to submit comments on the proposed information collection requirements of this proposed rule. Comments should refer to the above docket number and title, and should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for HUD, Washington, DC 20503.

FOR FURTHER INFORMATION CONTACT: David R. Williamson, Director, Office of Consumer and Regulatory Affairs, Room 9146, Department of Housing and Urban Development, Washington, DC 20410; telephone (202) 708–4560; or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/RESPA, or Grant E. Mitchell, Senior Attorney for RESPA, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone (202) 708–1550. (These are not toll free numbers). Persons with hearing or speech impairments may access this number via TTY by calling the Federal Information Relay Service at (800) 877–8339, which is a toll-free number.

SUPPLEMENTARY INFORMATION:

I. Introduction

In 1974, when the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. 2601–2617) was first enacted, the housing finance delivery system was very different than it is today. Much of today's technology and many of its lending sources and financing mechanisms did not exist. The secondary market for mortgage loans was still undeveloped, the present variety of loan products were rarely available (including the ''no fee, no point'' loan), and there were few types of providers of mortgage financing. Those few that were known as mortgage brokers generally operated differently than many mortgage brokers operate today. Today, mortgage brokers reportedly arrange financing for nearly half of all home mortgages. Some brokers serve as agents and fiduciaries of borrowers and others simply serve as conduits to provide borrowers mortgage funds as do other mortgage loan providers (such as mortgage bankers, thrift institutions, credit unions, and banks).

Late in 1992, HUD codified a previous legal opinion that mortgage brokers must disclose to borrowers direct and indirect fees that brokers received at settlement (November 2, 1992; 57 FR 49600). In 1995, as a result of concerns that this requirement placed mortgage brokers on an unequal footing with other mortgage loan providers and that information on indirect fees was confusing to borrowers, HUD issued a proposed rule (September 13, 1995; 60 FR 47650) to obtain the public's views on the disclosures of broker fees and on the legality of certain indirect fees to brokers from lenders (which were referred to in that rule as ''wholesale lenders'' and are referred to simply as lenders in this proposed rule). Shortly afterwards, HUD embarked on a negotiated rulemaking on these subjects (see notices published on October 25, 1995 (60 FR 54794) and December 8, 1995 (60 FR 63008)).

The 1995–1996 rulemaking activities on mortgage broker fees did not result in a final rule. Nonetheless, these prior efforts informed HUD and helped shape today's proposal. The earlier activities resulted in a clear consensus that there is confusion in the minds of consumers on the functions of mortgage brokers and the sources of their fees. This confusion may translate into a borrower failing to compare services and fees and thereby paying higher settlement costs. The rulemaking activities also indicated that HUD should consider which mortgage broker fees are or are not permissible, and/or consider establishing a regulatory framework for disclosure and a safe harbor for fees. Recent judicial action has further underscored the need for guidance from HUD.

For their services, mortgage brokers may receive ''indirect fees'' from lenders and/or direct fees from borrowers. Indirect fees to mortgage brokers are called a variety of terms, including ''volume based compensation,'' ''servicing release premiums,'' ''overages,'' or ''yield spread premiums (or differentials).'' This last term, ''yield spread premiums (or differentials),'' has been used to refer to that portion of the price that a lender would pay a mortgage broker for a loan at a particular rate and point combination; this type of compensation has been particularly controversial. In specific transactions, indirect fees may comprise a large part or even all of the compensation to mortgage brokers for services. Mortgage brokers indicate that various financing options and products available to borrowers, including ''no fee, no point'' loans, depend for their feasibility on the payment of indirect fees by lenders.

Several lawsuits have been brought recently seeking class action certification that are based in whole or in part on the theory that certain of the fees paid by lenders to mortgage brokers, particularly from lenders, are fees for the referral of business in violation of section 8 of RESPA. In early 1997, two Federal district courts considered cases involving mortgage broker fees and reached different conclusions. One held initially that indirect fees to mortgage brokers in the form of ''yield spread premiums'' violated section 8(a) of RESPA as referral fees.[1] The other court held that a payment for a loan above market was permissible under section 8(c) of RESPA as payment for a ''good.''[2] In June 1997, two other Federal district courts concluded that yield spread premiums (or differentials) were not per se violations of RESPA and therefore refused to certify class actions on this issue.[3]

HUD has never taken the position that yield spread premiums or any other named class of back-funded or indirect fees are per se legal. The Illustrations of the Requirements of RESPA, contained in the 1992 RESPA rule and codified as Appendix B to 24 CFR part 3500, specifically listed ''servicing release premiums'' and ''yield spread premiums'' as fees to be itemized on the HUD–1 Settlement Statement. More recently, on June 11, 1997 (62 FR 31982), HUD issued a revised Settlement Costs Booklet. In that booklet, HUD explained to the borrower: ''Your mortgage broker may be paid by the lender, you as the borrower, or both.'' Both of these issuances recognized how settlement service business is commonly transacted, but neither provision was intended to create a presumption of per se legality of any such fees, because HUD does not view the name of the fee as the appropriate issue under RESPA. The RESPA issue is whether the total compensation to a broker in a particular covered transaction is or is not reasonably related to the value of the goods furnished or services performed. If the compensation, or a portion thereof, is not reasonably related to the goods furnished or the services performed, there is a compensated referral or an unearned fee in violation of section 8(a) or 8(b) of RESPA, whether it is a direct or indirect payment.

This proposed rule seeks to address these matters by providing a framework for furthering consumer understanding of mortgage broker functions and fees. This framework will allow brokers to continue to offer borrowers beneficial loan products, so long as the broker's compensation is consistent with RESPA's requirements. In carrying out this purpose, this proposed rule remains true to and preserves RESPA's enduring consumer protections against unearned fees. Such fees only serve to increase the costs of homeownership.

Under this proposed rule, the Secretary of HUD proposes to establish a new mortgage broker contract to provide essential information to consumers concerning the functions and compensation of mortgage brokers. This contract is to permit consumers to understand a broker's functions and fees before becoming obligated to use the broker's services. To maximize use of this contract in brokered transactions, the rule would provide that when a broker enters into the contract prescribed under the rule, and meets other criteria designed to protect the consumer, the direct fees paid by the borrower and the indirect fees paid to the broker in the transaction would be presumed to be legal and permissible under section 8 of RESPA. In such cases the fees will fall within a ''qualified safe harbor.'' The presumption of permissibility and legality will not apply, however, if one or more of the requirements for the safe harbor is not met. Moreover, even if all of the requirements for the safe harbor are met, the presumption may be rebutted if the total compensation does not pass a test to be established by HUD. The purpose of the test is to distinguish between those fees that are acceptable under section 8 of RESPA and those that are not. A major purpose of soliciting public comments under this rulemaking is to assist HUD in developing this test, which will be established in the final rule. Any test to be incorporated into the final rule must allow brokers, lenders, and consumers to determine with certainty whether total compensation to a broker in a loan transaction is or is not legal. Compensation outside of the safe harbor is presumed to violate section 8, but this presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided.

This preamble begins with a background discussion of the various roles and functions of mortgage brokers today, how mortgage brokers originate

[1] *Mentecki* v. *Saxon Mortgage*, No. 96–1629–A, slip op. (E.D. Va. Jan. 10, 1997). However, subsequently, in an order and opinion dated July 11, 1997, the court refused to certify the class.

[2] *Culpepper* v. *Inland Mortgage Corp.*, 953 F.Supp. 367 (N.D. Ala. 1997).

[3] *Barbosa* v. *Target Mortgage*, No. 94–1938, U.S.D.C., Southern District of Florida, *Martinez* v. *Weyerhauser Mortgage*, No. 94–160, U.S.D.C., Southern District of Florida, *Monoz* v. *Crossland Mortgage Company*, Civil Action No. 96–12260, U.S.D.C. for the District of Massachusetts.

loans, how they are compensated, and how RESPA's prohibitions and disclosure requirements apply to their fees. Following this background discussion, this preamble discusses the comments and information learned through HUD's prior regulatory initiatives on this subject—the 1995 proposed rule and the 1995-1996 negotiated rulemaking—which helped shape today's proposal. Finally, this preamble describes and explains the provisions of this proposed rule.

The regulatory record, as well as recent differences in legal interpretation of these issues in the courts, exemplify that this subject involves difficult and contentious issues that are not easy to resolve. This proposed rule seeks to move beyond this controversy to a fair resolution consistent with applicable law. Any proposal on this subject will be controversial. This proposal, however, is an attempt to take a fair and balanced approach to competing interests. Public comment on this rule will be critically important to refining this approach and formulating a final rule that will be consistent with RESPA's purpose, that will be workable in the market place, and that will address the financing needs of Americans.

In crafting a final rule, the Secretary will be guided by the following principles:

1. Protect consumers while recognizing the settlement services industry is changing. Although the settlement services industry is changing, RESPA's purposes—protecting consumers against inflated, burdensome settlement costs through meaningful disclosure and its prohibition against unearned fees—are as important today as when the statute was first enacted.

2. Include meaningful and timely disclosures to consumers. Consumers must have full information on settlement services provided and fees received for these services at a time when they can make meaningful choices. Clear, concise disclosures ensure that consumers are not misled about the role settlement service providers play in mortgage transactions and encourage consumers to comparison shop.

3. Protect against illegal fees; disclosure does not make illegal fees legal. While there may be debate about RESPA's specific applicability to mortgage broker fees, HUD cannot and will not sanction fees that are illegal under RESPA. Illegal and exorbitant payments for settlement services make the dream of homeownership more difficult for families to achieve.

4. Encourage innovative products to aid homeownership. Requirements established under RESPA should not impede the availability of innovative financing products, such as ''no fee, no point'' loans. If properly understood, these products can expand choice and lessen the costs of homeownership.

5. Not impede lending to underserved areas and borrowers. Requirements established under RESPA should not impede the efforts of settlement service providers to offer beneficial, reasonably priced services to underserved areas and borrowers.

6. Involve consumer and mortgage industry groups. HUD must give utmost attention in the rulemaking process to the comments of those affected by RESPA's requirements—including representatives of consumers and regulated industries—in fashioning an effective, workable regulatory structure under the law.

7. Provide clear rules for affected industries and consumers. Rules developed to implement RESPA's requirements must provide clear and certain guidance to the settlement services industry and consumers alike. Predictability in HUD's regulation will encourage innovation and discourage violations.

II. Background

On November 2, 1992 (57 FR 49600), HUD issued a rule revising Regulation X (24 CFR part 3500), the regulations interpreting RESPA. While primarily addressing other issues, the November 2, 1992 rule also codified certain previous informal interpretations of HUD and attempted to deal with changes in the real estate settlement services business since the original RESPA rule was issued in 1976. In particular, the 1992 rule defined the term ''mortgage broker'' since, by 1992, mortgage brokers were initiating a large proportion of the mortgage loans made. The rule required the disclosure of all fees, direct and indirect, to mortgage brokers at settlement, thereby codifying a 1992 opinion of HUD's General Counsel. Under the rule, payments to other loan sources following settlement were exempt from disclosure as ''secondary market'' transactions. As indicated above, largely because of concerns expressed about this disparity, on September 13, 1995 HUD issued a proposed rule (60 FR 47650) (1995 proposed rule) offering alternative approaches to disclosure of mortgage broker fees and fees to other lenders. Subsequently, after public notice, (60 FR 54794 (October 25, 1995) and 60 FR 63008 (December 8, 1995)), HUD conducted a negotiated rulemaking on this subject from December 1995 to May 1996. Although the negotiation process did not lead to consensus on a final rule, it was particularly useful in informing HUD and other participants on the roles and functions of mortgage brokers, and clarifying compensation and disclosure issues.

A. The Varied Roles of Mortgage Brokers in Lending

Under the 1992 rule, HUD defined a mortgage broker as ''a person (not an employee of a lender) who brings a borrower and a lender together to obtain a federally-related mortgage loan,'' and who renders settlement services.[4] In its 1995 proposed rule, HUD categorized mortgage brokers as a type of ''retail lender,'' which was identified as the entity that serves as an intermediary between the consumer and the ''wholesale lender.'' 60 FR 47650–47651. The proposed rule identified the ''wholesale lender'' as the entity purchasing or servicing the loan. 60 FR 47651.[5]

Today there are two main types of mortgage brokers—those that represent the borrower and those that do not. Mortgage brokers may fill one role in one transaction and a different role in another. The first type of mortgage broker represents the borrower and generally has an agency relationship with, and a fiduciary duty to, the borrower. This type of broker has two variants: a mortgage broker that does not receive fees from any source other than the consumer, and a mortgage broker that does receive fees from a source other than the consumer, namely, the lender. An agency relationship may arise under State law or may be created by agreement between the mortgage broker and borrower. Although State law is largely undeveloped in this area, in some States mortgage brokers may be found to have a fiduciary responsibility to the borrower even in the absence of a contract provision.

The second type of mortgage broker does not represent the borrower. This type of mortgage broker makes mortgage loans available to borrowers either from one or a number of sources of funds with which the mortgage broker has a business relationship. This type of

[4] HUD issued a February 10, 1994 rule (59 FR 6506) that clarified that an ''exclusive agent of a lender'' as well as an employee of a lender were not included in the definition of mortgage broker.

[5] This proposed rule has generally abandoned the use of the terms ''retail lender'' and ''wholesale lender'' inasmuch as HUD concluded that neither created clarity for the consumer. This proposed rule uses the term ''lender'' (rather than referring to ''wholesale lender'') and ''retail lender,'' except when discussing provisions of earlier rulemakings that use the terms.

mortgage broker is not the borrower's agent; rather, brokers of this type present themselves as entities that try to sell borrowers mortgage loans as would other mortgage loan providers in the market. If this type of mortgage broker only makes mortgage loans available from one source of funds, the mortgage broker may or may not be functioning as the lender's agent.

B. Differing Methods of Mortgage Brokers in Originating Mortgage Loans

Some mortgage brokers process loans and close loans in their own names. However, at or about the time of settlement, they transfer these loans to lenders that simultaneously advance funds for the loans. This transaction is known in the lending industry as ''table funding.'' In table-funded transactions, the mortgage broker does not furnish the capital for the loans. Instead the lender provides the capital and, immediately after the loan is consummated, the mortgage broker delivers the loan package to that lender, including the promissory note, mortgage, evidence of insurance, and assignments of all rights the mortgage broker held.

In some transactions, mortgage brokers originate loans that are closed in the mortgage brokers' names, fund the loans temporarily using their own funds or a warehouse line of credit, and sell the loans after closing. These mortgage brokers function similarly to mortgage bankers, but they do not service loans.

Still other mortgage brokers function purely as intermediaries between borrowers and lending sources. They originate loans by providing loan processing and arranging for the provision of funds by lenders. The loans are closed in the names of the funding lenders.

C. Mortgage Broker Compensation

Compensation for the services of mortgage brokers frequently comes from fees paid by the borrower.

Compensation may or may not also come from ''indirect'' fees paid by the lender providing the mortgage loan funds. Frequently, mortgage brokers offer the following payment methods for the fees or points the borrower pays directly: (1) The borrower may pay from his or her own funds at closing, (2) the mortgage loan amount may be increased to finance the mortgage broker fees or points (which increases the amount the borrower borrows), or (3) some combination of (1) and (2).

Frequently, mortgage brokers offer payment options that enable the borrower to pay lower fees and points, or even no fees and/or points, in exchange for a higher interest rate, or higher points and fees for a lower interest rate. If the borrower pays lower fees and points and agrees to a higher interest rate, then the lender will pay the mortgage broker a fee that reflects the higher interest payments the lender will receive from the borrower. In other words, indirect fees paid by lenders to mortgage brokers are largely based on the interest rate of the loan entered into by the borrower and the amount of points and direct fees paid by the borrower. Typically, one or more times a day, lenders set prices that they are willing to pay to mortgage brokers for loans delivered to them. The price to be paid for a loan is generally expressed as a percentage of the loan amount. These prices are based on the interest rate of the loan arranged by the mortgage broker and the points and fees for the loan as compared to the price (a combination of an interest rate and points) that the lender would purchase the loan for that day.

The price that the lender will pay is, in turn, based on the value of the loan in the secondary mortgage market (i.e., the market price). Generally, the greater the difference between the rate a loan is entered into with the consumer and the market price for the loan, the greater the total compensation that will be paid to the broker. The price may also reflect factors such as the type of loan, the ''lock-in'' period, and the creditworthiness of the borrower. The price that the lender pays the mortgage broker, therefore, is based on the differential between the combination of rate and points that is the par or market rate for a loan at a given time, and the combination of rate and points at which the loan is entered into with the borrower. The lender may also make additional payments to the mortgage broker at or after settlement attributable to the number of loans provided over a given period. These additional payments constitute a ''volume-based discount.''

The following represents an example of the fee structure of a typical 30-year fixed rate loan involving a mortgage broker:

Rate available from lender to mortgage broker* (rate plus points)		Price charged by mortgage broker to borrower* (rate plus points)		Broker's total compensation*
Rate (percent)	Points	Rate (percent)	Points	
8.00	2.00, paid to broker	8.00	None	2.00 points.
7.75	1.00, paid to broker	7.75	1.00	2.00 points.
7.50	None	7.50	2.00	2.00 points.
7.25	1.00, paid by broker	7.25	3.00	2.00 points.

*These rates and fees are offered for illustrative purposes only, not as an indication of HUD's approval of the legality of any particular fee.

D. Views on Mortgage Broker Compensation

The legality of indirect fees to mortgage brokers from lenders has been the subject of much debate and recent litigation. Section 8(a) of RESPA prohibits compensation for the referral of settlement service business; section 8(b) prohibits unearned fees. Section 8(c)(2) of RESPA, however, provides that payment may be made for ''goods or facilities actually furnished or for services actually performed.'' [6]

Some have argued that any indirect fees paid by lenders to mortgage brokers are simply referral fees in violation of section 8(a) and 8(b) of RESPA. Others have argued that indirect fees violate section 8(a) and 8(b) and are not permitted under section 8(c)(2) except when they reflect the actual cost for the provision of such services, allowing margins for reasonable profit. Still others have argued that to the extent fees are reasonably related to the value of the goods, facilities, and services provided by mortgage brokers to lenders or borrowers, they are permitted under section 8(c)(2) of RESPA.

Those taking the position that fees are permitted if they are reasonably related to the value of the goods, facilities, and

[6] With respect to a mortgage broker that is the agent of a lender, section 8(c)(1) may also apply to the analysis. Section 8(c)(1) provides that nothing in section 8 shall be construed as prohibiting the payment of a fee by a lender to its duly appointed agent for services actually performed in the making of a loan. See also 24 CFR 3500.14(g)(1)(iii).

services have in the past disagreed on how to apply this test. Some argue that the test should include consideration of the value of the good (i.e., the mortgage loan) to the lender, subsuming or in addition to the value of the services performed and facilities provided by the broker (e.g., providing a retail outlet for the loan). Others would only allow consideration of the value of the services performed and facilities provided, arguing that the loan is not a ''good,'' or that the mortgage broker does not provide a loan, only a referral. Others would only allow consideration of the value of the services and facilities to the borrower, not their value to the lender; under this approach yield spread premiums may be permissible if they are solely for the benefit of, and are effectively regarded as owned by the borrower, e.g., when these amounts serve only to offset or decrease the borrower's closing costs. Finally, some argue that the bringing together of the borrower and the lender is a service, not a referral, and therefore may be compensated.

Among those who agree that fees are permitted under section 8(c)(2) of RESPA if they are reasonably related to the value of the goods, facilities, and services provided, there has been disagreement over how to value the goods, facilities, and services. Some suggest that the standard for determining the price of the good should be the price that the market would bear; others criticize this approach because it does not separate out any price that the market may pay for a referral from the price of goods, facilities, and services provided. Some suggest that the standard should be the actual cost for the provision of the goods, facilities, and/or services provided, allowing specific margins for reasonable profit; others criticize this approach as contrary to RESPA's legislative history, asserting that this was not intended to be a rate-setting statute. See S. Rep. No. 93–866, at 3–4 (1974), reprinted in 1974 U.S.C.C.A.N. 6546, 6548–49. Others maintain that HUD must at all times retain some degree of authority over the aggregate of payments to mortgage brokers to deter exorbitant total fees. HUD has been mindful of this debate in shaping this proposed rule.

E. Disclosure of Mortgage Broker Fees

The 1992 rule required the disclosure of all compensation paid to lenders and mortgage brokers as part of the settlement transaction. This was a codification of HUD's position under sections 4 and 5 of RESPA (12 U.S.C. 2603–2604) that all charges imposed on borrowers at settlement must be disclosed.

This meant that lenders and mortgage brokers both had to disclose direct compensation (i.e., fees and points paid by borrower). In addition, when mortgage brokers were acting as intermediaries or were using table funding, they had to disclose their indirect fees from lenders, which were shown as ''P.O.C.'' (paid outside of closing) on the HUD–1 or HUD–1A settlement statement. In contrast bankers, mortgage bankers and thrifts, as well as mortgage brokers that funded loans with their own funds or a warehouse line of credit for which they were responsible, did not have to disclose the compensation they might receive for a subsequent sale of mortgage loans in the secondary market.

The 1992 rule therefore had the effect of treating mortgage brokers serving as intermediaries or using table funding differently from brokers who used a warehouse line of credit or their own funds. The reasoning has been that mortgage brokers who used a warehouse line of credit or their own funds were acting as lenders and transferring their loans in the secondary market. A bona fide transfer of a loan obligation by them after the initial funding is a secondary market transaction exempt from RESPA. 24 CFR 3500.5(b)(7). RESPA does not require disclosure of fees paid in secondary market transactions. In determining what constitutes a bona fide transfer, HUD considers the real source of funding and the real interest of the funding lender. Id. The 1992 rule's requirements for disclosing fees on the Good Faith Estimate (GFE), HUD–1, and HUD–1A also made no distinction between those mortgage brokers that represent themselves as agents of the consumer and those that function like other retail lenders providing loans from various lending sources available to them.

III. Re-Examination of Disclosure of Mortgage Broker Fees

As indicated above, complaints about the difference in disclosure requirements for mortgage brokers serving as intermediaries or using table funding, as compared to disclosure requirements applicable to other loan providers, led HUD to re-examine whether, and if so to what extent, the disclosure of indirect fees, also known as ''back-funded fees,'' paid to mortgage brokers should continue to be required under section 4 of RESPA. For this purpose, HUD issued the 1995 proposed rule.

In the 1995 proposed rule, HUD sought comments on its requirements (reflected in the 1992 rule) that disclosure of ''all charges imposed on the borrower'' shall include fees paid to the mortgage broker by the ''wholesale'' lender, because all charges are ultimately borne by the borrower. HUD also indicated it would consider how all indirect fees should be treated under section 8 of RESPA. HUD sought comments regarding the related issue of whether ''volume-based compensation'' is legal under RESPA and whether it should be required to be disclosed.

The 1992 rule also reiterated HUD's position that ''a bona fide transfer of a loan obligation in the secondary market is not covered by RESPA and this part [24 CFR part 3500], except as set forth in section 6 of RESPA and § 3500.21 [mortgage servicing transfers].'' The 1995 proposed rule offered various alternative approaches for determining what does or does not constitute a secondary market transaction.

A. Alternative Regulatory Structures

In the 1995 proposed rule, HUD offered six alternative approaches to regulating the disclosure of fees paid to mortgage brokers (60 FR 47650, 47653–54) as follows:

Alternative 1

(1) Retaining the current RESPA regulation's approach of requiring disclosure of both direct and indirect fees at settlement for transactions not in the secondary market; (2) classifying mortgage loan sales after settlement as ''secondary market transactions'' not requiring disclosure of direct or indirect fees and exempt from RESPA, including its prohibitions against kickbacks and referral fees; (3) continuing to require disclosure of direct and indirect fees for table-funded transactions and making such transactions subject to RESPA (the loan sale is not a secondary market transaction, it is contemporaneous with and not after settlement); and (4) requiring disclosure of direct and indirect fees for loans closed in the name of the wholesale lender (not involving a sale).

Alternative 2

(1) Continuing to require disclosure of direct and indirect fees at settlement for transactions not in the secondary market; (2) classifying any mortgage loan sale—before, contemporaneous with, or after settlement—as a ''secondary market transaction''; (3) requiring disclosure of direct fees at settlement but exempting the sale at settlement of a table-funded mortgage loan from RESPA as a ''secondary market transaction,'' and making unnecessary the disclosure of ''indirect

fees'' associated with the table-funded loan sale; and (4) requiring disclosure of direct and indirect fees for loans closed in the name of the wholesale lender (not involving a sale).

Alternative 3

(1) Continuing to require disclosure of direct and indirect fees at settlement for transactions not in the secondary market; (2) classifying a sale of a mortgage loan following the date of first accrual (the date the first payment is due from the borrower) as a ''secondary market transaction''; (3) requiring disclosure of direct and indirect fees and applying other RESPA restrictions to table-funded transactions (the loan is sold at settlement, before the first accrual date); and (4) requiring disclosure of direct and indirect fees and applying other RESPA requirements to loans closed in the name of a wholesale lender (not involving a loan sale). Under Alternative 3, RESPA disclosure and other restrictions would cover more loan sales transactions (before the first accrual date) between retail lenders and wholesale lenders in addition to sales in table-funded transactions.

Alternative 4

(1) Requiring disclosure only of direct (not indirect) fees at settlement for transactions not in the secondary market (since indirect fees need not be disclosed, the secondary market exemption determines whether other RESPA prohibitions apply); (2) continuing to classify mortgage loan sales as ''secondary market transactions'' not subject to RESPA only if they occur after settlement; (3) requiring disclosure only of direct (not indirect) fees for table-funded transactions, such transactions would not be ''secondary market transactions'' and would be subject to RESPA (the loan sale is contemporaneous with and not after settlement); and (4) requiring disclosure of only direct (not indirect) fees for loans closed in the name of a wholesale lender with such transactions subject to RESPA's other restrictions.

Alternative 5

(1) Requiring disclosure only of direct (not indirect) fees at settlement; (2) classifying a mortgage loan sale, at any time, even simultaneously with loan funding (as in a table-funded transaction) as a secondary market transaction; (3) requiring disclosure of direct fees at settlement but exempting the sale at settlement of a table-funded mortgage loan from RESPA as a ''secondary market transaction''; and (4) requiring disclosure of only direct (not indirect) fees for loans closed in the name of the wholesale lender (not involving a sale) with such transactions subject to RESPA's other restrictions.

Alternative 6

(1) Requiring disclosure only of direct (not indirect) fees at settlement; and (2) classifying a loan sale as a secondary market transaction only if it occurred after the first accrual date. Under Alternative 6, RESPA disclosure and other requirements would cover more transactions than are currently covered, except that indirect fees would not have to be disclosed.

B. Overview of the Public Comments

HUD received 836 comments in response to the 1995 proposed rule. Most commenters were mortgage brokers or employees of brokerage organizations, although many were lenders. Consumer representatives also submitted comments. HUD also received comments from credit unions, banks, attorneys, or other persons and organizations in real-estate-related occupations.

Several national organizations submitted comments—including counsel for the National Association of Mortgage Brokers (NAMB), the Mortgage Bankers Association (MBA), the Real Estate Services Providers Council (RESPRO), the National Association of Realtors (NAR), the National Association of Federal Credit Unions (NAFCU), the American Bankers Association (ABA), the National Home Equity Mortgage Association, the Title I Home Improvement Lenders Association, and the Independent Bankers Association of America (IBAA). Additionally, several State associations representing mortgage brokers submitted comments. The Board of Governors of the Federal Reserve System, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) also commented.

C. Summary of Public Comments on Alternative Regulatory Structures

The preponderance of commenters, primarily industry members and representatives, favored Alternative 5, requiring only disclosure of direct fees and classifying a transfer of a table-funded loan as a secondary market transaction. The NAMB characterized the fees in question as ''fees in the nature of secondary market fees (e.g., service release premiums, excess yield differentials or volume discounts).'' NAMB also argued strenuously that these fees were legitimate and earned, and that their disclosure should not be required because ''they are not fees, points, or charges collected from the mortgagor or seller.''

NAMB and individual mortgage brokers urged that fees of the kind at issue were essential to the continued competitiveness of mortgage brokerage firms, and that their elimination would stifle competition in the mortgage lending industry. While their disclosure to the affected consumer was thought by these commenters to be unnecessary, a determination of their legality was the commenters' paramount concern. Many industry commenters expressed their belief that HUD needed to declare the legitimacy of these fees under RESPA.

The Board of Governors of the Federal Reserve System expressed some concern regarding HUD's proposal to eliminate disclosure of indirect fees paid to mortgage brokers, as that might impact on its determination of coverage under section 32 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103–325; approved September 23, 1994). That section prescribes special rules for high cost mortgage loans, loans which have rates and fees above a certain level. The Board, however, subsequently adopted a regulation that based its calculation on direct (borrower-paid) fees only. Under this circumstance, the Board's originally expressed concern is no longer relevant.

Most, but not all, of the comments adverse to positions taken by mortgage brokers and brokers' organizations came from consumer groups. Five consumer or legal service organizations responded to the proposed rule. Commenting consumer organizations, taking a different view than mortgage brokers, favored Alternative 1, the status quo, among the offered options. Additionally, however, they asked for further strengthening of the existing regulation to require greater disclosure, to cover a larger array of transactions, and to outlaw certain lender payments. Some consumer organizations characterized certain lender payments to mortgage brokers as ''kickbacks,'' impermissible under RESPA whether or not they are disclosed. These commenters urged HUD to issue a blanket prohibition against certain lender-paid fees.

A scattering of industry commenters also supported Alternative 1, the status quo. These included: Travelers Group, New Jersey Savings League, and First Commerce Corporation. These commenters took the view that the current RESPA regulation resulted in the most informative disclosure to consumers while still allowing bona fide secondary market transactions to proceed outside the scrutiny of consumers or others involved in the settlement.

Some other industry commenters supported Alternative 2 (continuing to require disclosure of indirect fees, but expanding the definition of ''secondary market transaction''). These included: McDonnell Douglas West Federal Credit Union, Comerica Inc., The Money Store of Sacramento, California, and the Michigan Bankers' Association.

Similarly, Alternative 4 (which required disclosure only of direct fees, but with no change in the current definition of secondary market transaction) attracted only a few commenters. Four commenters, including the MBA, opted for this structure. The MBA said it favored a ''modified'' Alternative 4. It disagreed that in a table-funded transaction a mortgage loan sale occurs at settlement. Because these sales ''effectively occur after settlement,'' MBA said, it favored Alternative 4 with the recommendation that the final rule conform to MBA's understanding of the table-funding issue.

American Federal Bank of Greenville, SC, PNC Mortgage Corporation of Vernon Hills, IL, and a PNC-affiliated company, The Home Mortgage Network, also favored Alternative 4. PNC Mortgage Corporation went on to suggest that, despite favoring the elimination of a recitation of ''indirect'' fees as the current rule requires, it would be useful for the RESPA regulation both to clarify that other forms of compensation are permitted and to require actual notice to borrowers when the retail lender is being paid ''servicing release premiums'' or ''yield spread premiums.''

There were no industry commenters that favored Alternatives 3 or 6. One consumer organization, Illinois Consumer Justice Council, Inc., supported, in essence, Alternative 3, although the commenter advocated outright prohibitions on specific forms of lender compensation to mortgage brokers.

Both Fannie Mae and Freddie Mac (Government-Sponsored Enterprises or GSEs) cautioned against the adoption, without clarifications, of Alternatives 3 or 6. At the least, Freddie Mac said, ''further elaboration of the concept'' would be necessary were HUD to adopt a definition providing that only mortgage loan sales that occur relatively long after settlement would be regarded as exempt secondary market transactions.

Similarly, Fannie Mae pointed out that narrowing the secondary market exemption could hamper the speed of mortgage financing and adversely affect mortgage lenders' ability to take advantage of technological innovations. Neither GSE registered an outright objection to a narrowing of the secondary market exemption. Each made clear that Alternatives 3 and 6 were not preferred, and, if adopted, would disrupt current practices. Neither GSE expressed a positive preference for any of the alternatives outlined in the proposed rule.

On the issue of volume-based compensation, the commenters were divided. Commercial Credit advocated permitting the payment of volume-based fees. NAMB specifically objected to HUD's questioning the ''propriety of paying volume discounts under RESPA.'' NAMB urged that such payments were a standard industry practice, that the issue should not be addressed ''piecemeal,'' but that HUD should ''articulate a simple standard of what *may* be paid.''

American Federal Bank, PNC Mortgage Corporation, and The Home Mortgage Network indicated that volume-based compensation should be permitted, but that a ''general'' form of disclosure should be required—to the effect that the retail lender ''may receive additional compensation in connection with the transaction.'' McDonnell Douglas West Federal Credit Union advocated disclosure of this form of compensation to borrowers.

Michigan Bankers Association and Comerica (in identical comments) stated that volume-based compensation could lead to loan steering. Arguing that disclosure of such compensation was too complex a matter, these commenters appeared to be suggesting that this form of compensation to brokers should be prohibited altogether. In addition, Travelers Group opposed it as being a form of kickback not tied to actual services rendered and also said that volume-based compensation almost always results in ''loan steering.''

IV. Negotiated Rulemaking

After issuing the 1995 proposed rule, HUD concluded that the issues in the rulemaking might be better understood and perhaps resolved by involving representatives of interested parties in a negotiated rulemaking process. In appropriate circumstances, this process brings together agency representatives with all parties substantially affected by the subject matter in order to negotiate the terms of a needed rule.

On October 25, 1995, HUD published a Notice of Intent to Establish a Negotiated Rulemaking Advisory Committee (60 FR 54794) to address mortgage broker fees and volume-based compensation. HUD received nine comments in response to the notice, most of which favored negotiated rulemaking.

On December 8, 1995 (60 FR 63008), HUD published a notice announcing the establishment of an Advisory Committee. HUD charged the Advisory Committee with: (1) Determining whether the amount and nature of indirect payments to mortgage brokers and certain other mortgage originators should be disclosed to the consumer; and (2) resolving whether volume-based compensation from wholesale lenders to mortgage brokers is permissible under RESPA (and implicitly, whether other payments from wholesale lenders to mortgage brokers are permissible, an issue mentioned explicitly in the October 25, 1995 notice), and whether and how the compensation should be disclosed. The notice set forth HUD's conclusion that, in view of the degree of controversy and in the interest of fashioning the best possible rule, the negotiated rulemaking process offered the best means of generating information and resolving the difficult issues involved.

The Advisory Committee was composed of parties possessing a definable interest in the outcome of a proposed rule—representatives of mortgage brokers, lenders, the Government-Sponsored Enterprises, State government, and consumer advocates. In addition to HUD, the following were members of the Advisory Committee: AARP/Legal Counsel for the Elderly, America's Community Bankers, American Association of Residential Mortgage Regulators, ABA, American Financial Services Association, Citizen Action, Freddie Mac, Fannie Mae, IBAA, the MBA, National Association of Consumer Advocates, National Association of Federal Credit Unions, NAMB, NAR, Office of the Attorney General of the State of Texas, RESPRO, and The Mortgage Capital Group.

A. Advisory Committee Activities and Approach

From December 1995 to May 1996, the Advisory Committee met for six 2-day negotiation sessions that were facilitated by HUD's Chief Administrative Law Judge, Alan W. Heifetz. The Advisory Committee began its deliberations with presentations by participants and industry experts regarding the functioning of the mortgage lending industry. The consumer representatives presented the group with their concerns and their perceptions of areas in which consumers were in need of increased protection. The Advisory Committee then framed the points in question and engaged in substantive discussion of the issues presented.

The Advisory Committee spent a large portion of its time on the issue of the appropriate scrutiny of indirect fees under section 8. Committee members were adamant that the starting point should be resolution of the permissibility of indirect fees. In analyzing fees, the participants recognized that there were different types of fees from lenders to mortgage brokers: (1) fees reflecting payment for a loan delivered at or near the par price, and (2) payments to a mortgage broker for a loan delivered considerably above the par price.

While nearly all participants recognized that mortgage brokers perform valuable services in brokering loans for consumers, they disagreed considerably over the appropriate means of analyzing the legality of mortgage broker fees under RESPA. One representative initially argued that all indirect fees are illegal under section 8(a) and 8(b) of RESPA. Other members of the Committee agreed that the standard RESPA test would apply. As discussed above, that test provides that although fees cannot be paid for the referral of business as proscribed in section 8(a) and 8(b), if fees are reasonably related to the value of the goods, facilities, and services provided, they are permissible under section 8(c)(2) of RESPA.

The Committee attempted to find a workable formula for applying the standard RESPA test to lender payments to mortgage brokers, but it did not reach consensus on how to apply the test to those payments. Advisory Committee members conferred on the options and considered that, if the value of the services was deemed to be the appropriate point of scrutiny, then there would be a further need to define the proper method for determining the value of such services. Others focused on the facilities a mortgage broker provides (which allow lenders to function without ''bricks and mortar''), and argued the value of these facilities should be analyzed in considering whether the broker's compensation was reasonable. Each of these approaches received criticism, however, as it would require establishing a level of appropriate payment for itemized services or facilities. That task would, however, be unworkable and inconsistent with RESPA's legislative history against price-setting.

Some believed that the loan provided by a broker to a lender could be regarded as a ''good'' under section 8(c)(2) with the compensation analyzed in terms of the loan's value to the lender. That approach was criticized, however, as undermining any meaning of RESPA's section 8, since it would allow the lender to pay for the value of the referral as part of the bundled value of the good.

Some suggested defining indirect fees to mortgage brokers as fees in the secondary market outside the scope of RESPA. The Committee addressed the possibility of altering the current definition of what constitutes a secondary market transaction. Although various alternatives were proposed and considered, the group could not agree on any particular approach. Likewise, on the permissibility of particular types of lender payments to mortgage brokers, including volume-based compensation, the participants suggested differing interpretations of the statute's meaning and intent, thus causing an impasse on this issue as well.

All agreed as a general principle that exorbitant rates and points should not be extracted from consumers and that mortgage brokers should not be paid total compensation that greatly exceeds the comparable compensation for comparable borrowers and loan programs. Most agreed that it is difficult to develop a workable test for the proper amount of this compensation. They also recognized the extent of public confusion over the role of mortgage brokers, particularly where the mortgage broker receives compensation from the lender. The participants struggled with the diversity of ways mortgage brokers operate for borrowers. For example, certain mortgage brokers act as the borrower's agent arranging the most favorable loan for the borrower. Certain mortgage brokers offer various loan products in a manner similar to retail lenders. Some offer the loan products of only one lender. Consumer advocates were particularly critical of mortgage brokers who asserted their role to be to place loans with one of several lenders with which they do business, yet took advantage of the consumer's perception that they were acting as the consumer's agent, although they were not, in fact, doing so.

The diverse views of the participants as to how mortgage brokers function and what types of fees they receive resulted in diverse views of the legality of the fees mortgage brokers receive and the extent to which they should be required to disclose their fees to borrowers. Some argued that limiting a mortgage broker acting as a retail lender to a fee for services (and ignoring the value of the good delivered) effectively forced the mortgage broker to act as the borrower's agent without an indication such a step was intended by Congress in enacting RESPA. Mortgage brokers, they argued, should be able to charge consumers whatever price they can obtain for a loan in the market, even if the price is above that at which the lender would have been willing to make the loan. In a competitive market where consumers shop, they claimed, such a broker would be limited by market competition.

On the other hand, when the broker is acting as the borrower's agent, most agreed that the mortgage broker is obligated to shop around for the consumer to obtain the best deal for the consumer. This kind of mortgage broker should not be compensated by a lender based simply on the value of the loan, most agreed, without disclosing such compensation to the borrower.

Few agreed on what circumstances would require mortgage brokers to serve as the borrower's agent. Most, however, concurred on the point that a great many consumers perceive the role of a mortgage broker to be their agent, which is different from how the mortgage brokers perceive themselves.

There was consensus on one point: that a rule should clear up this confusion and require that mortgage brokers inform borrowers of the role the mortgage broker is serving early enough in the transaction to allow the consumer to shop effectively for alternatives.

B. Advisory Committee Views on a Safe Harbor

As a result of the divisions among the negotiators concerning the appropriate analysis, most of the participants endorsed creating a ''safe harbor'' that would exempt from section 8 fees to mortgage brokers in circumstances in which the participants could be confident that the consumer is adequately protected. Most of the participants concluded that creating a safe harbor for mortgage broker fees was the only reasonable means of allowing fee payments while ensuring the consumer was protected. The participants, however, differed on the specific requirements for the safe harbor. Participants suggested differing types and levels of disclosures, depending upon the interests and views of the proponent.

One participant favored a safe harbor involving the execution of a binding mortgage broker contract between the mortgage broker and the borrower. First, this mortgage broker contract would provide terms of the relationship between the borrower and the broker. Second, the broker would disclose direct fees, and the disclosure would notify borrowers that the mortgage broker may receive additional (indirect) fees from a lender pursuant to that transaction. Third, the disclosure would notify the borrower that the broker does not distribute the products of all lenders, and that the products distributed may not represent the lowest price or the best terms available. Fourth, the mortgage broker contract would incorporate additional items that were required as a matter of State law.

One group of the participants proposed a safe harbor involving a borrower-broker contract detailing all the elements of the aforementioned proposal and adding two significant elements. First, the contract would require the broker to disclose the maximum total compensation (including indirect fees) it would receive from all sources (in terms of dollars and/or percentage of total mortgage loan amount). Second, once disclosed, this maximum amount would serve to limit the compensation paid to the broker. A variant of this option, proposed by another participant, would also require that the borrower be explicitly granted the option of paying the broker directly, either through points or from mortgage loan proceeds.

Another participant offered a proposal under which the broker would disclose only the relationship of the broker to the borrower and the broker's direct fees. Yet another participant supported establishment of a safe harbor requiring: (1) Disclosure of the relationship between the borrower and the broker, (2) a statement that the broker does not offer the products of all lenders and that the products offered do not reflect the broker's having shopped for the consumer to ensure the best price available, and (3) disclosure of the fees from the lender and the borrower. In addition, use of this safe harbor approach would only be available in a competitive mortgage market in which multiple services were not being provided by a single entity or affiliated entities. Another participant supported a similar proposal and suggested that a competitive market might be shown by such means as collecting comparable advertised prices by competitors, disclosing average national rates to the borrower, and complying with standards for ''high cost mortgages'' under section 32 of the Riegle Community Development and Regulatory Improvement Act of 1994 (section 103(aa) of the Truth in Lending Act, 15 U.S.C. 1602(aa)).[7]

On May 21, 1996, the Committee concluded its negotiations without reaching consensus on a proposed rule. On July 19, 1996, the Committee Facilitator submitted his final report on the negotiated rulemaking to HUD. That final report summarized the negotiated rulemaking proceedings and detailed the approaches discussed by the participants during the negotiations. In the report, the Facilitator observed that the numerous interests represented in the Committee conflicted and aligned along various permutations. The report noted the Committee's inability to reach consensus and stated that no party would be bound by discussions or particular positions taken during the negotiations.

Although there was a failure to reach consensus, it is significant that the Advisory Committee's deliberations resulted in almost unanimous support for the creation of a safe harbor approach to resolve issues relating to mortgage broker fees. This safe harbor would include the disclosure of the mortgage broker's relationship with the borrower and information about the mortgage broker's fees in the loan transaction. Such a safe harbor was believed to secure a level of consumer protection that would fulfill section 8's purpose. Indirect fees to mortgage brokers that complied with these specific disclosure requirements would be exempt under section 8 of RESPA. In light of the absence of consensus on any one safe harbor approach, HUD was presented with the task of creating acceptable criteria for a safe harbor, if it decided to adopt that approach.

V. This Proposed Rule

Following review of all of the comments and the results of the negotiated rulemaking, HUD is proposing a rule to encourage the use of mortgage broker contracts that will clearly establish the role of the mortgage broker, the mortgage broker's duties, and the mortgage broker's compensation. This proposed rule strives to protect consumers better by providing them the information they need to be better shoppers and by making the information disclosed to them in the mortgage broker contracts binding. This proposal seeks to discourage practices that give financial incentives to mortgage brokers that offer higher priced loans than what are generally available in the marketplace for the particular mortgage applicant.

This proposed rule is premised on the following facts and policy considerations:

1. Under current rules, there are reported cases in which exorbitant payments have been made to mortgage brokers by lenders. In these examples, the cost of the loans is significantly more than what the consumers could have obtained from other loan providers in the marketplace, and these additional costs have undoubtedly contributed to foreclosures.

2. Under the current RESPA rule, consumers are not provided sufficient information about the mortgage broker's role in the transaction. On the other hand, consumers are sometimes overloaded with more information about the home financing process than the consumers can use and receive confusing information about the mortgage brokers' fees.

3. The borrower would benefit from a useful mortgage broker contract specifying the mortgage broker's functions and compensation so that the borrower is not misled as to the role the mortgage broker plays in the transaction and does not fail to comparison shop.

4. Borrowers use interest rates, points, and closing costs to shop for mortgages. With this information, the borrower can make informed choices about loan services, provided the borrower is also aware of the mortgage broker's function and the extent and sources of its compensation.

5. The disclosure of mortgage broker fees paid by the lender on the GFE, HUD–1, and HUD–1A without further explanation is frequently confusing to borrowers. In particular, the fact that these fees are listed as ''P.O.C.'' (paid outside of closing) but are paid by the lender, rather than the borrower, is confusing.

6. Mortgage brokers should agree with borrowers by contract as to how they function, provide appropriate information about their fees, and be required to adhere to the terms of the contract.

7. The disclosure requirement in the 1992 rule may have caused mortgage brokers to establish warehouse lines of credit simply to avoid the disclosure requirement, thereby incurring unnecessary costs passed on to borrowers.

8. The industry requires certainty about the permissibility of payment practices.

9. Fees from lenders to brokers allow the borrower to have an array of choices in trading off interest rate and points,

[7] A ''high cost mortgage loan'' is an owner-occupied residential mortgage loan in which the annual percentage rate of interest (APR) will exceed by more than 10 percentage points the yield on Treasury securities of comparable maturity. A high cost mortgage loan is also a mortgage loan in which the total points and fees paid by the consumer will exceed the greater of 8 percent of the mortgage loan amount, or $400 (adjusted annually by the Federal Reserve Board—$412 in 1996), whichever is larger. 15 U.S.C. 1602(aa); Regulation Z, 12 CFR 226.32.

including ''no fee, no point'' loans. The borrower actually will pay these fees over time as reflected in the interest rate. However, if properly understood by the borrower, this pricing mechanism can expand choice and lessen the closing costs of loans to the homebuyer, making homeownership more affordable and facilitating refinancings to take advantage of lower rates.

10. Under appropriate circumstances it may be possible to recognize a class of compensation to mortgage brokers presumed to be legal. When establishing a class of compensation presumed legal, it is essential to identify any compensation that should not enjoy such a presumption.

11. Mortgage brokers reportedly originate approximately half of all mortgages. This volume of activity would not be possible if the majority of loans obtained through mortgage brokers did not have terms competitive with those of mortgages from other lending sources.

A. Department's Overall Approach to a Safe Harbor

This proposal offers a qualified safe harbor that affords limited protection for fees to mortgage brokers. The mortgage broker contracts required to qualify for the safe harbor proposed in this rule tackle two issues that are potentially controversial concerning mortgage broker fees: (1) How the role of the mortgage broker should be characterized for the consumer/borrower, and (2) how the consumer/borrower should be made aware of the total amount of compensation to the mortgage broker. The contracts proposed under this rule require the broker to specify whether or not the broker is acting as a representative of the borrower to shop for a mortgage loan, or whether the broker does not represent the borrower and serves only to arrange loans. If the broker indicates it acts as a representative, the broker must disclose whether or not it is receiving indirect fees from a lender. To qualify under the safe harbor, mortgage brokers must disclose whether the mortgage broker deals with one or more than one lender so that the consumer can understand the extent to which the broker will shop.[8]

The contract requires the broker to disclose the maximum amount of compensation the broker will receive in the loan transaction, distinguishing the fees coming from the borrower and the fees coming from the lender. Mortgage brokers also will continue to be required to disclose their direct fees as well as their indirect fees paid to them by lenders on the GFE, the HUD–1, or HUD–1A in transactions covered by the exemption.

For those transactions in which the proposed mortgage broker contracts are entered into and adhered to, and other requirements of the rule are satisfied, compensation to brokers will be regarded as having been paid within a ''qualified safe harbor'' within which fees paid to mortgage brokers from lenders will be presumed legal. This presumption of permissibility and legality would not apply, however, if one or more of the requirements for the safe harbor is not met. Moreover, even if all of the requirements for the safe harbor are met, the presumption may be rebutted if the total compensation does not pass a test to be established by HUD and incorporated in the final rule. When the fees do not pass this test, they are presumed to violate section 8 of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided. By providing that the safe harbor is ''qualified,'' HUD preserves the ability to protect consumers against illegal fees, as determined by the test to be established in the final rule following public comment. A qualified safe harbor will ease the difficulty and uncertainty involved in applying section 8(a), 8(b), and 8(c)(2) to total mortgage broker fees. HUD is specifically soliciting comments on the elements of this test.

In order to establish the ''qualified safe harbor,'' HUD is proposing to exercise its exemption authority under section 19(a) of RESPA (12 U.S.C. 2617(a)) to add a new, limited exemption to RESPA's prohibition against kickbacks and unearned fees. In addition, under section 8(c)(5) of RESPA, the Secretary may create regulatory exemptions for ''such other payments or classes of payments,'' after consulting with various Federal agencies (12 U.S.C. 2607(c)(5)). The exemption proposed is limited in that it creates a presumption of legality for compensation that meets the requirements of the exemption.

Regarding lender payments of indirect fees, mortgage brokers and lenders should be aware that, in addition to RESPA, they are also subject to the requirements of the Fair Housing Act and other fair lending laws. Discretionary pricing of loans is a major fair lending concern of HUD and the Department of Justice because of the possibility of disparate treatment of similarly qualified borrowers. Yield spread premiums or servicing release fees that are consistently higher for a minority population, for example, than they are for a similarly qualified nonminority population could be unlawful under the Fair Housing Act. While mathematical precision is not required between the premiums and fees associated with borrowers grouped by racial or other categories, the larger the differences, the closer enforcement agencies will look for possible disparate treatment.

Monitoring of such fees by mortgage brokers and lenders can help preclude unlawful conduct under the Fair Housing Act and other fair lending laws. HUD itself will monitor the number and type of fair lending complaints involving such fees and premiums upon implementation of the final RESPA rule regarding payments to mortgage brokers, and will, if necessary, revisit the issue if it appears that consumers are being subjected to discrimination in this area and would benefit from additional disclosures or additional contract terms.

For mortgage brokers meeting the requirements of the qualified safe harbor, volume-based compensation would be presumed legal (subject to application of the test developed for the final rule); outside of the safe harbor, volume-based compensation will be presumed to violate section 8(a) or 8(b) of RESPA. In making the representation regarding the maximum amount of fees from the lender in the mortgage broker contract, the mortgage broker is to state an amount that reflects expected volume-based compensation for the loan.

This rule does not propose to change the secondary market line. HUD concluded that there was little benefit to shifting the line.

B. Elements of the Safe Harbor Provision

In this proposed rule, HUD would amend 24 CFR 3500.14(g)(2) to provide that lender payments to mortgage brokers are presumed legal and permissible under section 8 if the following conditions are met:

1. Mortgage Broker Contracts

The mortgage broker and the prospective borrower(s) execute a mortgage broker contract for each loan transaction. The form of the mortgage broker contract that would be used would be set forth in Appendix F to part 3500 to facilitate mortgage broker compliance with the safe harbor requirements. The instructions for completing the form would be provided with the form.

[8] A mortgage broker that does not represent the borrower and that deals with only one mortgage lender's products might operate, for example, in an affiliated business arrangement. A Federal Housing Administration (FHA) correspondent could also fall in this category.

HUD is proposing a binding mortgage broker contract rather than a simple disclosure, because a binding contract creates an enforceable remedy for the borrower and ensures that the terms indicated cannot be changed or superseded unilaterally by the mortgage broker. The mortgage broker contract would provide meaningful terms regarding the broker's functions in the transaction, its duty to the borrower (whether it does or does not represent the borrower), the potential maximum amount of compensation to be received in the transaction including the amounts paid by the borrower and by the lender, and the mortgage broker's State license number, if applicable.

The contract would clarify for the borrower the differing functions of mortgage brokers and the role of the mortgage broker in the particular transaction. The contract would describe two main types of mortgage brokers, those that represent the borrower (including the two different variants of mortgage brokers that represent the borrower—those that do and those that do not receive indirect fees), and those that do not represent the borrower. Borrowers would be told whether the mortgage broker represents them and will shop for the most favorable mortgage loan that meets the borrower's stated objectives from the lenders the broker does business with, or whether the broker does not represent the borrower and merely arranges loans. Under the contract, the broker must disclose how many sources the broker will shop from or may use for a borrower's loan.

The mortgage broker is to check the appropriate box regarding how it will function in the particular anticipated transaction. The first box is for use by a mortgage broker that represents the borrower and does not receive a fee from the source of mortgage funds. The second box is for use by a mortgage broker that represents the borrower but may receive a fee from the lender. Both the first and second box are for the type of mortgage broker that, by operation of State law, is a borrower's agent, or that represents itself as a borrower's agent in arranging a mortgage loan in the transaction. Mortgage brokers that are agents of the borrower would be allowed to represent themselves to the consumer as an entity that is required to obtain the most favorable mortgage loan for the borrower from the sources with which they do business. The disclosure of the mortgage broker's function and whether the mortgage broker is receiving fees from the lender will assist the borrower in assessing whether the mortgage broker works only for the borrower, has competing interests, or may be receiving indirect fees.

The third box is for use by a mortgage broker that does not represent the borrower and does not represent itself as a borrower's agent in arranging a mortgage loan in the transaction. This type of mortgage broker may deal with one or more than one source of funds and may receive a fee from the source of funds. This type of mortgage broker would be required under the contract clearly to inform the borrower that it is not the borrower's agent and that it arranges loans from lender(s), and to state the number of lenders with which it brokers loans. Borrowers would not be lulled into paying more than necessary to obtain the loan they want on the assumption that this type of mortgage broker is shopping for the borrower to obtain the best price available. Thus, mortgage brokers that are not the borrowers' agents would not be able to take advantage of borrower confusion over the role of the mortgage broker to obtain a price that exceeds what informed borrowers would pay. The rule is designed to help ensure that ''what the market will bear'' is not inflated by the borrower's misimpression as to the service actually being provided.

The contract then describes how brokers are compensated. It also indicates to borrowers that if a borrower would rather pay a lower interest rate, the borrower may pay higher upfront points and/or fees. The contract specifies the maximum points and other compensation and the maximum total compensation the broker will earn in the transaction for a loan up to a particular amount and at the rate offered by the broker. The contract discloses the source of the compensation—the amount of fees that are to be paid by the borrower and the fees paid by the lender.

Because the compensation may differ under various combinations of rates and points, the contract advises the borrower that the broker has alternative loan arrangements that the broker will display for the borrower. (HUD plans to develop or to facilitate the development of software for use by brokers for this purpose that will be distributed in conjunction with the final rule.)

The contract cautions that the broker's commitment to the amounts disclosed applies only if the borrower qualifies for the loan.

The back of the contract form would include a useful, preprinted summary for the borrower of his or her rights in shopping for a mortgage loan, including rights under RESPA and the mortgage broker contract.

Those mortgage brokers seeking to qualify for the safe harbor in § 3500.14(g)(2) would, at the time a consumer expresses serious interest in obtaining a loan from the broker and prior to application or before receipt of any payment (whichever is earlier), determine which of the categories fits its functions respecting the consumer in the particular transaction. The mortgage broker would, before application or before receipt of any payment, whichever is earlier, complete and execute the mortgage broker contract in Appendix F, deliver a copy to the prospective borrower(s), obtain the borrower's or borrowers' signature(s), and retain a copy of the contract. Of course, a mortgage broker could check one box on the form for one transaction and a different box in a different transaction, depending upon the mortgage broker's function in the transaction. However, a mortgage broker would only check one box and complete and execute one form per transaction. For all transactions in which the mortgage broker wishes to qualify for the safe harbor, the mortgage broker would be required to use the form provided and comply with the terms applicable to the box checked. This will ensure consistency in the mortgage broker contracts provided to consumers. If an applicant wants the mortgage broker to shop for more than one type of loan with different rates and fees, then a separate contract would be executed for each possible loan.

Mortgage brokers not wishing to qualify for the safe harbor would not be required to use the form.

2. Performance and Representations Consistent With Contract

During the course of dealings with the prospective borrower(s), the mortgage broker would have to perform in accordance with the terms of the mortgage broker contract and not make representations inconsistent with such contract. The terms of the mortgage broker contract could only be changed through mutual written agreement between the mortgage broker and the borrower. A mortgage broker who indicates on the mortgage broker contract that ''I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives,'' is required to get the borrower the most favorable mortgage loan that meets the borrower's stated objectives from among the sources of funds with which the mortgage broker discloses it will shop.

3. Disclosure of Fees

In addition to the disclosures of fees in the contract, the mortgage broker would have to disclose fees on the GFE and the HUD–1 or HUD–1A in a manner consistent with §§ 3500.7 and 3500.8 of the regulations, as do all mortgage brokers whether qualifying for the safe harbor or not.

4. Mortgage Broker Licenses

If the State in which the property for which the mortgage loan is sought has licensing or registration requirements, the mortgage broker must have a valid license or registration and identify the license or registration number on the mortgage broker contract. A large proportion of States require, or are in the process of requiring, that mortgage brokers be licensed by a State regulatory body. This provision would make the borrower aware of State regulations and might assist an aggrieved borrower in pursuing an action under State law against a mortgage broker. All of the members of the Advisory Committee supported including this information on the contract.

C. Effect on State Law

Section 18 of RESPA (12 U.S.C. 2616) preempts State law that is inconsistent with its provisions, unless such law provides greater protection to the consumer. However, the RESPA regulations in § 3500.13 provide, in part, that RESPA and the RESPA regulations do not annul, alter, affect, or exempt any person subject to their provisions from complying with the laws of any State with respect to settlement practices, except to the extent of the inconsistency. Therefore, in accordance with § 3500.13, mortgage brokers must comply with relevant State laws regarding disclosure of mortgage broker fees and related issues, except when inconsistent with RESPA or the implementing regulations. HUD, to the extent feasible, will work with interested State regulatory bodies to determine if applicable disclosure terms or requirements may be combined in a single form.

D. Definition of Mortgage Broker

HUD's current definition of ''mortgage broker'' specifically excludes an ''exclusive agent of a lender'' from the definition of ''mortgage broker.'' This rule proposes to revise the definition to include an ''exclusive agent of a lender'' and thereby enable such an entity to qualify for the safe harbor. A mortgage broker that deals with only one lender may still perform the functions of a mortgage broker, regardless of whether he or she is the lender's exclusive agent. Such a mortgage broker could take advantage of the safe harbor if all applicable criteria are met. This rule proposes a similar conforming amendment to § 3500.17(b).

E. Questions for Commenters

HUD invites comment on all aspects of today's proposal. In particular, HUD is interested in the public's view regarding the following questions:

1. As proposed, the new safe harbor may be rebutted if the total compensation does not pass a test to be established by HUD. HUD is specifically requesting comments on an appropriate test or tests to determine with certainty what, if any, portion of compensation to a mortgage broker should be impermissible under RESPA. There are numerous possibilities for such a test that could result from this rulemaking. Any test established for the final rule must allow brokers, lenders, and borrowers alike to determine with certainty whether the total compensation to a broker is or is not legal. Accordingly, commenters are requested to suggest a quantifiable or otherwise objective test or tests for examining a broker's total compensation. Suggestions may include, without limitation, defining the outer boundaries of permissible or legal total payments in terms of ranges or amounts such as a specified dollar amount that could vary based on the size of the loan or as a fixed percentage of the loan amount; if compensation exceeds a specified range or amount, the excess could rebut the presumption of legality under section 8. A test also could be based on comparing the total compensation for a broker's loan to the total compensation for similar loans by mortgage brokers and lenders to borrowers of similar credit quality in the broker's area. This could be accomplished by establishing a baseline of the average market compensation for comparable loans for an immediately preceding time period. Any compensation for a loan that exceeds the baseline average by more than a specific amount could be used to rebut the presumption of legality.

Additionally, a test could establish the parameters of permissible compensation through plain and straightforward criteria. This could be accomplished, for example, by providing that a yield spread premium is impermissible unless it is considered owned by, under the control of, and for the benefit of the borrower, or such a premium is impermissible based upon other fixed criteria. Compensation that does not meet the established criteria would rebut the presumption of legality. In this proposed rule, if the mortgage broker does not enter into the specified contract, any mortgage broker compensation is presumed to violate section 8(a) or 8(b) of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided. Commenters are urged to provide any other formulations that also would provide a clear line between compensation presumed legal and compensation that would not enjoy such presumption. HUD requests commenters to provide rule language to accompany any suggested test(s).

2. As proposed, the rule offers a qualified safe harbor under which there is a presumption of legality regarding fees to ''mortgage brokers'' that use the prescribed contract. Is the definition of ''mortgage broker'' under this proposal adequate to avoid the possibility that settlement service providers or others that do not provide any real services could take advantage of the exemption to charge fees? Specifically, should this definition be changed, or should the final rule also require that a mortgage broker perform certain core services to qualify for the exemption? In a letter dated February 14, 1995 from Assistant Secretary Retsinas to the Independent Bankers Association, HUD described certain core services in connection with mortgage lending. To what, if any, extent should the substance of that letter be included in this rule? Those favoring additional requirements should provide their views on what these requirements should be.

3. As proposed, mortgage brokers wishing to qualify for the safe harbor would check a box on a form, depending upon which of the alternatives fits the mortgage broker's function in the particular transaction. HUD seeks comments on alternative approaches or alternative language for the form explaining the broker's function. Does the language proposed adequately distinguish the various categories of mortgage brokers? Would the language proposed unduly influence the consumer to prefer one type of mortgage broker over another? What revisions, if any, should be made to the form?

4. As proposed, mortgage brokers wishing to qualify for the safe harbor must complete and execute the mortgage broker contract ''before application or before receipt of any payment.'' HUD seeks comments on whether the final rule should maintain this general requirement respecting the timing of the disclosure, or whether the rule should specify a more precise time or occasion when the form should be provided. HUD also seeks comments on what, if any, requirements should be included in the rule to address a

situation in which a broker takes an application over the telephone or by other electronic means, including through the Internet. HUD believes the contract should be provided to the borrower as early in the process as possible, but recognizes that information that is provided too early can be so imprecise that it is not useful to the consumer.

5. As proposed, the safe harbor would only appear useful to mortgage brokers that are using table funding or that are acting as intermediaries; those brokers that lend their own funds or use a warehouse line of credit would still qualify for the secondary market exemption. HUD invites comments on whether it should require mortgage brokers that lend their own funds or use a warehouse line of credit to disclose their relationship with the borrower. If so, what would be the basis to impose such a requirement? Should HUD structure a safe harbor that would encourage mortgage brokers in these other circumstances and other loan providers to enter into mortgage broker contracts with borrowers? If so, how would it be structured and what would be its legal basis?

6. As proposed, mortgage brokers that make available the loan products of only one source of funds must disclose on the mortgage broker contract the name of the one lender with which it does business. Is this a fair burden to impose on such mortgage brokers as a part of qualifying for the safe harbor? Does it put such mortgage brokers at a competitive disadvantage?

7. HUD's intent is that the mortgage broker contract would be binding. HUD seeks views concerning the adequacy of consideration of each party under the contract.

8. As proposed, if the amounts of the compensation change, it is anticipated that the broker and the borrower will execute a new contract or amend the contract. HUD seeks public comments concerning the most practical methods to be incorporated into the final rule for affecting changes to the contract. HUD also seeks comments concerning what, if any, restrictions there should be on changes under the contract.

9. As proposed, the contract form provides that total compensation can be disclosed as a dollar amount or as a percentage of the loan. Would it be preferable to require for purposes of comparison that all compensation be disclosed in dollar amounts only? What if any problems would be presented by such a requirement?

10. Should either the contract or regulations address situations in which the borrower chooses not to ''lock in'' the interest rate and chooses instead to allow the rate to ''float'' until the borrower locks in? Should the contract provide that unless the particular loan is applied for by the borrower by a specified date that the broker's commitment to the fees set forth in the contract will expire? Those favoring such provisions should explain what rules, if any, should be added to address these situations. What, if any, rules would be needed to protect borrowers? For example, should the broker be required to provide a new contract detailing the terms of the loan at the lock-in rate? If the contract were to include an expiration date for the fees disclosed, can the borrower be protected from entering into an arrangement too hastily?

11. As proposed, the rule would allow mortgage brokers that represent the borrower and qualify for the safe harbor to collect fees from lenders if such compensation is disclosed and meets the other elements of the safe harbor. Should borrower's-representative mortgage brokers be permitted to receive such compensation, or should such compensation be prohibited? If such compensation were forbidden, how could such mortgage brokers offer ''no fee, no point'' loans? Does the benefit of allowing the flexibility to fund broker fees from interest rate offsets outweigh the disadvantage of creating a possible conflict of interest to the mortgage broker's fiduciary duty to the borrower?

12. As proposed, the rule obligates the mortgage broker—in those instances in which the broker checks the form to indicate that it represents the borrower—to obtain ''the most favorable mortgage loan that meets [the borrower's] stated objectives.'' The form also provides that the broker will identify how many lenders from which it will shop. Are these statements of the borrower's-representative duty to the borrower appropriate? Should the term ''most favorable'' include factors other than price, including, for example, quality or processing time of the lender, and should the rule so provide? Should the rule and the form simply obligate the borrower to obtain the lowest priced loan for the borrower from among the sources it uses?

13. While the market for purchase money loans and most first mortgage refinances is well advertised and highly competitive, this is not necessarily the case for reverse mortgages, as well as home equity, home improvement, high LTV, Alt A, and other less common types of loans. What are the arguments for or against limiting the safe harbor to purchase money and first lien refinancing loans? Should there be any different requirements for so-called B, C, and D credit?

Findings and Certifications

Paperwork Reduction Act

The proposed information collection requirements contained at § 3500.14 and Appendix F of this proposed rule have been submitted to the Office of Management and Budget (OMB) for review, under section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number.

The public reporting burden for each of these collections of information is estimated to include the time for reviewing and instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Information on the estimated public reporting burden is provided in the following table.

MORTGAGE BROKER CONTRACT

Information collection	Number of respondents	Responses per respondent	Total annual responses	Hours per response	Total hours	Regulatory reference
Disclosure to the borrower	10,000	400	4mil.	.033	132,000	3500.14

(b) In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning the proposed collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the

functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Comments must be received within sixty (60) days from the date of this proposal. Comments must refer to the proposal by name and docket number (FR–3780) and must be sent to the Office of Information and Regulatory Affairs of the Office of Management and Budget (OMB), at the address provided in the **ADDRESSES** section of this preamble.

Environmental Impact

In accordance with 24 CFR 50.19(c)(1) of HUD's regulations, this proposed rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate property acquisition, disposition, lease, rehabilitation, alteration, demolition, or new construction, or set out or provide for standards for construction or construction materials, manufactured housing, or occupancy. Therefore, this proposed rule is categorically excluded from the requirements of the National Environmental Policy Act (42 U.S.C. 4321).

Executive Order 12866

The Office of Management and Budget (OMB) reviewed this proposed rule under Executive Order 12866, *Regulatory Planning and Review.* OMB determined that this proposed rule is a ''significant regulatory action,'' as defined in section 3(f) of the Order. Any changes made to this proposed rule as a result of that review are clearly identified in the docket file. The docket file and the Economic Analysis prepared for this proposed rule are available for public inspection between 7:30 a.m. and 5:30 p.m. in the Office of the Rules Docket Clerk, Department of Housing and Urban Development, Room 10276, 451 Seventh Street, S.W., Washington, DC 20410.

Congressional Review of Major Rules

This proposed rule is a ''major rule'' as defined by 5 U.S.C. 804(2) of the Administrative Procedure Act, and will be reviewed by the Congress at the final rule stage.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this proposed rule before publication and by approving it certifies that this proposed rule would not have a significant economic impact on a substantial number of small entities. This proposed rule would provide a ''safe harbor'' from scrutiny under section 8 of RESPA for certain fees paid to a mortgage broker, so long as the mortgage broker complies with the requirements of the proposed rule. HUD strives to provide flexible requirements in order to reduce any burden on small entities. Small entities are specifically invited, however, to comment on whether and how this proposed rule will significantly affect them, and to provide any alternatives for less burdensome compliance.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, *Federalism*, has determined that the policies contained in this proposed rule would not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal Government and the States, or on the distribution of power and responsibilities among the various levels of government. As a result, the proposed rule is not subject to review under the Order. The requirements of the proposed rule are directed toward the disclosure to borrowers of fees paid to mortgage brokers.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) (Pub. L. 104–4; approved March 22, 1995), establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and on the private sector. This proposed rule would not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

List of Subjects in 24 CFR Part 3500

Consumer protection, Condominiums, Housing, Mortgage servicing, Mortgages, Reporting and recordkeeping requirements.

Accordingly, for the reasons set out in the preamble, part 3500 of title 24 of the Code of Federal Regulations is proposed to be amended as follows:

1. The authority citation shall continue to read as follows:

Authority: 12 U.S.C. 2601 *et seq.*; 42 U.S.C. 3535(d).

2. In § 3500.2, paragraph (b) is amended by revising the definition of ''*Mortgage broker*'' to read as follows:

§ 3500.2 Definitions.

* * * * *

(b) * * *

Mortgage broker means a person (not an employee of a lender) who brings a borrower and lender together to obtain a federally related mortgage loan, and who renders services as described in paragraphs (1) or (2) of the definition of ''*Settlement service*'' in paragraph (b) of this section. A loan correspondent meeting the requirements of the Federal Housing Administration under § 202.2(b) or § 202.15(a) of this title is a mortgage broker for purposes of this part.

* * * * *

§ 3500.7 Amended

3. In § 3500.7, the first sentence of paragraph (b) is revised by removing the phrase ''who is not an exclusive agent of the lender''.

4. In § 3500.14, paragraphs (g)(2) and (g)(3) are redesignated as paragraphs (g)(3) and (g)(4), respectively; and a new paragraph (g)(2) is added, to read as follows:

§ 3500.14 Prohibition against kickbacks and unearned fees.

* * * * *

(g)(2)(i) A direct payment from a borrower to a mortgage broker or a payment from a lender to a mortgage broker in a particular mortgage loan transaction is presumed to be legal, provided that the following requirements are met:

(A) Prior to the time of mortgage loan application or receipt of any payment, whichever is first, the mortgage broker and the prospective borrower(s) complete and execute a mortgage broker contract, in the form of appendix F to this part, as appropriate for the particular transaction.

(B) The mortgage broker represents himself or herself to the prospective borrower(s) and acts with regard to such borrower(s) in a manner consistent with the applicable terms of the mortgage broker contract executed by the mortgage broker, and the mortgage broker makes no representations to the prospective borrower(s) that are inconsistent with, and does not act in a manner that is inconsistent with, the terms of the mortgage broker contract. A mortgage broker that indicates on the mortgage broker contract that ''I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives'' is required to get the borrower the most favorable mortgage loan that meets the borrower's stated objectives from among the sources of funds from which the broker states in the mortgage broker contract that it will shop.

(C) The mortgage broker discloses its maximum total compensation along with the amounts of fees from the borrower and the lender for the transaction in accordance with appendix A to this part 3500, §§ 3500.7 and 3500.8, and the mortgage broker contract in the form of appendix F to this part and the instructions thereto.

(D) If the State in which the property (for which the mortgage loan is to be obtained in the particular transaction) is located licenses or registers mortgage brokers, the mortgage broker has a valid license or registration.

(ii) The terms of the mortgage broker contract referred to in paragraph (g)(2)(i) of this section can only be changed through mutual agreement between the mortgage broker and the borrower(s) executed in writing.

(iii) The presumption established under paragraph (g)(2)(i) of this section may be rebutted if the total compensation does not pass the following test: [Test will be published with final rule].

(iv) If the requirements in paragraphs (g)(2)(i) and (g)(2)(ii) of this section are not satisfied, or if the presumption established under paragraph (g)(2)(i) of this section is rebutted in accordance with paragraph (g)(2)(iii) of this section, payments to a mortgage broker from a lender are presumed to violate section 8(a) or 8(b) of RESPA. This presumption can be overcome if the total compensation is reasonably related to the value of the goods or services provided.

* * * * *

5. A new Appendix F to part 3500 is added, to read as follows:

Appendix F to Part 3500—Mortgage Broker Contract

BILLING CODE 4210–27–P

U.S. Department of Housing and Urban Development

DRAFT

Mortgage Broker Contract

Notice to Borrower(s): Read this contract carefully so that you make an informed choice. You are entitled to a copy of this contract. Signing this contract does not obligate you to obtain a mortgage loan through this mortgage broker, nor does it constitute mortgage loan approval.

This contract is between:

Name(s) of borrower(s): ____________________, the "Borrower(s)" or "you"

and

Name of mortgage broker company: ____________________, located at

Address of mortgage broker company: ____________________, who has authorized

Name of mortgage broker: ____________________ to enter into this

contract on its behalf. In this contract, the mortgage broker company and the mortgage broker are called "I" and the entity which will provide your mortgage loan funds is called "lender."

Whom Do I Represent?

☐ **I represent you.** I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives. I will shop for your loan from among ______ lender(s). For my services, I will charge you a fee, but I will not receive any fee for your mortgage loan from a lender.

☐ **I represent you, but I may receive a fee from a lender.** I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives. I will shop for your loan from among ______ lender(s). For my services, I may charge you a fee and I may also receive an additional fee for your mortgage from a lender.

☐ **I do not represent you.** I am not your agent. I arrange loans from lenders and get paid by lenders and borrowers. I make mortgage loans available from

☐ one lender (name of lender): ____________________; or

☐ among (number) ________ lenders.

What Will I Be Paid?

For arranging your loan of [up to] $____________ at an interest rate of ________ (% rate or reference/attach ARM program), I will receive no greater than ______ points and other compensation of $ ____________, so that my total compensation will be no greater than: ________________ (total compensation in $ amount and/or % of loan).

My **Total Compensation** will be made up of: ________________ Fees **You Pay** me ($ amount and/or % of loan) plus ________________ Fees a **Lender Pays** me ($ amount and/or % of loan)

If you would rather pay a lower interest rate, you may pay higher upfront fees; if you pay less up front, you may pay a higher interest rate. Before you sign this contract, I can display alternatives for you.

The amounts disclosed here apply only if you qualify for this loan.

We agree to the terms of this contract. By signing below, the mortgage broker further certifies that the information in this contract is accurate and complies with all provisions of section 8 of the Real Estate Settlement Procedures Act and 24 CFR part 3500.

Borrower(s) Signature & Date:	Mortgage Broker Signature & Date:
X	X
Borrower(s) Signature & Date:	Mortgage Broker License No: (where applicable)
X	

Borrowers: Know Your Rights!

Attention Borrower:

This may be the largest and most important loan you get during your lifetime. You should be aware of certain rights before you enter into any loan agreement.

1. You have the RIGHT to shop for the best loan for you and compare the charges of different mortgage brokers and lenders.
2. You have the RIGHT to be informed about the total cost of your loan including the interest rate, points and other fees.
3. You have the RIGHT to ask for a Good Faith Estimate of all loan and settlement charges before you agree to the loan and pay any fees.
4. You have the RIGHT to know what fees are not refundable if you decide to cancel the loan agreement.
5. You have the RIGHT to ask your mortgage broker to explain exactly what the mortgage broker will do for you.
6. You have the RIGHT to know how much the mortgage broker is getting paid by you and the lender for your loan.
7. You have the RIGHT to ask questions about charges and loan terms that you do not understand.
8. You have the RIGHT to a credit decision that is not based on your race, color, religion, national origin, sex, marital status, age, or whether any income is from public assistance.
9. You have the RIGHT to know the reason if your loan was turned down.
10. You have the RIGHT to ask for the HUD settlement costs booklet "Buying Your Home."

Buying Your Home and other helpful information is available at HUD's WEB site:
http://www.hud.gov/fha/res/respa_hm.html

For other questions call 1-800-217-6970.

Instructions to Preparer:

This contract shall be used by a mortgage broker who wishes to claim the qualified safe harbor provided in 24 CFR 3500.14(g)(2). At the top of the contract, insert the name of the prospective borrower(s), the name and address of the mortgage broker's company, and the name of the mortgage broker.

Mark the applicable box from among "*I represent you*", "*I represent you, but I may receive a fee from a lender,*" or "*I do not represent you*". If "*I do not represent you*" is selected, mark the applicable box corresponding to either: (1) "*one lender*" (and insert the name of the source of funds), or (2) "*among (number)* ______ *lenders*", fill in the blank.

Under "*What Will I Be Paid,*" fill in: (1) the loan amount (which may be stated in terms of an "up to" amount) and the interest rate for the loan (in the case of ARMs, attach or reference descriptive material for the particular ARM program); (2) the points and other compensation to be received by the broker for the loan; (3) the total compensation to be paid to the mortgage broker for the loan including all points and other compensation which may be paid by the borrower and/or the lender; (4) the applicable dollar amount or percentage of mortgage loan principal amount that represents the prospective borrower(s) direct fee (including points, application and any other origination fees)(if none, put "NONE"); and (5) the maximum indirect fees that may be received from the lender in connection with providing the borrower(s) a mortgage loan (if none, put "NONE").

The prospective borrower(s) and the mortgage broker are to sign and date the contract. The preparer is to fill in the mortgage broker license number where indicated or fill in "State does not license mortgage brokers" if applicable. One copy is to be provided to the prospective borrower(s); another is to be retained in the borrower's mortgage loan file. This contract is to be in clear and conspicuous type. The heading "Appendix F to Part 3500" and these *Instructions to Preparer* should not appear on the contract.

Dated: September 17, 1997.

Nicolas P. Retsinas,

Assistant Secretary for Housing-Federal Housing Administrator.

[FR Doc. 97–27343 Filed 10–15–97; 8:45 am]

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