

**Meeting Between Federal Reserve Staff
and the Real Estate Services Providers Council (RESPRO)
January 10, 2011**

Participants: Susan Johnson (RESPRO), Jay Varon (Foley & Lardner), Tim Wilson (Long & Foster)

Jim Michaels, Allen Fishbein, Catherine Henderson, Nikita Pastor, Paul Mondor and Maureen Yap (Federal Reserve Board)

Summary: Staff from the Federal Reserve Board met with representatives from RESPRO to discuss the ability to repay and qualified mortgage provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The representatives specifically discussed the potential impact of the Dodd-Frank Act on creditors with affiliate relationships. The representatives also discussed the possible consequences of the Board's loan originator compensation rule, in particular its provision on affiliates, for creditors with affiliate relationships. The representatives provided two documents to Board staff, which are included with this public summary.



The “Points and Fees” Definitions Under the “Ability to Repay” Standard and HOEPA

Background

Section 1411 of the Dodd-Frank Wall Street Reform Act requires mortgage lenders to determine the borrower's ability to repay the loan based on their compliance with a variety of specified practices.

Section 1412 of the Act creates a safe harbor and rebuttable presumption that a mortgage lender has complied with the new ability to repay” standard for certain “qualified mortgages”, which are mortgages that have a set of particular characteristics that Congress believed are less likely to pose repayment or other problems for consumers.

However, a mortgage is *not* a “qualified mortgage” if the total “points and fees” paid by the consumer in the transaction exceed 3% of the loan amount.

In determining what “points and fees” are included in the 3% threshold that determines whether a loan falls under the safe harbor and rebuttable presumption, the Act adopted (with slight variations) the “points and fees” definition under Home Owners and Equity Protection Act (HOEPA), which counts fees retained by a mortgage lender's *affiliated* company towards the 3% threshold, but not fees paid to a third party, even if the fees retained by an affiliated company are no more than or are less than the charges made by an unaffiliated third party.

As a result, loans in which a mortgage lender's affiliated title, appraisal, and/or other settlement service companies are used would more likely exceed the 3% threshold in which case the lender would not be presumed to comply with the “ability to repay” requirement, even if the mortgage lender complies with all other requirements under the new law.

Separately, Section 1431 of the Act lowers the “points and fees” threshold under which mortgage loans are considered “high cost” loans under HOEPA from 8% to 5% of the total loan amount for loans of \$20,000 or more. Fees retained by a mortgage lender's *affiliated* company count towards this 5% threshold, but not fees paid to a third party—again regardless of whether the fees of the affiliated company are bona fide, and reasonable.

The Issue

The majority of the nation's leading 300 real estate brokerage firms and 100 homebuilders offer both mortgage and title services through wholly-owned subsidiaries or joint ventures that are required to comply with the Real Estate Settlement Procedures Act (RESPA) and HUD RESPA regulations.¹ According to

¹ Consumers who use mortgage lender's affiliated title and settlement service businesses are provided protections under RESPA, many of which are not available to consumers who use unaffiliated companies. Specifically, RESPA and HUD regulations require any mortgage lender that refers a consumer to an affiliated title or settlement service company to disclose in writing that it may benefit from the referral, disclose an estimate of market prices for the referred service, advise the consumer that there may be lower prices available and that he/she should shop around, obtain a written acknowledgment from the borrower

national surveys of recent home buyers, consumers who used affiliated services had a more satisfactory home purchase experience.²

If the “points and fees” definitions under Sections 1411 and Section 1431 of the Wall Street Reform Act take effect as passed, these companies’ affiliated mortgage lenders would be subject to significant regulatory compliance and legal costs and it would be more difficult for them to sell smaller loans in which an affiliated title company is used in the secondary mortgage market.³ As a result, mortgage companies with affiliated title businesses would no longer offer smaller loans, which would reduce the availability of loan products for lower- income and lower middle-income consumers.⁴

The Recommended Solution

The U.S. House of Representatives had foreseen this issue by creating a narrow exemption for affiliated title and title-related fees under the HOEPA “points and fees” definition when it adopted the Mortgage Reform and Anti-Predatory Lending Act in 2007, which again passed the House in 2010 as part of the Wall Street Reform Act. This language would have significantly reduced the discrimination against affiliated mortgage companies under both the new “ability to repay” standard and HOEPA; however, it was deleted without explanation during the House-Senate Conference for this Act.

Although the Wall Street Reform Act is now law, Congress gave federal regulators the authority to exempt by regulation certain loans from the “ability to repay” requirements, whether or not an affiliated company is used. The Federal Reserve Board (Fed) can exempt smaller loans, and the Fed, the FHA, the VA, and the Department of Agriculture can “revise, add to, or subtract from the criteria that define a qualified mortgage” under their jurisdiction”. The Act specifically allows these regulators discretion to make changes “*upon a finding that such regulations are necessary and proper to ensure that responsible, affordable, mortgage credit remains available to consumers.*”

RESPRO® believes that a rule that reinstate the narrow exemption for affiliated title and title-related fees from the “points and fees” definition as passed by the House in 2007 and again in 2010 would prevent the withdrawal of affiliated loan products from the lower-income to lower-middle income marketplaces – with the resulting negative impact on competition and mortgage loan costs -- without any adverse effect on title and title-related costs.

that he/she has reviewed these disclosures, not require the use of the affiliated service, and not pay or receive any referral fees from the affiliated company that are otherwise prohibited under RESPA.

² A 2008 Harris Interactive consumer survey found that buyers who used one-stop shopping in their latest real estate transaction are more satisfied with their home buying experience (8.3) than those who used services from multiple providers (7.6). A 2002 Harris Interactive survey of recent home buyers found that 64% of home buyers who recently used one-stop shopping programs had a better overall experience with their home purchase transaction.

³ Under the “ability to repay” standard, the Act also gives a consumer a perpetual right (without any time limit) to assert as a defense against the mortgage lender a violation of the “ability to pay” standard in any future action to collect the loan.

⁴ A RESPRO® member survey found that mortgage lenders with affiliated title companies would be disinclined to originate loans under \$175,000 due to the 3% threshold under the “ability to repay” standard and would be disinclined to originate loans under \$100,000 under the 5% threshold under HOEPA.

First, according to the most recent national study on affiliated title and title-related costs, affiliated title and title-related fees are competitive in costs with unaffiliated title and title-related fees.⁵

Second, the Wall Street Reform Act already states that any charge that is not “reasonable” shall be included in the 3% threshold under both the “ability to repay” standard and HOEPA, thereby requiring that any affiliated title and title-related charges must be reasonable.

There are numerous ways for federal regulators to enforce this “reasonableness” requirement. First, because a mortgage lender cannot require a consumer to use an affiliated title company, it would be able to compare the costs of loans in which the affiliated title company was used to those in which it was not. Second, 44 states require that title insurance rates be set by the state, approved by the state, or filed with the state, which makes it easy in these states to determine if the affiliated title fees are reasonable. Of the remaining six states and the District of Columbia, two states (Iowa and West Virginia) do not recognize title insurance and one state requires that the rates be posted.⁶ Third, there are web sites where information can be obtained on the costs of title insurance and title searches for most, if not all, states.⁷

Therefore, we recommend that the Fed create a narrow exclusion from the “points and fees” definition under the “ability to repay” standard (Section 1412) and under HOEPA (as revised by Section 1431) for title fees paid to title companies that are affiliates of a creditor so long as the fees are reasonable.

⁵ “*Affiliated Business Arrangements and Their Effects on Residential Real Estate Settlement Costs*” (2006), The CapAnalysis Group LLC.

⁶ A.M. Best, Report to National Association of Insurance Commissioners (NAIC), 2006.

⁷ See, www.tdi.state.tx.us/company/titlemm3.html (Texas), <http://aphaadv.net/patitle/> (New Jersey, New York, and Pennsylvania), and www.federaltitle.com (D.C. Maryland, and Virginia).



Loan Originator Compensation Provisions in the Federal Reserve Board Rule That Could Impact Affiliated Businesses

RESPRO® is concerned that language in the Federal Reserve Board's final regulation on loan origination compensation may be interpreted to unnecessarily discriminate against mortgage brokerage firms with affiliated title or other settlement service providers. We do not believe that that this discrimination was intended by Congress when it enacted the Wall Street Reform Act's loan origination provisions or by the Fed when it published its regulation; therefore, we ask the Federal Reserve Board to clarify that it was not its intent to do so before the rule take effect on April 1, 2011.

The Issue

The final regulation prohibits any "loan originator" from receiving direct or indirect compensation from any person other than the consumer in connection with the transaction if the loan originator receives compensation directly from the consumer in that transaction.

A "loan originator" is defined as a mortgage broker, a company that brokers mortgages, or an employee of a creditor (mortgage lender). A creditor is only considered to be a "loan originator" if the loan is table-funded by a third party.

The problem for affiliated businesses is due to the fact that a loan originator and its affiliates are treated as a single "person" (page 107). The rule also states that the final rule applies whether a creditor's payment is made to a natural person, including an employee of the creditor, or a business entity (page 31).

The Federal Reserve Board says in its rule that it is trying to prevent a parent company with two mortgage lending subsidiaries (Subsidiaries A and B) from circumventing this prohibition by arranging to pay a loan originator who can deliver loans to both subsidiaries greater compensation for an 8% loan offered by Subsidiary A than it would pay the same originator for a 7% loan offered by Subsidiary B. It appears to assume that the only type of affiliation is one where a parent company has two originating affiliates — but the universe of possible affiliations is much wider than this since loan originators often have title and other settlement service affiliates.

The following are two examples of compensation that an affiliated business may receive that may violate the new rule if clarification is not provided.

Example 1: A Borrower Pays the Loan Originator and a Seller Pays its Affiliated Title/Settlement Service Company

The borrower pays a mortgage brokerage firm a mortgage origination fee or other charge. A seller (who could be an individual or a homebuilder) pays the loan originator's affiliated title or other settlement service affiliate compensation for services performed. The mortgage brokerage firm would have violated the rule because the seller and borrower are two different persons who are compensating one entity (the loan originator and the title/settlement service company), even though all the borrower/seller did was pay fair value for a title policy that is required to complete the transaction.

Example 2: A Mortgage Lender Pays the Loan Originator and a Borrower Pays its Affiliated Title/Settlement Service Company

A mortgage brokerage firm provides loans to a mortgage lender and receives a back end fee from that lender that otherwise appears to meet the requirements of the rule because the borrower does not directly pay any mortgage compensation or fees to the mortgage broker. The borrower (or seller) purchases title insurance from the mortgage brokerage firm's affiliated title or other settlement service affiliate. Under this circumstance, the mortgage broker would have violated the rule because the mortgage lender and the borrower (or seller) are two different persons who are compensating one entity (the mortgage broker and its title affiliate), even though all the borrower/seller did was pay fair value for a title policy that is required to complete the transaction.