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BULLETIN 08-14

To: All Old Republic National Title Agents and Offices
From: Underwriting Department
Re: Respa Reform
Date: December 12, 2008

Following is an analysis of the RESPA reform that recently occurred.

2008 RESPA REFORM ANALYSIS

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- * Modified GFE will contain non-itemized title charges in 1100 series
- * Modified HUD-1 with new page 3 will compare actual costs to GFE and disclose tolerances
- * Recording charges subject to 10% tolerance
- * Average charge can be used for any settlement service subject to specific requirements
- * Definition of "required use" changed and discounts can be offered through affiliated settlement service providers in some cases
- * Effective date for new GFE and HUD-1 is January 1, 2010. Effective date for remainder of rule is January 16, 2009.

ANALYSIS

Although the most significant changes in the March 2008 proposed HUD regulation failed to make the final cut, there are still some important changes being made by HUD in its final RESPA rule. These changes will impact the title insurance industry in different ways, but not nearly as much as the original proposal would have.

What was left out: The worst case scenario failed to occur. In the face of thousands of comments, HUD decided to remove some of the more controversial provisions of the proposed rule, all of which the title insurance industry had lobbied against. For instance, the closing script was eliminated, which would have caused a great many problems for the title insurance industry. HUD also decided against calling owners' title insurance "optional." In addition, recording charges were originally subject to a no-tolerance standard and that has been changed. Finally, while HUD decided against specific language permitting volume discounting at this time, it will consider rule changes in the future allowing for negotiated and volume discounts which balance consumer protection while providing "adequate market flexibility and due consideration to small business concerns." Preamble pg. 117. HUD did state on the same page, though, that if discounts are negotiated between

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settlement service providers and the discount is ultimately passed on to the borrower in full, there is no violation of Section 8.

Overview of the new rule: The final rule is a stripped-down version of the original proposal. It contains a new GFE and HUD-1, each of which must be used as of January 1, 2010. The regulations concerning those forms become effective the same day, including the concept of "tolerances" for the cost of items listed on the GFE. However, other changes will be effective January 16, 2009. These include the ability to use average cost pricing for certain settlement services and a new definition of "required use" in the affiliated business setting and a description of how "required use" relates to packaging and consumer discounts.

Description of Elements of the New Rule

New forms: The new GFE and HUD-1 forms have been changed to make them more comparable than they have been in the past. It will be easier for consumers to find particular categories of costs on each form and to see how the actual amount charged differs, if at all, from what was estimated in the GFE. In place of the closing script concept, the HUD-1 will have a new third page which includes a chart comparing GFE disclosures with HUD-1 charges. The chart is divided into three categories, with each category representing a different "tolerance" for pricing changes (from the GFE to the HUD-1) for the component costs found in each category. Charges that cannot increase include most of the lender charges for the loan itself and transfer taxes on deeds and mortgages/deeds of trust. Charges that, in total, cannot increase more than 10% include recording charges, (a welcome change from zero tolerance proposed in March), lender required settlement services where the lender selects the provider, and title services, title insurance and owner's title insurance where the borrower uses a settlement service provider identified by the lender. The amount charged for all other services may change at closing.

Page three of the HUD-1 also contains a table of loan terms. The lender is supposed to supply information for this form, so that the settlement agent can put it together, including loan amount and term, initial interest rate, initial monthly payment amount, whether the interest rate can go up and how much, whether the principal balance can rise, whether there is a balloon payment or prepayment penalty and the amount of the monthly escrow payments, if any.

The GFE is binding on the lender unless a new GFE is provided prior to settlement. This can be done if "changed circumstances" result in increased costs for any settlement service, such that the charges would exceed the tolerance for those charges. However, if there is a violation of tolerance requirements, which would violate Section 5 of RESPA, the originating lender will have 30 days after closing to remedy the situation by reimbursing the borrower for the overages. A similar 30 day cure provision is permitted for settlement agents to revise the HUD-1 should an inadvertent or technical error occur in its preparation whether the error involves an overcharge, undercharge or any misstatement of fact. Such an error would violate Section 4 of RESPA and would need to be corrected to avoid liability.

ALTA attempted to get HUD to alter the GFE so that the 1100 series of charges would be fully itemized in order to enhance the ability of borrowers to comparison shop. This category includes not only title insurance charges, but also attorneys' fees and costs of survey. ALTA believes that borrowers having a detailed listing of each service (including lender's title insurance, owners' title insurance and closing services) would be armed with the information they need to shop. HUD decided that too much detail would be confusing to consumers and left the form as it was. ALTA also lost its argument that the agent and underwriter portions of the title insurance premium should

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NOT be split out on lines 1107 and 1108, since the split does not affect the consumer. Although it seems inconsistent with its position of itemization in the 1100 series of charges, HUD decided the split should be shown on the HUD-1.

The HUD-1 will also contain a designated line for the closing fee (Line 1102). In order to limit what it considers unnecessary itemization, however, HUD's rule calls for the settlement statement to combine administrative and processing services related to title insurance at line 1101 with the overall charge for title services. Because of this change, HUD finds it unnecessary to continue to define "primary title services" as a particular set of services. The definition of "title services" is "any service involved in the provision of title insurance (lender's or owner's policy), including but not limited to: title examination and evaluation; preparation and issuance of a title insurance policy or policies; and the processing and administrative services required to perform these functions. The term also includes the service of conducting a settlement." 24 CFR 3500.2.

Effective Dates: As mentioned earlier, the new GFE and HUD-1 forms will be required as of January 1, 2010. The current forms will remain in effect until that time. If, however, a settlement provider issues a new GFE form prior to the effective date, it will be subject to all the requirements of the new GFE including compliance with tolerance provisions and use of the new HUD-1. Other components of the final rule, including the average charge and required use provisions and the technical amendments will take effect immediately upon the effective date of the rule (January 16, 2009).

Average Charge: An average charge can be used for any settlement service, "provided that the total amounts received from borrowers for that service for a particular class of transactions do not exceed the total amounts paid to the providers of that service for that class of transactions." Preamble p. 125. While the average charge concept will be very useful for industry, the preceding quote is important to remember. Care will have to be taken so that the total average charge billed does not exceed the total paid for a given service. HUD states that one of the benefits of the average charge is that it will save administrative fees for settlement service providers and HUD expects that those savings will be passed onto consumers due to the pressures of competition.

In calculating an average charge, a provider may define a class of transactions based on time, loan type or geographic area. The average charge must be recalculated at least every 6 months. If a settlement service provider uses an average charge for a class of transactions, the provider must use the same average charge for every transaction within that class. An average charge may NOT be used for services where the charge is based on the loan amount or property value, because it would cause smaller borrowers to subsidize larger borrowers. For instance, an average charge may NOT be used for title or mortgage insurance. A provider "must maintain all documents that were used to calculate the average charge for at least three years after any settlement in which the average charge was used." This last provision concerning record-keeping will be very important to keep in mind, as well. See 24 CFR 3500.8 (b)(2).

It is important to note that the average charge concept is the exception to HUD's rule. HUD states in its proposal that "(t)he amount stated on the HUD-1 for any itemized service cannot exceed the amount actually received by the settlement service provider for that itemized service, unless the charge is an average charge in accordance with paragraph (b)(2) of this section." 24 CFR Section 3500.08 (b)(1). In other words, RESPA does not allow mark-ups. Should we provide distinct and necessary additional services, however, it is appropriate to charge a fee equal to the value of the additional services rendered.

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Required Use and Packaging: The concept of “required use” and how it relates to offers for consumers to use affiliated businesses was examined by HUD. Basically, “economic disincentives that are used to improperly influence a consumer’s choices are as problematic under RESPA as are incentives that are not true discounts.” Preamble pg. 133. Legitimate consumer discounts can still be offered, but the rule limits the tying of such a discount to the use of an affiliated service provider.

The definition of “required use” has been changed to explain when discounts can be offered so that they qualify for the affiliated business exemption under 24 CFR 3500.15. “(A) settlement service provider may offer a combination of bona fide settlement services at a total price (net of the value of the associated discount, rebate or other economic incentive) lower than the sum of the market prices of the individual settlement services and will not be found to have required the use of the settlement service providers as long as: (1) the use of any such combination is optional to the purchaser; and (2) the lower price for the combination is not made up by higher costs elsewhere in the settlement process.” 24 CFR 3500.2.

HUD’S Economic Analysis: HUD put together a Regulatory Flexibility Analysis which contains more interesting information. For instance, HUD maintains that annual savings from the new rule will be approximately \$8.35 billion, or about \$668 per loan, approximately the same amount HUD thought would accrue when volume discounts were in the proposed rule and most of the savings were to come from such discounting. In discussing the costs of the GFE for settlement agents, HUD suggests that closers may want to check information regarding costs, tolerances and loan terms to make sure they agree with the GFE. Closers may also have to calculate tolerances. In its analysis, HUD estimates it will take approximately 5 minutes for settlement agents to deal with the demands of the new GFE.