HUD'S RESPA Regulations:
the Proposals, the Comments, the Future

by Sheldon E. Hochberg

What happens when HUD proposes changes to its RESPA regulations that would fundamentally reshape the way in which the mortgage market and settlement service industries operate, tilt the playing field in favor of big mortgage lenders and against small lenders and mortgage brokers, and threaten the survival of small business service providers—all without any authorization from Congress? Just what you would imagine. An outpouring of comments—over 40,000—from every major industry association and consumer group, tens of thousands of mortgage lenders and brokers, title companies and other settlement service providers, and federal and state regulators. While some (primarily the major lenders and consumer groups) expressed general support for HUD's reform efforts, the overwhelming majority of comments expressed grave concerns about the impact of the proposals. And virtually all comments—including those from the lending community and the consumer groups—pointed out significant legal and practical problems that HUD failed to consider or needs to correct.

This article will discuss the HUD proposals, published for comment on July 29, 2002, and provide a thumbnail summary of what the significant players in the RESPA debate had to say to HUD. Of perhaps greatest interest, the article will also discuss the choices facing HUD—once it digests the comments—and offer an educated guess as to HUD's likely next steps. (NOTE: a copy of the HUD proposal, a summary prepared for the title insurance industry, and many of the significant comments are available at the ALTA website: www.alta.org.)

The HUD Proposals—A Brief Summary

There are three major aspects of the proposed regulations: (1) revisions to the "good faith estimate" (GFE) regime that has been in effect since 1976; (2) a new, alternative regime for the provision to consumers of a Guaranteed Mortgage Package (GMP) via a Guaranteed Mortgage Package Agreement (GMPA); and (3) in connection with the revised GFE regime, a major change in the way in which fees paid by funding lenders to mortgage brokers (frequently referred to as "yield spread premiums" (YSPs)) must be disclosed and accounted for.

The Revised GFE Regime

Section 5(c) of RESPA specifies that within three days of receiving an application, a lender must provide to the applicant a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur." The proposed GFE form, rather than providing good faith estimates of the individual charges the borrower is likely to incur, requires settlement costs to be grouped into certain categories (e.g., loan origination charges, lender-required charges, title services and title insurance, government charges, reserves/escrows) that do not disclose the individual costs within the various categories. More importantly, the HUD proposals would require the lender to guarantee that the "estimates" given for the various categories either will not be exceeded at closing or will not be exceeded by more than 10%. The revised GFE form would also include disclosure of certain information otherwise covered by the Truth in Lending Act (TILA)—information regarding the loan, the interest rate being offered, the APR, and the monthly payment.

The new GFE, with its tolerance limits, would have to be provided within three business days of the lender's receiving a redefined "application" that need only include limited credit information, an estimate of the value of the house, and the type and amount of the requested loan. If, at the time the borrower decides to lock in, the loan interest rates have changed (or if the lender declines to make the loan after full underwriting), a new GFE has to be provided. But the amount of any category of settlement charges that is not dependent on the interest rate cannot change from the original estimate.

The Proposed GMPA Regime

Under this alternative, packagers would offer, at no cost and within three days of receipt of the revised and limited application, a guaranteed mortgage package agreement to be kept open for 30 days that would include a loan at a particular interest rate and a single price for essentially

all closing costs for that loan (with no disclosure of the individual services contained in the package). Until accepted by the applicant, the interest rate on the loan can only vary based on changes in an objective and verifiable index. The making of the loan would, however, be subject to final underwriting by the lender. The package price for the closing costs could not be exceeded. Some TILA-type disclosures would also be required. While HUD claims that anyone can provide a GMPA, the comments received make clear that because of the requirement that the GMPA include a loan at a guaranteed interest rate, only lenders will effectively be able to offer GMPAs.

To encourage the offering of discounts in prices by third-party settlement service providers, lenders who package, and those providers offering services covered by the package, would be given an exemption from RESPA §8's prohibitions on referral fees and mark-ups. This exemption would also permit lenders to require the use of their affiliated service providers without running afoul of RESPA's prohibitions on such required use.

The overwhelming majority of comments expressed grave concerns about the impact of the proposals.

New Mortgage Broker Disclosures

One of the most controversial proposed changes—and the one that was the focus of thousands of comments from mortgage brokers throughout the country—relates to the treatment of mortgage broker compensation. Mortgage brokers would have to disclose their aggregate compensation from both the borrower and the funding lender as an amount paid by the borrower, with the payment from the funding lender being treated as a credit against the amount deemed paid by the borrower. Through this approach, HUD hopes to place the mortgage broker in a position where, because any yield-spread premium received from the lender for delivering a higher yielding loan will be credited toward the aggregate fee deemed to be paid by the borrower, the broker has no incentive to obtain a higher interest rate loan for the consumer.

The Comments

Virtually all the comments I have thus far reviewed, even those from the leading proponents of packaging and disclosure reform, expressed concerns about significant aspects of the various proposals. Comments from industry tended to focus on the ways in which HUD's proposals were impractical, exceeded HUD's statutory authority, would impair the continued healthy functioning of the mortgage market, would not achieve HUD's consumer-oriented objectives, and, the most often heard theme, would adversely affect small businesses. Not surprisingly, consumer groups, on the other hand, generally felt that HUD had not gone far enough to protect consumers from unscrupulous lenders.

The fact that proposals of such dramatic and widespread impact would generate strong views will not be a surprise to HUD. What may be eye-opening for the department, however, is the enormous number and variety of significant—and meritorious—practical and legal problems and concerns that have been brought to its attention. What HUD faces is not simply a situation, which federal agencies face all the time, of trying to accommodate reasonable comments received in a rulemaking proceeding and moving ahead with appropriate final regulations. The problems and concerns raised will require, if HUD wants to avoid placing the Bush Administration and the housing and mortgage markets in a most precarious position, a fundamental rethinking of the practical and legal alternatives available to achieve HUD's objectives.

The Views of Mortgage Lenders

As the parties most directly impacted by the proposed changes and the industry constituency of greatest concern to HUD, mortgage lenders are likely to have the greatest weight with the department. Those views, while frequently introduced by words of praise for HUD's reform objectives and generally supportive of the packaging concept, reflected deep concerns about the wisdom and practicality of many aspects of the proposals.

For example, the Consumer Bankers Association noted that many lenders are "quite wary of the GMP option . . . but it is an experiment that must be allowed a fair chance to work." Because the GMP option will "change the face of lending" and "force a realignment of business and a reassessment of pricing that we cannot really foresee at this time," these changes "need to be entered into with care." The Mortgage Bankers Association of America (MBAA), while "embrac[ing]" the GMP proposal, particularly the exemptions from RESPA § 8, urged HUD in no uncertain terms to "clarify and revisit many of the proposed components—particularly the interest rate guarantee—before issuing any final rule."

On certain issues there was a division of views between large mortgage lenders (who generally were supportive of the GMP approach) and the smaller banks, credit unions, and other mortgage lenders (who felt that the GMP approach would place them at a competitive disadvantage to their larger competitors who would have greater clout in obtaining discounts from service providers). For example, in contrast to the views of

the major lender groups, the Independent Community Bankers of America expressed the conclusion that "HUD's proposal will dramatically alter the manner in which mortgages are offered, making the process more confusing, removing consumer choice in the selection of individual settlement services, and decreasing consumer options for mortgage products. . . . In our view, elements of the proposal will further confuse consumers, enable dishonest brokers and lenders to hide unnecessary fees, and overall increase mortgage costs."

This division was reflected in the comments of the American Bankers Association, which represents both large and small banks. While noting that both the GFE and GMP proposals may well have merit, "both raise very serious issues of workability, consumer confusion, costs, and the ability of all types of lenders to compete fully in the changed marketplace. While unanimous agreement is unlikely in such a complex area, ABA believes it is critical that a broad-based consensus be achieved among participants in the mortgage process, or the reform effort is unlikely to be successful."

A comment (clearly coordinated) by many lender trade associations was that HUD should focus on making modifications to the GMP proposal but should not attempt to overhaul the GFE regime at this time. The concerns expressed were that lenders would face enormous costs and difficulties in adjusting to two new regimes at the same time and that a proper test of the packaging approach in the marketplace could only be achieved if the comparison were to the existing and familiar GFE regime. (On the other hand, the National Association of Realtors urged just the opposite approach, that HUD proceed with the revisions to the GFE regime and defer the GMP proposal.)

The most frequent comment by lenders on the GMP approach was directed at the inclusion of a guaranteed mortgage loan in the GMPA proposal. Noting that settlement services and costs were the domain of RESPA, while loans and loan-related charges were the domain of TILA, lenders pointed out that there were significant conflicts in definitions and approaches between how the GMP proposal (and the revised GFE proposal) treated the mortgage loan and the requirements under TILA. As the MBAA said, "in proposing to combine settlement costs with interest rates in the GMPA, HUD is combining two costs with entirely different levels of volatility and risks for lenders." "Until RESPA and TILA are harmonized by legislation to allow a single disclosure form," commented the Consumer Mortgage Coalition, "duplication of disclosures regarding payment schedules, prepayment penalties, balloon payments, and ARM terms will be confusing and lead to legal problems for lenders." Their suggestion was to limit the GMP to settlement services and leave information regarding the mortgage loan to TILA and the Federal Reserve Board's Regulation Z.

Lender groups also repeatedly pointed out the economic and practical difficulties of (a) requiring a lender to commit to a mortgage interest rate before receiving a complete application with all of the information needed by the lender and undertaking an underwriting review, and (b) limiting changes in that rate to changes in some verifiable and objective index. The MBAA described this as the most troublesome aspect of the GMP proposal and as "technically infeasible." Virtually all lender groups noted the difficulties and costs caused by the fact that lenders would have to hedge a loan guaranteed under a GMPA against the risk that the applicant might accept the GMPA, and that, as a result of Internet inquiries, some borrowers could file dozens of applications, thereby requiring lenders to incur the costs of hedging many loans that would never be made. Some lender groups suggested that in lieu of tying the interest rate to an index, the rate should be allowed to change on a day by day or hour by hour basis, provided that the lender's new rate be constantly disclosed on the lender's Web site or otherwise be continuously publicly available. (In contrast, associations representing smaller lenders pointed out that this might not be feasible for smaller lenders or would force them into offering a much more limited range of loan products.)

Other major comments by lender groups on the GMP proposal included:

- strong support for not having to disclose what services are in the package: "It is important that the consumer understand that all items obtained by the packager to make the loan are for the packager, not the consumer";
- if the applicant selects his or her own provider for a particular service in the package, the applicant should have to pay the fee for that service with no reduction in the GMP price;
- the 30-day period during which the GMPA would be held open should be shortened to 5 or 10 days; and
- lenders should be allowed to charge an up-front fee for providing a GMPA and a fee when the borrower locks in the loan.

Regarding the GFE proposal, apart from urging that HUD not move ahead with modifications to the current GFE regime, the lender comments tended to emphasize:

- the conflicts between HUD's

revised GFE approach and TILA requirements;
- that no limits should be placed on third-party fees that the lender cannot control;
- the need for a broad interpretation of what constitutes an "unforeseeable and extraordinary" circumstance in which tolerance can be exceeded;
- the need to allow lenders to cure technical violations of the GFE requirements (and the GMP requirements as well); and
- that the new GFE form is too long and complicated and tends to include information that is better placed and explained in the HUD Special Information Booklet.

The Views of the Title Insurance Industry

ALTA submitted its comments in early October to enable ALTA members, state land title associations, and other trade associations to consider ALTA's views when preparing their own submissions. This was an effective approach as over a thousand letters echoing themes developed in the ALTA comments were submitted by ALTA members and state land title associations. Other associations, such as RESPRO and the National Association of Realtors®, commented on ALTA's proposal for a "two-package" approach. ALTA's comments made four points:

1. HUD lacks statutory authority for the proposals it is making; the kind of firm estimates HUD wants lenders to provide was contained in RESPA as originally enacted, but Congress repealed that provision and enacted the current provision of § 5(c) requiring only a good faith estimate that is not subject to any sanctions;
2. HUD's proposals are based on the faulty assumption that whatever services are needed by, and are good enough for, the lender will also meet the needs of the buyer and the seller in the transaction;
3. the proposals tilt heavily in favor of the GMP alternative, and that proposal would have significantly adverse affects on the title industry, particularly small businesses in the industry; and
4. HUD could achieve its objectives while avoiding these consumer and competitive problems by providing for two packages: a Guaranteed Mortgage Package that would be offered by lenders consisting of the loan and all lender-related services and charges (basically the 800 series charges on the HUD-1 form) and a Guaranteed Settlement Package that could be offered by any party and that would provide a guaranteed single price for all of the 1100 series services and charges (the title and related charges), the 1200 series charges (government recording and transfer charges), and those charges required for title assurance or closing purposes that may be listed in the 1300 series.

The Views of the Realtors® and Other Industry Groups

The National Association of Realtors® was strongly opposed to the GMP approach, noting that the goals of reform could be achieved by improving the GFE regime, that "there is not enough evidence of consumer and industry benefit to move forward with the Guaranteed Mortgage Package (GMP) at this time," and that "Congress should address many of the changes to RESPA in this proposal." In support of its views, NAR attached an economic analysis by Ann Schnare, PhD, entitled "The Downside Risks of HUD's Guaranteed Mortgage Package."

Regarding their concern that HUD's proposal would effectively allow only lenders to offer GMPs, NAR noted: "A proposal put forward by the American Land Title Association (ALTA) recommends that HUD entertain a 'two-package approach, a lender package and a settlement package. This is a variation of the GMP that attempts to create additional opportunities for nonlenders to participate. While we have not thought through this idea, it indicates there might be alternative reforms that have not yet been considered."

The comments filed by other settlement service industry trade associations (such as associations representing escrow agents, credit reporting agencies, and appraisers) tended to emphasize the adverse effects on small businesses (because they would be unable to offer the same level of discounts to lenders as their larger competitors), and the adverse impact on consumers if lenders, because of their inability to pass on any increased cost incurred in transactions where more or better credit information or appraisals were required, declined to obtain such additional services that would have helped the borrower to qualify for a better loan.

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The Views of Consumer Groups

In many regards the views of consumer groups were in direct conflict with the views expressed by the lending industry. That such a fundamental chasm exists points out one of the major dilemmas facing HUD in deciding what to do. If it tries to accommodate the concerns

and views expressed by consumer groups, it risks doing significant damage to the mortgage market. If it tries to accommodate the concerns and views expressed by the lending and settlement service industries, it risks consumer groups claiming that HUD has not done enough to reform RESPA.

A recurrent comment from across the spectrum of submissions was that HUD lacked statutory authority to change the mortgage and settlement services markets in the ways it was proposing to do.

The most significant filing was made by the National Consumer Law Center (NCLC) on behalf of a broad group of national and local consumer organizations. While commending HUD for the "dramatic approach to RESPA reform advocated in these Proposed rules," the NCLC made clear "[t]here are several overarching concerns and a myriad of important details which must be worked through to ensure that the Rule does in fact protect consumers, instead of simply providing a shield behind which mortgage originators can hide inappropriate, unfair, and illegal activities."

The "major concerns" of the consumer groups were: (1) the Rule as proposed will facilitate predatory lending unless HUD (a) makes clear the GMPA cannot be used in any HOEPA loan, any loan with a prepayment penalty, or any loan where the total mortgage package price exceeds 5% of the loan; and (b) in coordination with the Federal Reserve Board ensures that the prices paid for individual settlement services are disclosed in the GMPA and in the HUD-1 form so that consumers and their lawyers can ascertain when loans might violate TILA and HOEPA; (2) HUD's new regulations on the disclosure of YSPs should be in the § 8 regulations, not the disclosure regulations, so that § 8 sanctions will apply to violations; (3) the new GFE form must be changed in a number of ways; and (4) to correct the "absurd" situation that the proposed rules do not currently include any mechanisms to punish transgressors. HUD should establish civil enforcement penalties, remove its stated prohibition against RESPA § 8 class actions, make a lender's failure to follow the new GFE rules an unfair and deceptive act that would enable private enforcement, and make a violation of the new GMPA rules a presumptive violation of § 8. (Other consumer groups urged $10,000 penalties for violations of the requirements.)

The NCLC also identified a "myriad of specific details which must be addressed to transform the Proposed Rule from a good idea with dangerous—and unintended consequences—into a truly progressive consumer protection regulation." With regard to the GMPA proposal, the consumer groups urged significant changes including:

- lenders—at no cost to the consumer—should provide an offer of a guaranteed loan at a specific rate, with a fixed amount of points and a guarantee of total settlement costs, on the basis of the "application" provided by the consumer, a credit report, and asking the applicant additional questions; this commitment should only be subject to the lender's verifying the applicant's income and asset information, and the value of the collateral;
- GMPAs that are subject to "final underwriting" should not be given an exemption from § 8; indeed, "[a]ll HUD need do is remove the current regulatory barrier for volume-based discounts by requiring that the value of volume-based discounts be passed along to consumers. This seems a far simpler solution than the current construct for the GMPA;"
- affiliated business arrangements must be disclosed in the GMPA (and in the revised GFE) because such disclosures are critical in determining whether a loan is a HOEPA loan;
- HUD should reject the arguments of the lenders that the GMPA should not include a guarantee of the loan; and
- the guaranteed loan interest rate should only be allowed to change pursuant to a publicly discernible index or in accordance with changes that are publicly known (e.g., published on the lender's website).

With regard to the revised GFE regime, other consumer groups made the following suggestions:

- the lender should guarantee the interest rate included in the GFE;
- because lenders may turn down applicants in the underwriting phase and then rush them through a new, more expensive loan, a revised GFE should have to be provided at least three days before the closing of the new loan; and
- the 10% tolerance for third-party fees is too high; and
- the "extraordinary and unforeseen circumstances" exception to the tolerances should be very narrowly drawn.

Preemption of State Law

One of the points repeatedly made by lender groups—particularly those reflecting the views of the larger lenders—was the importance to HUD's reform effort of preempting state laws and regulations that lenders regard as being in conflict with

HUD's packaging approach or that would inhibit achieving the benefits HUD is seeking in the GMPA proposal. The range and variety of state laws that the lenders want HUD to preempt are nothing short of breathtaking. They include state

- anti-affiliation and tie-in restrictions;
- laws that trigger "high cost" loan requirements, to the extent they apply to the GMP price as a whole;
- disclosure laws that would require disclosing the amounts of any specific charges that make up the GMP;
- anti-mark-up laws that prohibit lenders from marking up third-party costs;
- anti-kickback and referral fee laws (mini-RESPAs);
- laws governing closing practices;
- insurance laws prohibiting rebates and "discrimination" in pricing on any grounds; and
- laws requiring lenders to permit borrower choices of service providers.

The comments filed by state regulators generally urged HUD to go slow in considering whether to preempt state laws and tended to point out that some of the state laws sought to be swept away by the lenders are not inconsistent with RESPA and provide greater protection to consumers. It is also noteworthy that at least two of the comments (from the American Association of Residential Mortgage Regulators and the Conference of State Bank Regulators), while generally supporting revisions to the GFE regime, were much less supportive of the GMPA approach.

The coalition of consumer groups were adamantly opposed to preemption of state laws. "[T]hese laws provide significant and important protections for consumers. RESPA is the lesser important law, and its provisions should be implemented so as to facilitate compliance with these state consumer protection laws. . . . Any attempt by HUD to preempt consumer protection laws on the state level would completely {undermine} the beneficial purposes of this regulation."

Concerns About HUD's Lack of Statutory Authority and the Need for Legislation

A recurrent comment from across the spectrum of submissions was that HUD lacked statutory authority to change the mortgage and settlement services markets in the ways it was proposing to do. This view was expressed with regard to numerous aspects of the proposals. For example:

- the American Bankers Association stated that many banks believe that the current RESPA statutory language requiring a "good faith estimate" precludes HUD from imposing the changes incorporated in the GFE proposal;
- the Consumer Bankers Association urged HUD to defer any changes to the GFE regime until a later date, "when a more informed decision can be made about what changes are appropriate and what is within HUD's legal authority to accomplish";
- the Consumer Mortgage Coalition noted that, "[w]hile HUD has clear authority to issue regulations to carry out the purposes of RESPA, it is questionable whether it has the specific authority to impose, in the context of the GFE, a zero tolerance on any cost category." The CMC also advised HUD that it is questionable whether HUD has the authority to create the penalty that the lender must provide a refund to the applicant if it violates the tolerances;
- the Mortgage Bankers Association of America, one of the major proponents of packaging, cautioned HUD on its attempt to establish penalties for violations of its new disclosure requirements: "[I]t is not at all clear on what authority HUD can wage such a remedy in the context of the GFE. The statutory language of RESPA does not provide any remedies for noncompliant GFEs. Nor does RESPA authorize HUD to create such remedies. We are concerned that this absence of authority could lead to legal entanglements against the entire reform proposal";
- the National Association of Mortgage Brokers pointed out that legislative changes are needed to avoid legal challenges to the final regulations: "It is uncertain as to whether HUD has the authority to make such sweeping changes to the good faith estimate requirements under RESPA. It appears that any changes . . . would be ripe for judicial challenge without corresponding legislative authority";
- the National Association of Realtors: "While we support the concept of the Enhanced GFE, we question whether HUD has the authority to require lenders to guarantee their fees";
- the coalition of consumer groups noted that they had supported the GMPA concept in the past "in the context of statutory changes in the law" that would amend RESPA and TILA so as to coordinate disclosures and protections against predatory lending, but they cautioned that "attempting to address the disclosure problems of RESPA only through regulation creates serious implications for enforcing TILA requirements and removes existing protections against predatory lending";
- law firms representing plaintiffs who have filed class-action cases against lenders warned HUD that the § 8 safe harbor HUD proposes

for packaging "is beyond HUD's legal authority to create"; and
- the Real Estate Settlement Providers Organization (RESPRO) agreed with ALTA's analysis that the proposed HUD regimes and sanctions constituted an attempt to regulate disclosures and pricing of loan costs and settlement services that is inconsistent with the RESPA regime created by Congress.

Whether the current provisions of RESPA would support the sweeping changes and sanctions HUD is proposing is just one part of the question of whether HUD can move forward with its proposals without further legislation. Of equal significance is the fact that, as many comments noted, the HUD proposals are in conflict with, or cannot be fully implemented without changes in, other statutory and regulatory regimes including TILA, HOEPA, HMDA, and the Bank Holding Company Act. For example, providing that individual settlement costs do not have to be disclosed under the revised GFE or the GMP regimes is in conflict with TILA (which requires information on the amounts paid by the consumer for those items included in the "finance charge" and APR) and with HOEPA (which requires information on the amounts paid for those charges that are included within the definition of "points and fees" used to determine whether a loan is subject to HOEPA's requirements).

One comment in this regard is of particular note. The staff of the Federal Reserve Board pointed out to HUD that federal anti-tying laws that apply to banks, thrifts, and other deposit-taking entities "may affect the ability of these entities to provide customer discounts on GMPs or even to offer GMPs." The FRB staff letter directed HUD's attention to the 1998 joint HUD/FRB report on RESPA/TILA reform, where the Board noted that federal law prohibits banks and thrifts from "tying packaged settlement services to their mortgage loans" and urged that, if RESPA § 8 is amended to allow creditors to require the use of affiliated service providers, these anti-tying restrictions should also be amended. In short, if HUD attempts to create its proposed GMP regime without further legislation, most lenders may be unable to package or to use their affiliated service providers without facing allegations that their packaging activities violate federal anti-tying law.

What Will HUD Do Next?

HUD is facing a significant legal, political, and economic dilemma. If the stakes were not so high, HUD, in its desire to press ahead with reform, might try to give the comments received a quick review, make a few changes in the proposals, and then promulgate final regulations in the hope that any "imperfections" can be corrected later. That will not work here. The stakes are simply too high.

The mortgage and real estate markets are one of the few areas of the American economy that have been operating in a healthy and robust manner. The comments, if HUD reviews them with the care and consideration that went into their preparation and is required of a federal agency as a matter of law and sound policy, make absolutely clear that without very significant changes and adequate legislative authorization, HUD risks, at best, creating confusion and disruption in the mortgage and real estate markets, and, at worst, a political and economic disaster that could have enormous repercussions for HUD and the Bush Administration.

I believe that the folks at HUD are ultimately reasonable people trying to do their best, as they see it, to promote the availability of housing, to protect the interests of consumers, and to ensure a healthy mortgage market. Accordingly, I think what is most likely to happen is the following.

First, the HUD staff will carefully review and catalog the various concerns, problems, and suggestions contained in the comments. Those concerns and problems cannot be written off as "the plaintive complaints of industries that do not want to see reforms that will lower their charges." The concerns and problems raised—including those by the consumer groups—are too real and too serious.

After reviewing the comments, HUD is likely to come to appreciate (as I did after reviewing hundreds of the comments) that:

- the mortgage and settlement markets are more diverse and complicated than HUD may have understood;
- there are significant problems in trying to move ahead with the kind of reforms proposed in the absence of amendments to RESPA (to provide both statutory authorization for the guarantees HUD wants lenders to give for interest rates and closing costs, to eliminate the need for itemization of the individual charges incurred, and to provide reasonable enforcement measures where none currently exist) and to TILA, HOEPA, HMDA, and other federal statutes that may conflict with what HUD is trying to achieve;
- a number of major "compromises" will have to be struck between the kind of reforms that HUD (and the consumer groups) would like to see made and (i) the realities of the mortgage market, (ii) the need to ensure that small business enterprises are not placed at an unfair disadvantage in an area of the economy that has been most hospitable to small businesses, and (iii) the need to ensure that purchasers and sellers in real estate

transactions are able to continue to obtain the services they need that may differ from those needed by the lender; and
- there are an enormous number of banking, insurance, and consumer protection laws and regulations at the state level that HUD would have to preempt in order to make packaging work the way lenders want it to work.

The Bush Administration, without clear congressional support and direction, is not likely to be willing to engage in such wholesale preemption of state rules in this area, particularly over the adamant opposition of the consumer groups and with the prospect of successful judicial challenges to such preemption efforts.

Moreover, if HUD undertakes a review of the case law involving challenges to agency rulemaking that were alleged to exceed statutory authority, it will find that the courts are likely to strike down agency rules that, as here, (a) establish requirements that Congress has expressly rejected (here, HUD is converting the GFE regime Congress enacted into a regime that requires firm estimates of settlement costs, a regime Congress had enacted and repealed), and (b) use an agency's exemption power to get parties to behave in a manner that the agency would have no statutory authority to require directly (here, HUD's use of its § 8 exemption power to encourage packaging).

Of particular note in this regard is a recent decision of the U.S. District Court for the District of Columbia, which struck down a 1998 regulation of the Food and Drug Administration requiring drug manufacturers to assess the safety and effectiveness of new drugs in pediatric patients. *Association of American Physicians and Surgeons, Inc. v. U.S. Food and Drug Admin., 2002 WL 31223411 (D.D.C. Oct. 17, 2002)*. After reviewing the language and regulatory approaches that Congress had enacted and the agency's claim that it had broad statutory powers to promulgate regulations for the efficient enforcement of the act, the court, on the basis of extensive precedent, concluded that such rulemaking powers do "not constitute an independent grant of authority that permits FDA to issue any regulation the agency determines would advance the public health." The rules adopted by the agency "must be a means of administering authorities otherwise delegated to it by Congress."

After discussing the merits of the rule and finding no statutory authority for it, the court concluded:

This court does not pass judgment on the merits of the FDA's regulatory scheme. The Pediatric Rule may well be a better policy tool than the one enacted by Congress . . . The issue here is not the Rule's wisdom. . . . The issue is the Rule's statutory authority, and it is this that the court finds lacking.

Because of the concerns about its legal authority, HUD is likely to attempt to bifurcate its reform objectives and decide what it can do in the short run without amendments to RESPA and other federal laws (and without needing to preempt state laws and regulations) and then develop a legislative package that it can propose to Congress for further reforms.

What, you may ask, is the likely scenario if HUD does not see things along the lines described above?

If HUD is determined to press ahead without seeking legislative authority, it will have to decide (a) what changes need to be made to accommodate the legitimate problems and concerns identified in the comments, and (b) what it thinks it can accomplish without the significant risk of a successful judicial challenge to its statutory authority to promulgate whatever final regulations it decides to adopt. This process is likely to take a number of months. Moreover, it is possible that during this period Congress will hold hearings on the HUD proposals, their impact on small business, and the need for congressional authorization—and participation—in any overhaul of the way in which the mortgage and settlement service markets are regulated under federal law.

The comments filed by state regulators generally urged HUD to go slow in considering whether to preempt state laws.

Accordingly, at best, HUD is not likely to develop its revisions until mid-2003. It will then have to decide whether to promulgate its changes in the form of final regulations or to seek further public input in light of the significance of the changes made to its proposed regulations. If the changes are significant, HUD would be well advised to seek further public comment to ensure that it has all the necessary input before finalizing its reform proposals. (Federal agencies frequently engage in a second round of public comment when major changes have been made to the proposals on which the public provided initial comments and where the agency wants to ensure it has a full understanding of the implications of its revisions.) This could mean that final regulations would not be published until late in 2003 or early 2004.

Once published in final form, a delayed effective date is virtually certain. A number of comments noted that it would take the lending and settlement services industries a significant amount of time to prepare computer programs, modify business relationships, train staff, etc., and asked for a delay of one to two years. Depending on the extent of the

changes ultimately adopted, some period of delay would be needed. Moreover, the HUD Special Information Booklet would have to be rewritten and republished to reflect the final amendments, and that will take some time.

Conclusion

The realities that RESPA reform along the lines proposed cannot be implemented in short order may be upsetting to those at HUD who believe that reform is needed now. But charging ahead without giving full heed to the problems and concerns noted in the many excellent comments that have been filed would almost certainly result in successful legal challenges to the final regulations. Implementation of the regulations will either be enjoined during the time it takes to resolve the challenges, or will cause a political uproar as lenders and settlement service providers face the prospect of having to gear up for the effective date of the new regulations with the prospect that shortly before or after implementation the courts could well determine that the regulations lack legal foundation. Either possibility could be unnerving to the mortgage markets and adversely affect the entire U.S. economy.

Sheldon E. Hochberg is a partner in the Washington, D.C., office of Steptoe & Johnson LLP. He is a nationally known expert on RESPA and has represented the title insurance industry and ALTA since 1973 in connection with RESPA matters and on other issues facing the industry, such as the Norwest TOP program. He can be reached at Shochber@Steptoe.com or through questions and comments posted on the RESPA Discussion Forum on the ALTA Web site. See the box on the homepage.