

JUNE 2003

### **THE NEW RESPA POLICE: HUD Fortifies the RESPA Enforcement Division**

Although the Real Estate Settlement Procedures Act (“RESPA”), 12 U.S.C. §§ 2607 *et seq.*, has been on the books since 1974, and although the U.S. Department of Housing and Urban Development (“HUD” or “Department”) is charged with the responsibility of enforcing RESPA, the Department historically has not engaged in stringent enforcement efforts. Various industry professionals and consumer groups have criticized HUD for its failure to issue substantive RESPA rules and penalize those who violate RESPA requirements.

HUD’s perceived reluctance to enforce RESPA over the past several years may be due largely to the fact that, until recently, the Department employed only a handful of individuals dedicated to RESPA enforcement matters, despite its receipt of nearly 1,000 RESPA complaints per year and its persistent duty to provide guidance to the lending industry and advise Congress with respect to RESPA reform. While prior impediments may have rendered RESPA enforcement slow, the Department has taken action over the past year to evidence its commitment to RESPA enforcement and its intent to hold violators accountable for their actions under the statute. These measures include not only the issuance of a proposed rule in July 2002 that has divided the real estate industry into different factions, but the hiring of 30 new RESPA enforcement staff members and a significant increase in the number of enforcement actions.

The purpose of this Client Alert is to summarize the Department’s enhancement of its RESPA Enforcement Division, the types of violations that are likely to trigger an enforcement action, and the steps one should take to avoid RESPA violations.

#### **THE RESPA ENFORCEMENT DIVISION**

##### **1. The New RED**

While the real estate industry has been focused on HUD’s proposed RESPA rule, which would, among other things, revise the Good Faith Estimate and exempt those who offer guaranteed mortgage packages that meet certain criteria from RESPA’s prohibitions on kickbacks and the splitting of unearned fees, the Department has been fortifying its RESPA Enforcement Division (“RED”). In the past, the Department employed as few as three individuals to police the entire real estate industry in connection with RESPA matters. As HUD Assistant Secretary John Weicher announced at a recent American Land Title Association conference, however, HUD is tripling its enforcement staff and plans to have over 30 employees working on RESPA enforcement matters before a final RESPA rule is published.

## 2. Heightened Enforcement

Not only has the Department fortified RED in terms of staff, but it has begun to investigate a significantly increased number of complaints and potential RESPA violations. As reported in the National Mortgage News on April 21, 2003, HUD receives approximately 900 RESPA complaints per year, about one-third of which involve Section 8 complaints from the industry concerning illegal kickbacks and referral fees, and about one-quarter of which involve servicing issues under Section 6 of RESPA (e.g., the failure of servicers to pay insurance or property taxes, or respond to and resolve borrowers' complaints for information). The Department is currently investigating at least 20 cases involving allegations of "sham" affiliated business arrangements, and is working with the HUD Office of the Inspector General to investigate certain consumer complaints. HUD officials have indicated that, when HUD reviews a particular company's practices, it will also review such practices by other entities rather than waiting to receive a complaint before investigating, as well as employ private investigators to conduct on-site investigations of various entities.

The Department typically engages in two different types of RESPA reviews: (1) preliminary inquiries; and (2) formal investigations. A preliminary inquiry generally involves RED sending a letter to an individual or entity and requesting certain information and documentation to help the Department determine whether it has jurisdiction over the individual/entity and whether the conduct at issue rises to the level of a RESPA violation. In our experience, the Department has generally resolved matters subject to preliminary inquiries informally. A formal investigation, however, is more serious. Once HUD determines that it has jurisdiction over a particular individual or entity and that such individual's or entity's conduct rises to the level of a RESPA violation, RED will issue a formal notice informing the individual or entity that it is subject to a RESPA investigation. The notice will describe the alleged violation and request numerous pieces of information and documentation concerning various business practices and procedures. The notice usually requires a response within 30 days. When an entity receives a notice of formal investigation, we recommend that the entity:

- if necessary, request an extension of time within which to reply,
- furnish the requested information and documentation, and
- submit a detailed written response to RED that explains (1) any legal or factual defenses to the alleged violation, (2) any mitigating circumstances, and (3) any corrective actions that the entity has taken.

One might also wish to consider requesting a meeting with RED staff.

It is important to keep in mind that, if an accused violator does not cooperate with the Department's investigation, the Department may subpoena documents and witnesses as well as conduct a formal administrative hearing. In the event that an entity receives a notice of a hearing, the entity should consider contacting legal counsel immediately. A hearing will be "on the record" and a HUD staff attorney will be present to represent the Department.

As evidence of HUD's increased enforcement efforts, the Department's website posts 20 RESPA settlement agreements that it has negotiated with various companies since September 1999. The terms of these settlement agreements reflect a wide range of issues, including, among other things, direct payments for referrals, failure to make the required disclosures in connection with escrow accounts, the provision of virtual tours, and overcharges to borrowers. The penalties range anywhere from \$1,200 to \$350,000, and in some cases the Department required that the respondent make substantial contributions to non-profit organizations. For example, in one case, the settlement agreement required payment of \$200,000 to the Department and \$1 million in charitable contributions. In another series of settlements, the Department announced five major settlement agreements with mortgage lenders and service providers, with total payments of nearly \$2.3 million.

The Department's strengthening of RED reflects its ongoing efforts to be more proactive in the area of RESPA reform. As Secretary Mel Martinez indicated during his statement before the United States House Committee on Financial Services in October 2002, the Department has "committed new resources to enforcing RESPA—to address current violations and to make certain that the benefits of the proposed reforms are achieved." For example, although most RESPA investigations have focused on companies involved in "sham" business arrangements rather than on individuals who receive referral fees, such as real estate agents, HUD officials have commented that RED is likely to begin seeking penalties against individual recipients.

## **VIOLATIONS THAT ARE LIKELY TO TRIGGER AN ENFORCEMENT ACTION**

RESPA was designed to protect consumers. To this end, it requires advance disclosure of settlement costs, prohibits kickbacks and referral fees, which tend to increase the cost of settlement services, reduces the amount that homebuyers must place in escrow accounts, and modernizes recordkeeping requirements. The statute applies only to federally related mortgage loans. While federally related mortgage loans do not include construction loans, temporary financing or commercial loans, they do include virtually all purchase-money, second lien and reverse mortgage loans, as well as refinances of both conventional and government loans.

### **1. Potential Violations**

Until recently, HUD has identified RESPA violations primarily through information provided by consumers, consumer interest groups, state attorneys general, insurance commissioners, and industry competitors. For example, many settlement service providers have expressed frustration about referral programs in which their competitors engage, but which they rejected due to legal concerns. Such providers may complain to HUD about their competitors' conduct, as well as second-guess their own efforts to comply in the wake of non-enforcement. As explained above, however, RED intends to begin conducting on-site reviews of companies' offices and enforcement actions are on the rise.

Most alleged RESPA violations concern Section 8. Section 8(a) prohibits the giving or accepting of any fee, kickback or thing of value, pursuant to an agreement or understanding, for the referral of settlement service business. Section 8(b) prohibits any person or entity from giving or accepting any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service other than for services actually performed. The Department has clarified that these provisions do not prohibit referrals themselves, but merely payment for the referral of settlement service business. The majority of HUD's Section 8 concerns appear to focus on whether a payment was made in return for goods or facilities actually furnished or services actually performed, and whether a settlement service provider has marked up another provider's costs.<sup>1</sup>

While most RESPA enforcement actions to date have involved Section 8 violations, there are a number of activities that are likely to trigger HUD's concern. The following are a few examples:

- Providing virtual tours to those in a position to refer settlement service business (e.g., real estate agents) at no or nominal cost.

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<sup>1</sup> Although Section 8 itself requires the splitting of the unearned portion of a fee between two or more parties in order for a Section 8(b) violation to occur, and despite several Federal Circuit Court decisions upholding the statutory language, see, e.g., Mercado v. Calamet Federal Savings & Loan Association, 763 F.2d 269 (7th Cir. 1985); Echevarria v. Chicago Title & Trust Co., 256 F.3d 623 (7th Cir. 2001); Boulware v. Crossland Mortgage Corporation, 291 F.3d 261 (4th Cir. 2002); Krzalic v. Republic Title Co., No. 02-2285, 2002 U.S. App. LEXIS 26744 (7th Cir. December 26, 2002); Haug v. Bank of America, No. 02-2458, 2003 U.S. App. LEXIS 1009 (8th Cir. January 23, 2003), the Department continues to take the position that the mere marking up of another's fee constitutes a Section 8 violation and has expressed its intent to pursue those who mark up costs.

- Engaging in portfolio review services (i.e., the examination of a lender’s existing loan portfolio) for free or below cost in return for future referrals.
- Charging homebuyers a percentage of the purchase price (e.g., 1.5% of the sales price) to cover certain fees without regard to whether the actual fees totaled the percentage charged to the homebuyer.
- Imposing an additional fee on homebuyers who elect not to use an affiliated title company.
- Engaging in Internet loan origination programs that offer fees to real estate agents for performing limited mortgage services, such as “click-throughs” and links to lenders.
- Setting up “sham” employment arrangements with real estate agents for the purpose of paying fees for referrals under HUD’s employer-employee exception to Section 8.
- Providing anything of value for the referral of business, including, among other things, money, discounts, free rent, the opportunity to participate in a money making program, a reduction in credit against an existing obligation, gifts, vacation trips, the use of office space or equipment, or anything else of value.
- Paying excessive fees to one who provides legitimate services, with the excessive portion constituting payment for referrals.
- Failing to disclose affiliated business arrangements to consumers.
- Requiring a consumer to use an affiliated provider.
- Splitting fees for little or no work with one in a position to refer settlement service business.
- Failing to provide Good Faith Estimates, HUD-1 Settlement Statements, or information booklets in a timely manner.
- Collecting excessive escrow reserves.
- Failing to provide required escrow statements and transfer disclosures.

These are just a few of the various situations that HUD has questioned over the years. There are numerous other ways to violate RESPA requirements, and those subject to RESPA should take care to ensure compliance.

## **2. Penalties for Non-Compliance**

The Department has authority to impose numerous different sanctions against RESPA offenders. For example, violators may face:

- criminal penalties of up to one year’s imprisonment,
- fines up to \$10,000,
- treble damages to consumers,
- enjoinderment of certain business activities,
- bad publicity, and
- the potential for class action lawsuits.

In the case of loans insured by the Federal Housing Administration, a violator may also face:

- debarment,
- civil money penalties of \$5,500 per transaction up to \$1.1 million in any one year,
- withdrawal of FHA approval, or
- indemnification of individual loans.

While RED officials have expressed a preference to settle allegations of RESPA non-compliance through simple correspondence, it has also stated its intent to serve subpoenas and take any other action necessary to prevent perceived abuses.

## **AVOIDING RESPA VIOLATIONS**

Given HUD's renewed commitment to RESPA enforcement and the dire consequences of non-compliance, it is important that settlement service providers consider how best to avoid RESPA violations.

First and foremost, a settlement service provider should not pay any fees or offer anything of value to one in a position to refer settlement service business. One should pay only reasonable compensation for goods or facilities actually furnished or services actually performed.

In addition, if it is unclear whether a particular practice would pass RESPA scrutiny, one should seek the advice of counsel before engaging in the questionable activity. One might also seek advice directly from HUD, which may be willing to offer an informal advisory opinion.

Finally, every participant in the settlement service industry should make RESPA compliance a priority and monitor internal activities to ensure that violations do not occur. If a company identifies RESPA concerns, it immediately should cease the conduct at issue, take corrective action, make restitution to any consumers who may have been harmed, and terminate employment relationships if necessary.

In sum, HUD is working to be more responsive to RESPA matters, and settlement service providers should expect increased attention from the new RED. Given the civil and criminal implications of non-compliance, it is crucial that those subject to RESPA diligently monitor their business activities and take care to resolve RESPA concerns before it is too late.

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If you have any questions about the new RESPA Enforcement Division or need assistance in connection with a RESPA inquiry, please contact Phillip L. Schulman (202.778.9027 / [pschulman@kl.com](mailto:pschulman@kl.com)) or Emily J. Booth (202.778.9112 / [ebooth@kl.com](mailto:ebooth@kl.com)).

## MORTGAGE BANKING/CONSUMER FINANCE GROUP

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