

MORTGAGE BANKING UPDATE

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NOVEMBER 2001

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FEDERAL RESERVE BOARD AMENDS REGULATION Z DISCLOSURE REQUIREMENTS

The Federal Reserve Board has adopted a final rule amending Regulation Z, which implements the Truth in Lending Act (“the Act”). The rule revises the disclosure requirements for credit and charge card solicitations and applications. Compliance became mandatory on October 1, 2001.

The Act requires disclosure of the annual percentage rate (APR) and other cost information in direct mail and other applications and solicitations to open credit and charge card accounts. The revisions to Regulation Z, discussed in more detail below, are intended to enhance consumers’ ability to find and understand this cost

information, which generally must be provided in tabular form.

Under the final rule, the APR for purchases must be in at least 18-point type, and must appear under a separate heading from other APRs, such as the penalty rates. The disclosures must be “readily noticeable,” as well as in “reasonably understandable form.” As to type size, disclosures in at least 12-point type would be deemed readily noticeable, but smaller type size does not automatically violate the standard. However, disclosures in less than 8-point type would likely be too small to satisfy the standard. Disclosures are sufficiently prominent if they are on the same page as an application or solicitation reply form. If located elsewhere, the disclosures still would be considered prominently located if the application or solicitation reply form contains a clear and conspicuous reference to the location of the disclosures, and indicates that the disclosures contain rate, fee and other cost information, as applicable. Disclosures required by section 226.5a(b) of Regulation Z that are placed outside the table must begin on the same page as the table, but need not end on the same page.

A disclosure of any balance transfer fee must now be included either in the table or clearly and conspicuously elsewhere on or with the application or solicitation (just as with any disclosure relating to the cash advance fee, the late payment fee and the over-the-limit fee). In addition, if

the balance transfer fee varies by state, the card issuer may disclose the range of the fees instead of the amount for each state (again, just as with any disclosure relating to the cash advance fee, the late payment fee and the over-the-limit fee).

Special rules have been added for electronic disclosures. Disclosures that are transmitted by electronic communication are judged for purposes of the clear and conspicuous standard based upon the form in which they are provided even though they may be viewed by the consumer in a different form. Electronic disclosures are deemed to be prominently located if they are posted on a Web site and the application or solicitation reply form is linked to the disclosures in a manner that prevents the consumer from bypassing the disclosures before submitting the application or reply form, or if they are located on the same page as an application or solicitation reply form that contains a clear and conspicuous reference to the location of the disclosures and indicate that they contain rate, fee and other information, as applicable.

The rule also includes some technical revisions relating to the proper location for information relating to the penalty fees.

MINNESOTA COURT AFFIRMS ORDER CONDITIONING THE TRUTH IN LENDING ACT RESCISSION ON PAYMENT BY BORROWER OF PRINCIPAL, INTEREST AND LATE CHARGES

In an unusual holding, the Minnesota Court of Appeals affirmed a district court order that conditioned rescission of a mortgage loan on payment by the borrower of all principal, accrued interest and late charges to the lender's assignee.

In September 1995 borrowers, a husband and wife, obtained a loan to refinance their home. Just prior to the closing, the husband wrote a letter to his broker describing a "hardship" that necessitated a quick closing and the waiver of his three-day rescission right. The wife did not sign the letter or otherwise waive her right to rescind, but in response to the letter, the lender closed the loan before the expiration of the rescission period. Less than one week after the closing, the borrowers rescinded the note and the mortgage. The lender did not release the mortgage from the property, and around this same time sold the loan to an assignee that had no knowledge of the alleged Truth in Lending Act ("the Act") violations.

In March 1998 the assignee commenced an action against the borrowers for rescission and a decree of foreclosure. The borrowers defended by alleging violations of the Act by both the lender and the assignee. The court granted the assignee's motion for partial summary judgment and ordered rescission of the loans and a decree of foreclosure if the borrowers failed to repay the principal, accrued interest and late charges to the assignee within 60 days of the order. The borrowers appealed.

The court of appeals affirmed the lower court's order. While the court of appeals acknowledged that the Act generally requires the creditor to terminate its security interest and return any earnest money or down payment to the borrower before the borrower is obligated to tender any property to the creditor, it stated that the Act gives courts discretion to devise other procedures. Therefore, the court of appeals stated that courts may condition an obligor's right of rescission on tender of the loan principal to the creditor. The court of appeals went on to hold that while the Act states that a borrower that rescinds a mortgage loan "is not liable for any finance or other charge," in light of the facts, the district court properly

exercised its discretion under section 1635(b) of the Act to devise other procedures.

It is nice to see that justice prevailed in this situation, as the borrowers were clearly attempting to take advantage of the law, to the detriment of an innocent assignee. We nevertheless must caution mortgage lenders against taking positions that are too aggressive against rescinding borrowers, as it is the rare court that will hold that equity favors the creditor rather than the borrower in such a situation.

HUD ISSUES GUIDANCE ON COMPLETING HUD-1, HUD-1A AND GOOD FAITH ESTIMATE FORMS FOR HOME MORTGAGE LOANS

This article summarizes a HUD guidance letter that was issued in the summer of 2000. We are providing this summary because our experience indicates that many lenders are not aware of this guidance.

The U.S. Department of Housing and Urban Development recently issued two sets of questions and answers relating to how to complete the HUD-1, HUD-1A and Good Faith Estimate forms. The first set of questions dealt with the HUD-1 form, aggregate accounting adjustments, "paid outside of closing" (P.O.C) and third party settlement service provider issues, and title charges. The second set of questions dealt with the charges imposed by a lender that purchases third party vendor services for the purposes of closing a federally related mortgage loan, and led HUD to conclude that, under the Real Estate Settlement Procedures Act ("RESPA"), a lender may not mark up the third party fees to make a profit. If a lender performs actual settlement services in addition to those provided by third party vendors, RESPA

rules and regulations permit the lender to charge the borrower for those services plus those provided by the third party vendor. Such fees must be disclosed specifically and separately, however, from any fees for third party settlement services.

Other matters addressed by HUD in the guidance include the following:

- If an applicant for a residential mortgage loan changes products midway through the approval process and the change results in different estimates of settlement costs, HUD strongly recommends that a new Good Faith Estimate be provided to the applicant, even though RESPA does not expressly impose such a requirement.
- A cosigner of a promissory note is a joint obligor with primary responsibility for the obligation, and must therefore have his or her name and address included on the HUD-1 form. A guarantor is not a primary obligor, and is not required to be listed on the settlement statement.
- If a lender provides a list of closing attorneys that includes a person who serves on the lender's board of directors, board of trustees, or similar board or committee that is involved in managing the affairs of the lender, the lender must provide all applicants who receive the list with an Affiliated Business Arrangement Disclosure for the particular attorney serving on the board or committee.
- If the borrower retains an attorney in connection with a closing or settlement of a federally related mortgage loan and the use of an attorney is not required by the lender, the fee paid by the borrower to that attorney should be included on the HUD-1 form if the fee is paid at closing or settlement. If the fee is paid outside of closing, it should be

included on the HUD-1 form, and should be marked "P.O.C.", placed on the appropriate line next to the borrower or seller columns, and not be included in computing totals. For all items except those paid to and retained by the lender, the name of the person or firm ultimately receiving the payment should be shown. In the case of "no cost" or "no point" loans, the charges to be paid by the lender to an affiliated or independent service provider should be shown as P.O.C.

- Items paid by the seller well in advance of the loan closing, but which are required by the lender, must be listed as P.O.C. on the HUD-1 form, placed on the appropriate line next to the borrower and seller columns, and not be used in computing totals.
- Neither RESPA nor Regulation X provides tolerances for variations between the figures disclosed on the Good Faith Estimate and the final charges listed on the HUD-1 or HUD-1A forms. HUD believes, however, that a pattern or practice of quoting Good Faith Estimate amounts that are lower than the corresponding amounts later shown on settlement statements may serve as evidence that the disclosures were not made in good faith.
- If the lender accepts a normally required item previously obtained by the applicant (such as an appraisal) using the applicant's funds in advance of the application being submitted to the lender, the item must be listed as P.O.C. on the Good Faith Estimate and the settlement statement. The settlement statement must itemize the actual charges for those items required by the lender, so the implication is that the lender will have to ask the applicant for the cost of the appraisal in order to reflect it properly on the settlement statement.

- It is not a violation to add fees to the HUD-1 or HUD-1A forms that were not disclosed on the Good Faith Estimate if such fees were, in good faith, unanticipated and unforeseeable at the time the Good Faith Estimate was prepared.
- If a loan is to be sold by the lender after closing, costs associated with the sale but paid by the borrower at closing should be disclosed on the Good Faith Estimate and the settlement statement, and the name of the person or firm ultimately receiving the payment should be disclosed.
- A fee paid by the lender to a mortgage broker and not passed through to the borrower should be shown as P.O.C. on any of the blank lines provided in the 800 series of the HUD-1 form. HUD pointed out that the lender should carefully review the payment to assure that it does not violate RESPA's anti-kickback or unearned fee provisions.
- If the lender offers the borrower a coupon for a credit toward closing costs, the amount of the credit should be shown on lines 204–209, which list items paid by or on behalf of the borrower.
- If a lender collects an application fee and uses that money to pay for appraisal and credit reports, the amount of the application fee should be shown on the Good Faith Estimate and the settlement statement on a blank line in the 800 series, and should be marked P.O.C. The charges relating to the appraisal and the credit report should be shown on lines 803 and 804, and also should be marked P.O.C. To ensure that there is no confusion about double charging, fees listed on lines 803 and 804 should indicate that those fees are included in the "application fee" amount, or alternatively, the line in the 800 series containing the application fee

could include an annotation clarifying that the charge includes those fees listed on lines 803 and 804.

- Where the lender purchases a loan from a correspondent lender, the correspondent lender must provide the Good Faith Estimate, unless the correspondent lender is the exclusive agent of the purchasing lender, in which event the responsibility falls on either of them, as they may agree.
- Tax service and flood determination fees are most likely to be listed on any of the blank lines in the 800 series, since they are generally required by the lender. Overnight delivery fees should be listed on any of the blank lines of the series pertaining to the specific settlement service provider that requires the use of overnight delivery.
- If an error is discovered in the HUD-1 form at settlement, it should be corrected at the time of settlement, and should be appropriately initialed by the affected parties and the settlement agent. If the error is discovered after settlement, the servicer should act with due diligence in correcting the error as quickly as possible, and must use all reasonable means to inform borrowers of any such changes or corrections. While there is no requirement that the servicer attain a borrower's acknowledgment on any post-closing correction, HUD believes that obtaining consumers' signatures to demonstrate acknowledgment of any changes would constitute a prudent business practice.
- Aggregate accounting adjustments that show the difference between the required balance in an

escrow (impound) account using aggregate analysis and the required balance using single-item analysis must always be either negative or zero. Whatever the aggregate accounting adjustment is, even if zero, that number must be entered on the final line of the 1000 series of the settlement statement. The aggregate accounting adjustment is required even if there is only one escrow (impound) item.

- If a payment is made outside of closing, the lender need not indicate the name of the entity making the payment. However, if the payment is made by the lender to a mortgage broker, HUD Statement of Policy 1999-1 states that the payment is to be clearly identified and labeled paid by the lender.
- If there is insufficient room on the settlement statement to show the name of the party receiving the payment and P.O.C. (if required), the lender may place an asterisk on the appropriate line and explain the asterisk at the bottom of the settlement statement or on a separate page attached to the settlement statement.
- If an applicant pays any fees at the time of application, the fees must be listed on the Good Faith Estimate and identified as P.O.C.

IF YOU HAVE ANY QUESTIONS OR COMMENTS ABOUT ANY OF THE FOREGOING, PLEASE CONTACT:

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