

**DATE:** March 24, 1999

**SUBJECT:** HUD rules lender-paid compensation to mortgage brokers not illegal *per se*. Legality depends on two-part *reasonableness* test for services performed or goods furnished.

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HUD has issued its long awaited interpretive rule regarding the legality under RESPA, Section 8 of lender payments to mortgage brokers in connection with federally related mortgage loans. The interpretive rule, Statement of Policy 1999-1, was effective upon its publication in the Federal Register (64 F.R. 10079) on March 1, 1999. The Statement of Policy is issued under the authority of RESPA, Section 19(a), which provides lenders protection from liability under RESPA when acting in good faith reliance on a rule, regulation or interpretation of the statute by HUD. The rule applies only to payments made to mortgage brokers in *table funded* transactions or *intermediary* brokered transactions, in which the mortgage broker is not the real source of funds, and does not apply to *secondary market transactions*, which are exempt from RESPA coverage.

As espoused by the rule, HUD does not consider the payment of so-called *yield spread premiums* or other back-funded lender payments to mortgage brokers to be illegal *per se*. HUD recognizes that methods of compensating mortgage brokers vary, and in any particular transaction a broker may receive compensation directly from the borrower, indirectly in back-funded fees paid by the wholesale lender funding the loan, or through a combination of both. In determining whether a payment by a lender to a mortgage broker is permissible under RESPA, Section 8, HUD will apply a two-part test:

First – HUD will determine whether services were actually performed or goods or facilities were actually furnished in exchange for the compensation paid;

Second – If so, HUD will next determine whether the amount of the payments are reasonably related to the value of the services actually performed or the goods or facilities actually furnished.

In determining whether compensable services were actually performed, HUD will look for the types of services described in its informal opinion letter to the Independent Bankers Association of America (IBAA) dated February 14, 1995, regarding what loan origination services a mortgage broker or other agent or contractor must perform to justify compensation under RESPA, Section 8. This 1995 informal opinion enumerated 13 distinct services, in addition to the taking of the loan application, that are normally performed in the origination of a residential mortgage loan and it created a “safe harbor” of sorts in any case in which HUD finds that the mortgage broker or other lender’s agent or contractor had taken the loan application and had performed at least five (5) additional services from this list of 13. In applying the two-part test, the Statement of Policy adopts this same standard for reviewing whether sufficient origination work has been performed in any case to justify compensation. Services other than these 13 may be evaluated and acknowledged as compensable by HUD if they are meaningful services akin to those set out in the IBAA opinion.

HUD also recognizes that, in addition to services, mortgage brokers may furnish goods or facilities to the lender for which the broker is entitled to compensation. For example, appraisals, credit reports, and similar documents needed to complete a loan file may be regarded as *goods* and a portion of the brokers’ retail premises as *facilities* for this purpose. However, consistent with recent federal case law, the loan itself arranged by the mortgage broker cannot be regarded as a *good* that the broker can be said to sell to the lender for its market value based upon the loan’s yield or other value as a secured debt instrument.

In applying the second part of the test — whether the payments by the lender to the mortgage broker reasonably relate to the value of the services actually performed or goods or facilities furnished — HUD will scrutinize the *total compensation* received by the broker, including direct origination and other fees paid by the borrower, yield spread premiums and similar lender-paid fees derived from the interest rate (which HUD regards as paid indirectly by the borrower), and any volume-based compensation (the latter of which HUD hastens to add it generally regards as illegal referral compensation when based on the volume or value of business transacted). It is neither necessary nor feasible according to HUD to attempt to identify or allocate which goods or services are provided for the benefit of the borrower or the lender because all services, goods and facilities benefit both the borrower and lender in the sense that they make the loan possible. Instead, HUD will evaluate total compensation paid the broker in relation to total services performed and goods or facilities furnished. HUD considers that higher interest rates alone cannot justify higher total compensation to the broker. Rather, total compensation must be evaluated in light of the price structures and practices for compensating brokers for similar transactions in the same or similar market area to determine reasonableness of the compensation.

HUD reiterates that current RESPA regulations require as a minimum that all fees or other compensation paid to a mortgage broker be clearly labeled and estimated on the Good Faith Estimate at loan application and the actual amount of the compensation and broker's name be clearly labeled and listed on the HUD-1 or HUD-1A settlement statement at closing. While not mandating disclosures beyond that currently required by RESPA, HUD believes that mortgage brokers nevertheless should provide loan applicants with information about the broker's services and compensation as early as possible in the loan shopping process and obtain agreement by the borrower to the arrangement before the borrower makes application for the loan. The true market price for the mortgage broker's services could be best attained, HUD believes, under practices of this kind in which the fee a borrower will pay (along with its relationship to the interest rate and points charged by the lender and lender-paid compensation to the broker) is fully disclosed by the broker and agreed upon before application is made.

Statement of Policy 1999-1 was issued in response to a Congressional directive set out in the Conference Report on the 1999 HUD Appropriations Act that the Department clarify its position on the legality of lender payments to mortgage brokers under RESPA. However, HUD believes that broad legislative reform is still required on this issue to provide mortgage lenders and brokers clearer rules and to assure that consumers are provided better and firmer information about the costs of home loans consistent with the objectives of RESPA.

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