

COMMENTS
On
RESPA: Solicitation of Information on Changes in Warehouse Lending and Other
Loan Funding Mechanisms
[Docket No. FR-5459-N-01]

December 27, 2010

The National Association of Consumer Advocates¹ (NACA) and the National Consumer Law Center,²(NCLC) on behalf of its low income clients, submit these comments in response to the Department of Housing and Urban Development’s Notice of Solicitation of Information on Changes in Warehouse Lending and Other Loan Funding Mechanisms (Docket No. FR-5459-N-01).

I. Introduction: The Interests Protected by the Real Estate Settlement Procedures Act (RESPA)

Congress enacted RESPA in 1974 “to effect certain changes in the settlement process for residential real estate.” 12 U.S.C. § 2601(b). The purpose of those changes was, among other things, to cause “(1) . . . more effective advance disclosure to home buyers and sellers of

¹ The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA’s mission is to promote justice for all consumers. As part of its mission, NACA manages the Institute for Foreclosure Legal Assistance (IFLA), a program designed to fund and train organizations that help consumers protect their homes from foreclosure.

² The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (7th ed. 2010 (forthcoming)), *Cost of Credit: Regulation, Preemption, and Industry Abuses* (4th ed. 2009), and *Foreclosures* (3rd ed. 2010), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to address predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws.

settlement costs; [and] (2) . . . the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services.” *Id.*

The statute was enacted against the background of congressional findings that “significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country.” 12 U.S.C. § 2601(a).

RESPA consequently sweeps broadly. RESPA covers consumer transactions respecting any “federally related mortgage loan,” *id.* §§ 2601(1), 2607, a term that encompasses virtually every consumer mortgage transaction; and the referral of any “settlement service,” which consists of “the origination of a federally related mortgage loan, including, but not limited to, . . . the underwriting and funding of loans . . .” *Id.*

There have been changes in the real estate settlement services industry since 1974, but nothing suggests that Congress’s original purpose was misplaced or that the scope of the statute should be diminished. Indeed, many of the changes since 1974 by the settlement services industry have been aimed at evading the scope of the statute.

On the rare occasion that Congress has revisited RESPA, it has made clear that the same concerns as in 1974 remain valid today. In 1983, for example, Congress addressed Controlled Business Arrangements, recognizing that these arrangements could harm consumers in several ways:

[T]he advice of the person making the referral may lose its impartiality and may not be based on his professional evaluation of the quality of service provided if the referrer or his associates have a financial interest in the company being recommended. In

addition, since the real estate industry is structured so that settlement service providers do not compete for a consumer's business directly, but almost exclusively rely on referrals from real estate brokers, lenders or their associates for their business, the growth of controlled business arrangements effectively reduce the kind of healthy competition generated by independent settlement service providers. [H.R. Rep. No. 97-532, 97th Cong., 2nd Sess. at p. 52 (1982).]

As a result, today all such arrangements are subject to explicit restrictions, *see* 12 U.S.C.

§ 2607(c)(4).

Other changes since 1974 – such as the role of mortgage brokers in the real estate lending process—have, if anything, underlined the need for a robust, expansive RESPA statute and enforcement process. Narrowing the statute would be directly contrary to Congress's stated (and since repeated) intent in enacting the statute.

II. Background on Warehouse Lending and Table-Funding

Warehouse lines of credit, as HUD is fully aware, are a legal and unexceptional way for mortgage lenders who lack access to the deposit base of funds to obtain liquidity so that they can engage in mortgage loan transactions. In a standard, arms-length warehouse lending transaction, an unaffiliated warehouse lender and its mortgage banker borrower enter into commercially reasonable, market-based transactions that govern the terms, interest rate, underwriting standards, repayment and replenishment terms, and other similar matters. For example, the interest rate on warehouse lines is often set at the one-month LIBOR rate plus a spread. Other transaction terms will vary, but in a genuinely arms-length lending relationship, they will all be market-based. Such independent lending relationships can – and we stress *can* -- result in a *bona fide* secondary market transaction within the meaning of the Real Estate Settlement Procedures Act (RESPA), *see* 24 C.F.R. § 3500.5(b)(7).

By contrast, transactions between related or affiliated parties are often denominated warehouse lines of credit when they are actually table-funded transactions. Table-funded transactions are ones in which the funding and assignment of the loan occur contemporaneously. HUD has long recognized that a “table-funded transaction is not a secondary market transaction.” 24 C.F.R. § 3500.2. Nothing that we have seen suggests that this restriction should be loosened or changed. Yet changes to the warehouse lending definition could do this by ignoring the role of affiliated entities.

When the so-called warehouse lending occurs between one entity and another controlled or related entity (a “captive mortgage lender”), which makes mortgage loans, the terms of the “loan” may be unusual. In court records recently unsealed in a RESPA case filed in federal court in Maryland, for example, the mortgage lender was owned by a bank, which also acted as the mortgage lender’s warehouse lender. The mortgage lender’s records revealed that it paid *no interest whatsoever* to its owner/warehouse lender – despite the extension of credit for hundreds of millions of dollars. *See Minter v. Wells Fargo Bank, N.A.*, No. 07-cv-03442-WMN (D. Md.), Dkt. Entry #186, pp. 21-22. In such a situation, there is plainly no shelter from RESPA’s restrictions, nor should there be.³

Frequently, captive mortgage lenders routinely sell or assign most of the loans they originate back to the warehouse lender, in another marker of transfers that are not arms-length or bona fide as required by 24 C.F.R. § 3500.5(b)(7). We have seen cases in which a captive mortgage lender assigns or transfers 90% or more of its loans back to a related-party mortgage

³ The Notice asks for comments on how “warehouse lending [has] evolved” since HUD issued its 1994 regulations. Practices in such related-party transactions may have “evolved,” but not in a positive way. Schemes established to evade RESPA’s anti-kickback rules, or to skirt the requirements of the Affiliated Business Arrangement rules, should be subject to RESPA scrutiny, whether they are termed “warehouse lines of credit” or not.

lender, which also happens to be an owner or affiliate of the captive mortgage lender. *See, e.g., Petry v. Prosperity Mortgage Company*, 07-CV-03442 (D. Md.), Dkt. Entry #124, pp. 22-23, 31, 32. In such related party cases, the fact that the mortgage lender sells a high proportion of its loans back to its warehouse lender indicates that the transaction is anything but arms length.

In light of Congress's clearly expressed intent about the scope of RESPA, discussed above, narrowing via regulation or policy statement would be directly contrary to the purpose of the statute. Even if new guidance by HUD would be appropriate in certain circumstances, nothing would justify a relaxation of the rules in the context of related party transactions, such as warehouse lines of credit extended by one owner or affiliate to another.

III. Current Rules and Interpretations Regarding Secondary Market Transactions, Warehouse Lending and Table-Funding Should Not Be Altered

A. Given Congress's Intent and the Potential for Abuse, RESPA's Protections Should Not Be Narrowed

The Warehouse Lending Notice suggests that HUD is considering revising or even narrowing the protections afforded by RESPA to consumers in certain types of loans that involve warehouse lending. Given the broad sweep of the statute's language and Congress's plainly expressed intent about the need for stringent controls on anticompetitive conduct, there is no basis for such action. The history of the settlement service industry since RESPA's enactment is one of increasing sophistication and efforts to avoid RESPA's requirements through the creation of Affiliated Business Arrangements and other means.

But even if there is some justification for action, related party transactions like the ones described above should never be exempted from RESPA's prohibitions as secondary market transactions. When related parties structure a warehouse line of credit or assign loans to each other, the opportunities for manipulation are apparent. Simply put, such a loan transaction is

never a “bona fide” transfer of a loan obligation to the secondary market. 24 C.F.R.

§ 3500.5(b)(7). It is all too easy to structure such arrangements in a way that might comply with the letter of a regulation or policy statement. HUD should not encourage the real estate industry to invent new schemes that will shrink the scope of RESPA, and such an action would encourage precisely this conduct.

B. The Federal Courts have Relied on HUD’s Existing Interpretations to Build a Body of Law That Properly Interprets RESPA’s Protections in Related Party Cases

HUD should be extremely cautious about redefining the scope of RESPA’s protections because the federal courts of appeal have relied on HUD’s existing interpretation to erect a body of law that provides an appropriate level of protection for consumers. *See Moreno v. Summit Mtg. Corp.*, 364 F.3d 574 (5th Cir. 2004); *Chandler v. Norwest Bank Minnesota, N.A.*, 137 F.3d 1053 (8th Cir. 1998). Under these decisions, a mortgage purchased by the same warehouse lender who supplied the funds for the mortgage loan falls outside the RESPA secondary market exemption. Using such a “captive line of credit” makes a lender subject to RESPA.

In *Chandler*, for example, in finding that the loan was not table-funded and thus not subject to RESPA’s protections against kickbacks, the court underlined the importance of having a warehouse lender separate from the ultimate purchaser, taking pains to repeat, “The Chandlers have neither alleged nor shown any affiliation between CoreStates and Norwest.” *Id.* at 1056 n.5. Similarly, in *Moreno v. Summit Mtg.*, the Fifth Circuit followed *Chandler* in analyzing a loan sold by the defendant lender, Summit Mortgage. “For the loans it originated, Summit borrowed the money to fund them from its warehouse lender, Bank United.” 364 F.3d at 575. When Summit sold the loan to a genuine third party, First Nationwide, the Fifth Circuit found that this was a secondary market transaction. As in *Chandler*, “Summit borrowed the money to fund the Morenos’ mortgage loan through its established line of credit with Bank United, *not First*

Nationwide.” *Id.* at 577 (emphasis added). Under this jurisprudence, bona fide purchasers and legitimate warehouse lenders are already protected, while sham transactions are subject to greater scrutiny.

These decisions, of course, illustrate the way that bona fide, arms-length lending relationships work in the market, and are thus directly responsive to HUD’s request for such information. But just as important, they demonstrate that the current approach, under existing HUD guidance, is working well and does not require change or correction. Moreover, these decisions suggest that the courts have relied to a significant extent on HUD’s current interpretation of RESPA and its exemptions. Any change to that interpretation would carry significant risks.

IV. The Risks Involved in Loosening Controls over Table-Funded Transactions

The Warehouse Lending Notice suggests that HUD is considering changing or diluting RESPA protections for consumers who finance the purchase of a home through table funding involving warehouse lenders. As explained above, current HUD regulations make clear that table-funded loans – where a lender closes a loan in its own name using funds advanced by another party and then contemporaneously assigns that loan to that funding party (see 24 CFR § 3500.2(15)) – are not secondary market transactions. As a result, table-funded mortgage transactions – which typically involve origination through a mortgage broker or an affiliated company – are covered by the full panoply of RESPA protections (*e.g.*, prohibition on kickbacks, required disclosures, regulation of Affiliated Business Arrangements or ABAs, etc.). See 24 CFR § 3500.5(b)(7). The Warehouse Lending Notice suggests consideration of a

process which blur, if not totally eliminate, this line between bona fide secondary market transactions and table-funded mortgages.

Such an action would lead to terrible results for consumers. It would diminish RESPA's coverage over a large segment of mortgage lending. If table-funding involving warehouse lenders is removed from the scope of RESPA protection, we have no doubt that the non-transparent business model this would allow would significantly increase the cost of home loans to American consumers. In fact, we have seen this already attempted where table-funding is already used by large institutional lenders who set up sham ABA "lenders" with real estate brokers, mortgage brokers, and others to facilitate illegal kickbacks for referrals of business. These large lenders advance mortgage funds to sham ABA "lenders," who, contemporaneous with the closing, assign the loans to the real lender – i.e., the true source of funds in the transaction.

In table-funded transactions, the true identity of the actual lender is concealed from the borrower. In such transactions, the borrower is often saddled with thousands of dollars in unnecessary – and illegal – "underwriting," "administrative," "application," "processing" and similar junk fees. The terms of the table-funding transaction may require the imposition of those fees directly or may encourage them as a way of paying kickbacks along the chain.

As explained above, at least two federal circuit courts have already held that such table-funding practices are subject to RESPA,⁴ and several state courts, following HUD's current regulations and policies, have found that table-funding facilitated predatory practices such as loan-flipping. Moreover, a number of lawsuits are currently pending around the country challenging various table-funding abuses. Often, as explained above, the advance of funds by

⁴ *Moreno v. Summit Mtg. Corp., supra; Chandler v. Norwest Bank Minnesota N.A., supra.*

the real lender in a table-funded mortgage is done through what the lender will call a “warehouse line of credit,” but the effect is the same – a concealed lender charging and receiving inflated settlement fees.

The HUD “guidance” that the Warehouse Lending Notice anticipates being issued will enable these abusive practices. Such a move by HUD now, when Americans are still reeling from a recession fueled by a spate of disastrous predatory banking practices – including many caused by table-funded lending in the subprime market – is a recipe for disaster and is the last thing American consumers need today.

Finally, and frankly, we remain concerned about HUD’s decision to issue this Warehouse Lending Notice. First, with the pending start-up of the Consumer Financial Protection Bureau (“CFPB”), we believe HUD should issue no new rules or opinions on RESPA, but leave rulemaking under RESPA to the CFPB, which is charged with both rulemaking under RESPA and research into many different matters relating to consumer lending.

Second, we strongly believe that there are far more pressing issues in the mortgage lending and servicing marketplace for all regulators, including both the CFPB and HUD, to focus on. Loosening the standards for warehouse lending or table-funded transactions is a response to a “problem” that doesn’t need to be fixed. Bona fide secondary market transactions are currently exempt from RESPA and require no additional HUD interpretations or guidance; and genuine warehouse lenders (large financial institutions which extend credit to unrelated, unaffiliated mortgage lenders) do not run afoul of RESPA unless they table-fund. Under current HUD regulation and policy, RESPA is working as intended and covers residential home mortgage transactions, regardless of the funding method employed.

There is no valid reason to carve out an exemption from RESPA for one segment of mortgage transactions, i.e., where the mortgage is table-funded through fictional warehouse lending. Indeed, if HUD were to exempt table-funded warehouse loans to affiliated entities from RESPA, we are certain that the mortgage industry as a whole would re-tool itself to exploit such a large and gaping RESPA loophole. Even if there were a problem that needed addressing, the contemplated “cure” would end up killing the patient.

V. The Mortgage Lending Industry Seeks to Preempt Efforts to Build a Fair and Accountable Mortgage Lending System

As of the submission of these comments, twenty-two industry related businesses and trade groups have submitted comments to HUD regarding the "need" for changes to HUD's regulations regarding warehouse lending. HUD's November 24 Notice, however, requested comments from the industry and others on "changes in warehouse lending and other finance mechanisms" since 1992. The comments submitted from the industry fail to address any such changes or evolutions; rather, the comments simply urge changes to regulations that will exempt "table funding" from HUD and RESPA's regulation.

The comments urge changes to HUD's treatment of "table funding" that will have serious repercussions for consumers:

1. Changing the current regulations would undermine attempts to hold mortgage lenders responsible for the quality of loans they fund. Table-funded transactions allow poorly capitalized entities—often mortgage brokers masquerading as legitimate lenders—to originate loans without retaining any liability for those loans. If a table funded loan, originated by a mortgage broker, is considered a secondary market transaction, and thus outside the regulation of RESPA, then institutional lenders will have less incentive to police the underwriting and other origination activities of the assignor.
2. Large institutional lenders could establish sham lending affiliates with real estate brokers and other referral sources, merely by running the mortgage funds through a

warehouse line of credit. At the moment such transactions fall within RESPA. If the changes suggested by the industry are adopted, then sham lending will become institutionalized, with large opportunities for unregulated and often undiscoverable kickbacks. Not only would consumers be harmed by this kickback arrangement, small businesses (including more moderate size lenders that do not have the resources to establish such affiliates) will suffer a competitive disadvantage.

In the end, any changes to HUD's current regulations would be short sighted. Expanding the reach of the warehouse lending exceptions could have a serious impact on consumers and the economic recovery. As the comments and submissions to date suggest, the industry is not seeking merely to modify current HUD regulations; rather the industry is urging HUD to stop regulating many of the very types of predatory practices that gave rise to the mortgage crisis of 2008.

For these reasons, we suggest that no further action or guidance by HUD is required, particularly not in the case of affiliated or related-party transactions involving so-called warehouse lines of credit.

Respectfully Submitted,

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