1979

Federal Regulation of Home Mortgage Settlement Costs: RESPA and Its Alternatives

Diana Stoppello

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Part of the Law Commons

Recommended Citation
https://scholarship.law.umn.edu/mlr/1143

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
Federal Regulation of Home Mortgage Settlement Costs: RESPA and its Alternatives

Diana Stoppello*

TABLE OF CONTENTS

I. INTRODUCTION ........................................... 368
II. THE SETTLEMENT PROCESS ............................ 369
III. RECENT HISTORY OF FEDERAL SETTLEMENT COST REGULATION .................. 373
IV. BASIC PROBLEMS IN FEDERAL REGULATION OF SETTLEMENT COSTS .............. 382
   A. THE CONSTITUTIONALITY OF FEDERAL REGULATION ....................... 382
   B. THE PRACTICABILITY OF FEDERAL REGULATION ..................... 391
V. THEORIES OF FEDERAL REGULATION OF SETTLEMENT COSTS ..................... 391
   A. FEDERAL ESTABLISHMENT OF MAXIMUM CHARGES FOR SETTLEMENT SERVICES .......... 392
   B. FEDERAL REQUIREMENT THAT LENDER PAY ALL SETTLEMENT COSTS ATTRIBUTABLE TO THE TRANSFER AND FINANCING OF THE PROPERTY .......................... 394
      1. The Advantages and Disadvantages of Lender Pay: Professor Whitman's View .. 398
      2. The Advantages of Lender Pay: A Closer Look .......................... 400
      3. The Disadvantages of Lender Pay: A Closer Look ....................... 411
   C. FEDERAL REQUIREMENT OF DISCLOSURE OF SETTLEMENT COSTS .................. 421

† Copyright 1979 by Diana Stoppello.
* Associate Professor of Law, Rutgers University School of Law at Newark. From 1971 to 1973, the author was an attorney-advisor in the United States Department of Housing and Urban Development (HUD) and was involved directly in HUD's efforts to study and reduce real estate settlement costs. During the 1975-76 academic year, the author was on leave of absence from Rutgers University and served as Special Assistant to the Secretary of HUD and as Associate Deputy General Counsel of HUD. The author did not participate in HUD's implementation of the Real Estate Settlement Procedures Act of 1974 nor in HUD's implementation of the 1975 amendments thereto. The views expressed are those of the author and not necessarily those of HUD. The author wishes to thank Douglas Wolfson, J.D. 1977, Rutgers-Newark and Robert Boehm, J.D. 1978, Rutgers-Newark for research assistance in connection with this Article.
VI. RESPA: THE REFORM THAT NEVER WAS ...... 423
VII. RESPA REVISED: RECOMMENDATIONS FOR FURTHER CONGRESSIONAL ACTION ...... 435
   A. DISCLOSURE OF ESTIMATED COSTS ............... 435
      1. Real-estate Broker Precontract Disclosure 435
      2. Builder Precontract Disclosure ............. 440
      3. Mortgage Lender Postcontract Disclosure . 442
   B. DISCLOSURE AND PAYMENT OF ACTUAL SETTLEMENT COSTS ........................................ 443
   C. RESTRICTIONS ON SELECTION BY MORTGAGE LENDERS OF SETTLEMENT SERVICE PROVIDERS . 445
VIII. EVALUATION OF DISCLOSURE PROPOSALS . . . 449
   A. ADVANTAGES OF DISCLOSURE PROPOSALS .......... 449
   B. CRITICISMS OF DISCLOSURE REGULATION: COMPARISON OF PROPOSED RESPA DISCLOSURES AND TRUTH-IN-LENDING .......... 451
IX. CONCLUSION ........................................ 456

I. INTRODUCTION

When the Real Estate Settlement Procedures Act1 (RESPA) was enacted in 1974, some hailed it as a law that would “ensure that the costs to the American home buying public will not be unreasonably or unnecessarily inflated by abusive practices.”2 Others condemned it as “a major defeat for consumers and a stunning victory for the real estate settlement lobby.”3 Realistically, RESPA merited neither high praise nor condemnation. RESPA’s requirements of distribution of information booklets to homebuyers and at least twelve days advance disclosure of the settlement costs payable upon transfer of title were only a modest effort by the federal government to make the oftentimes bewildering process of buying and selling a home somewhat less mysterious for the parties to the transaction.

Little more than six months after its effective date, however, even that modest effort was undone. Following an intensive lobbying campaign by mortgage lenders, real estate brokers, and title insurance companies,4 Congress passed the Real Estate Settlement Proce-
RESPA

dures Act Amendments of 1975,\(^5\) which repealed the heart of RESPA. In its place, Congress substituted a regulatory scheme that requires mortgage lenders to estimate settlement costs and to disclose these costs to homebuyers in a form that is of little value and that denies homebuyers the right to know all of their actual settlement costs until the date of settlement.

The Congressional finding that led to the enactment of RESPA is set out in the Act itself:

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.\(^6\)

The purpose of this Article is to analyze and evaluate RESPA, as amended, to determine whether it fulfills this need for significant reform in the real estate settlement process. In addition, this Article discusses various alternatives to the method of regulation employed by RESPA and concludes with a proposal for legislation that would better accomplish the purpose of RESPA.

An analysis and evaluation of RESPA and its alternatives must be based on an understanding of the settlement process; the history of federal settlement cost regulation; the basic legal, political, and practical problems inherent in such regulation; and the current theories of such regulation. The discussion of RESPA in this Article, therefore, is preceded by a consideration of these background topics.

II. THE SETTLEMENT PROCESS

The settlement process consists of various steps that accompany the passage of ownership of real property from the seller to the buyer. The term "settlement costs," as used in this Article, means all monies paid by the buyer or seller in connection with the purchase and sale of the property. In addition to the fees charged by participants in the settlement process for the services described in this section, the following are considered to be settlement costs: all charges made by the mortgage lender for mortgage financing, including loan discount payments (mortgage points); all items required by the mortgage lender to be paid in advance and to be deposited into reserve accounts; all adjustments between buyer and seller for items such as property taxes; and all state and local recording fees and transfer taxes.\(^7\)


\(^7\) Professor John C. Payne has classified these costs under four headings: (1)
In its broadest sense, the settlement process begins when the real estate broker solicits the owner's listing for sale and ends when the deed from the seller to the buyer is recorded. Although the individual elements and participants in the settlement process vary according to local law and custom, the procedures described below are common to most residential real estate transactions.

Most homeowners, upon deciding to sell their homes, list the property for sale with a real estate broker on the standard listing form used in the area. If the property is in a new development, the developer may use a real estate broker, but most often relies on a sales staff of his own. When a real estate broker is involved, he almost always is the agent of the owner, who, therefore, is obligated to pay the broker's commission.

Most prospective buyers of existing homes also rely upon the services of a real estate broker. After the real estate broker has brought buyer and seller together, the settlement services listed below are performed by one of the following providers: the real estate broker; an attorney who represents the buyer, the seller, or the lender; a title insurance company; an abstractor; a mortgage lender; or an

sellers; (2) financing; (3) establishing title and security interest; and (4) meeting statutory charges. Payne, Ancillary Costs in the Purchase of Homes, 35 Mo. L. Rev. 455, 460 (1970). Although Professor Payne considers prorated items such as taxes irrelevant because they are attributable to ownership rather than to the transfer, id., this Article includes these prorated costs because they must be paid at the time of transfer and may, therefore, affect the buyer's financial ability to purchase a home.


9. Based on intermittent local statistics, the National Association of Realtors estimates that of existing homes, ninety percent are sold by real estate brokers, and that most new homes are sold by builders. Telephone Interview with Kenneth Kerin, Director of Research, National Association of Realtors (July 15, 1977) [hereinafter cited as Kerin Interview].


independent escrow agent. Which provider performs each task and who pays each provider's fee are subject to local variation and also to negotiation by the parties.\textsuperscript{12}

The settlement services include:

1. \textit{Negotiating and preparing the contract of sale.} The contract of sale may be negotiated and prepared by either the real estate broker or an attorney. It usually is on a standard form drafted by the local bar association and adopted by the local real estate board.

2. \textit{Arranging for financing.} Arranging for financing the purchase of an existing home is the buyer's responsibility. If the buyer does not have his own source of financing, the real estate broker or the attorney may refer the buyer to a lender.

3. \textit{Searching, examining, and assuring the title.} The title search and examination are made to ensure that the seller is able to convey a marketable title. Title assurance is a means of compensating the persons who have an interest in the property in the event that the title turns out to be defective. Five basic methods of establishing title currently are practiced in the United States: (1) a personal search of the title records conducted by an attorney, followed by the attorney's written opinion to the lender and buyer concerning the state of the title; (2) a commercially prepared abstract of the title records prepared by an abstractor and examined by an attorney and the attorney's written opinion to the lender and the buyer concerning the state of the title; (3) a personal search by the attorney, followed by certifying title to a title company that issues a policy of title insurance for the benefit of the lender, or the buyer, or both; (4) an examination of an abstract plus title insurance; and (5) a title search and examination conducted by employees of the title insurance company plus title insurance.\textsuperscript{13}

\textsuperscript{12} See generally Payne, supra note 7, at 458.

\textsuperscript{13} The HUD-VA report contains a map of the United States that illustrates the dominant form of title proof in each state. Method (1) is typical in the New England states; method (2) is typical in Iowa, Kansas, and North Dakota; method (3) is typical in Ohio, Pennsylvania, and the southeastern states; method (4) is typical in New Jersey, Florida, and most of the midwestern states; and method (5) is typical in Illinois, Michigan, New York, the District of Columbia, and the western states. HUD-VA REPORT, supra note 8, at 45, reprinted in 1972 House Hearings, supra note 8, at 779.

A sixth form of title proof is title registration, sometimes called the Torrens system after Sir Robert Torrens, the Australian official who proposed it in 1857. Under title registration, the sovereign initially examines all titles and then issues the owner a certificate of ownership, a duplicate of which is kept by the appropriate governmental official. When title is transferred, title examination and registration do not have to be repeated. Instead, the title certificate passes from seller to buyer and the transfer is entered in the official records. Losses due to errors in registration are indemnified by the government with funds derived from title registration fees. Although title registration is widely used outside the United States, its use in this country has been vigorously
4. **Preparing title and loan documents.** Documents to be prepared include the deed that will convey the property from the seller to the buyer, a note or bond evidencing the buyer's personal liability for the loan that finances the purchase, a mortgage or deed-of-trust making the property security for the loan, and a settlement statement summarizing all of the financial aspects of the transaction. The various documents, most of which are on standard printed forms, may be prepared by the real estate broker, the attorney for the buyer or the lender, an employee of the lender, or an employee of the title insurance company, according to local custom.

5. **Conducting the settlement.** All of the foregoing tasks, plus assorted others such as credit checks, surveys, and inspections, are undertaken with a view to the settlement. The purpose of the settlement is to bring all the interested parties together to execute and deliver the necessary documents simultaneously with the payment of the purchase price and the settlement costs. Depending on local custom, the settlement may be supervised by an attorney for one of the parties, the real estate broker, a representative of the title insurance company, or a representative of the lender.

At a typical settlement, the seller must give the buyer a deed and evidence of good title and perhaps a survey and termite inspection report. The buyer must give the seller a check in the amount of the balance of the downpayment and any adjusted items, such as real estate taxes paid in advance by the seller. The buyer also must give a check to the lender for any required items, such as deposits into reserve accounts for real estate taxes or insurance premiums. If the seller owns the property free and clear of any mortgage, the buyer’s lender makes its check for the balance of the purchase price payable opposed. Most practicing real estate attorneys and academicians believe that title registration is unlikely to expand and is of historical interest only. See HUD-VA REPORT, supra note 8, at 21-23, reprinted in 1972 House Hearings, supra note 8, at 756-58; Payne, supra note 7, at 457 n.7.

14. In some states, antideficiency legislation eliminates the borrower’s personal liability, either entirely or only as to specific types of mortgage loans. See, e.g., CAL. CIV. PROC. CODE § 580(b), (d) (West 1976); N.C. GEN. STAT. § 45-21.38 (1976); OR. REV. STAT. § 88.070 (1975); S.D. COMP. LAWS ANN. § 44-8-20 (1967). In other states, the borrower’s personal liability is limited to the difference between the unpaid balance of the loan and the fair market value of the property (as opposed to the foreclosure sale price). See, e.g., N.Y. REAL PROP. LAW § 1371 (McKinney 1963); 12 PA. CONS. STAT. § 2621.1, .6 (1967). Both types of statutes had their origin in the depression of the 1930s. For a contemporaneous discussion of mortgage relief legislation, including a state by state list of statutes, see Poteat, State Legislative Relief for the Mortgage Debtor During the Depression, 5 LAW & CONTEMP. PROBS. 517 (1938).

15. In many parts of the country, the settlement is called the “closing” and, according to Professor Cribbet, the day set for settlement or closing is known as “law day.” See J. CRIBBET, PRINCIPLES OF THE LAW OF PROPERTY 132 (2d ed. 1975). Since RESPA uses the term “settlement,” that is the term used throughout this Article.
to the seller. If, as more often is the case, the seller has a balance owing to his lender, the buyer's lender makes a check to the seller's lender for the balance due on the seller's loan and a check to the seller for the seller's equity. The seller gives a check to the real estate broker for his commission and the buyer gives a check to the attorney for his services. The payment to the attorney may include, in addition to the legal fee, an amount for any title insurance and applicable local government costs, such as recording fees and real estate transfer taxes, that the attorney will disburse.

In some localities, instead of the parties personally appearing at a settlement, an escrow device is used. Although purists still insist that the term "escrow" refers to a conditionally delivered instrument, this term, in the context of the purchase of real property, has come to refer to the process by which the seller, buyer, and lender deposit the necessary documents and checks, together with instructions, with a third party. The escrow agent may be any of the persons who otherwise would conduct a settlement, or he may operate independently. Generally, when the escrow agent has received all of the necessary documents and checks, he is authorized to record the deed. The title is then checked for inclusion of the recording, and if title is clear in the buyer, the escrow agent disburses the purchase money and other checks. There may be a separate escrow fee or, if the escrow agent is also providing other services, his fee may include the escrow fee.

No wonder the buyer is bewildered. As he sits at settlement writing checks for services he may only vaguely comprehend, he might well be thinking that if only someone had told him about all of these settlement costs ahead of time, he might not have been so quick to sign the contract of sale. The settlement statement, which shows the allocation of the various charges, is somewhat helpful to the buyer, but traditionally it has been prepared at or after settlement. From the buyer's standpoint, the very least that he needs is an explanation of the settlement process, including the identities of the providers of services and their fees and charges, before he becomes bound under the contract of sale. RESPA must, therefore, be evaluated in light of how well it meets this need.

III. RECENT HISTORY OF FEDERAL SETTLEMENT COST REGULATION

The settlement process traditionally has been regarded as a matter to be governed by state law. Until recently, federal regulation has

---

16. Id. at 175.
been limited to homes sold under programs administered by the Department of Housing and Urban Development (HUD) and the Veterans Administration (VA). The recent history of federal settlement cost regulation dramatically illustrates the politically controversial nature of any attempt by the federal government to regulate the settlement process.

The federal government's recent concern about settlement costs grew out of its more traditional concern about mortgage interest rates. Upon the recommendation of the Commission on Mortgage Interest Rates, Congress enacted the Emergency Home Finance Act of 1970. Section 701 of this Act deals with settlement costs, and subsection (a) authorizes HUD and VA, with respect to housing under those agencies' programs, "to prescribe standards governing the amounts of settlement costs allowable in connection with the financing of such housing in any area." Subsection (b) directs HUD and

19. 38 C.F.R. § 36.4312 (1977). Mortgage insurance programs administered by HUD frequently are called FHA programs. When HUD was created as an executive department in 1965 by the Department of Housing and Urban Development Act, Pub. L. No. 89-174, § 2, 79 Stat. 667 (codified at 42 U.S.C. §§ 3531-3537 (1976)), the legislation transferred to HUD all of the functions, powers, and duties of the Federal Housing Administration (FHA). 42 U.S.C. § 3534(a). The legislation requires that there be within HUD a Federal Housing Commissioner, who shall be one of the Assistant Secretaries and who shall administer departmental programs relating to the private mortgage market. Id. § 3533(a).
20. The Commission on Mortgage Interest Rates was created by Pub. L. No. 90-301, § 4, 82 Stat. 114 (1968), "to study mortgage interest rates and to make recommendations to assure the availability of an adequate supply of mortgage credit at a reasonable cost to the consumer . . . ."
In a 1969 report, the Commission found that special attention should be given to the question of closing costs associated with mortgage transactions. These costs at times add significantly to the burden of acquiring a home since they come on top of whatever down payment must be made . . . . Buyers sometimes do not learn of these costs until quite late, and then have no time to shop around for a less expensive deal.

U.S. COMMISSION ON MORTGAGE INTEREST RATES, REPORT TO THE PRESIDENT OF THE UNITED STATES AND TO THE CONGRESS (1969) [hereinafter cited as MORTGAGE INTEREST COMMISSION REPORT]. The Commission concluded that

with respect to closing costs and other fees collected in connection with mortgage financing, the Commission recommends that FHA and VA: (a) continue the present administrative practice of reviewing such costs to see that they are consistent with the accepted standard in each local area; (b) develop regulations and procedures to assure that prospective borrowers have reliable estimates of such costs within a reasonable time prior to the loan closing; and (c) undertake a joint study for submission to the Congress by mid-1970 recommending steps to reduce and standardize such costs.

Id.
22. Id. § 701(a). Such standards are to "be based on the Secretary's and the
VA to "undertake a joint study and make recommendations ... with respect to legislative and administrative actions which should be taken to reduce mortgage settlement costs and to standardize these costs for all geographic areas."\(^{23}\)

HUD and VA submitted a joint report on mortgage settlement costs\(^2\) to the Congress early in 1972. Among the findings were the following:

6. The Buyer seldom decides who will provide settlement services for him. If there is a choice, he usually depends upon advice of the broker, escrow agent, seller, or settlement attorney. Often the buyer is or believes he is required to deal with a particular source for some or all settlement services.

7. Competitive forces in the conveyancing industry manifest themselves in an elaborate system of referral fees, kickbacks, rebates, commissions and the like as inducements to those firms and individuals who direct the placement of business. These practices are widely employed, rarely inure to the benefit of the homebuyer, and generally increase total settlement costs.

8. Settlement charges often are based on factors unrelated to the cost of providing the services. The overall level of charges tends to be significantly lower when the charge for a service is not directly related to the sale price of the property.

9. Minimum or recommended fee schedules by local legal or real estate groups often do not reflect the actual work done and tend to increase settlement costs.

10. Most public land record systems need to be improved in

\[\text{Administrator's estimates of the reasonable charge for necessary services involved in settlements for particular classes of mortgages and loans.} \] Id. § 701(a)(3).

\[\text{Both the House and Senate reports, using identical language, make clear the purpose of the study:} \]

FHA and VA presently do pay some attention to closing charges, and attempt to protect individual borrowers from having to pay more for a particular service than is generally customary in the local area involved. . . . [T]his practice should be continued and . . . procedures should be developed to provide helpful information about such charges to prospective borrowers. . . .

It is the committee's intent that the study and recommendations on settlement costs cover not only Government-assisted mortgage transactions but also all residential real estate transactions, with particular reference to those transactions involving single-family homes where the unsophisticated purchaser or seller is often unfamiliar with the complex details of transferring real estate title. It is hoped that a thorough study will be made toward developing a simplified method of locally controlled recording and guaranteeing of real estate titles to speed up and reduce the costs of title transfers.


\[\text{HUD-VA REPORT, supra note 8, reprinted in 1972 House Hearings, supra note 8, at 735-811.}\]
order to facilitate title search and eventually reduce title related and other settlement costs. 25

Many of the recommendations for immediate action at the federal level foreshadowed the enactment of RESPA:

HUD and VA will require the use of a single uniform settlement statement for all HUD and VA insured or guaranteed transactions . . . . This statement will separately itemize buyer and seller costs in order to provide full disclosure and assure that costs reported were actually incurred . . . .

. . . HUD and VA will require that buyers and sellers receive detailed estimates of probable individual settlement costs which are applicable to the transaction.

. . . . HUD and VA will require that initial deposits in the mortgagee's escrow account should be collected so that when the tax bill is paid, only 1/12 of the estimated annual tax bill remains in the escrow account . . . .

. . . HUD and VA will . . . recommend that the Congress enact legislation prohibiting all fees for the preparation of disclosure statements. 26

The foregoing recommendations caused little comment at the time they were made. Criticism was directed at the most controversial of the recommendations:

HUD and VA will establish maximum allowable charges for all individual settlement costs items paid by both the buyer and seller, except loan discount payments and costs fixed by State and local statutes, for identifiable housing market areas. Government insurance or guarantee will not be issued in any case in which charges exceed any one of the maximums. 27

In order to implement the HUD-VA Report, HUD, with limited data and limited capability to collect additional data, embarked on

25. Id. at 2-3, reprinted in 1972 House Hearings, supra note 8, at 738-39. Many of the findings in the study were corroborated in a series of Washington Post articles published at about the same time that the HUD-VA report was submitted to Congress. The articles, which were entitled The Settlement Squeeze, appeared from January 9-12, 1972. See 1972 House Hearings, supra note 8, at 1-19 (entire series reprinted). The articles explored the settlement process in the Washington, D.C. area, which includes several counties in Maryland and Virginia. The articles focused on the interrelationships among real estate brokers, lenders, attorneys, and title insurance companies, and revealed the existence of kickbacks, referral fees, and other hidden charges flowing to these parties. The series closed with a comparison of settlement practices and costs in the Washington, D.C. and Boston areas; costs in the former were found to be double or triple the costs in the latter.

26. HUD-VA REPORT, supra note 8, at 3-4, reprinted in 1972 House Hearings, supra note 8, at 739-40.

27. Id. at 3, reprinted in 1972 House Hearings, supra note 8, at 739.
the difficult task of fixing maximum settlement charges. HUD published proposed maximum charges on July 4, 1972. Maximum charges were set for the following settlement services, no matter which provider performed them: credit report, survey, title examination, title insurance, closing fee, and pest and fungus inspection. The proposed regulation did not seek to set maximum real estate broker commissions.

Public comment on the proposal was overwhelming. HUD received over 800 comments, more than it previously had received on any other subject. Nearly all of the comments were critical of HUD's effort. Congressional reaction was mixed; the Senate version of the Housing and Urban Development Act of 1972 reaffirmed HUD's role in setting maximum settlement charges for FHA-insured housing and expanded HUD's authority to cover some other federally related mortgages. The House Subcommittee on Housing, however, voted to repeal HUD's authority to regulate settlement costs. Faced with these conflicting reactions, HUD never made its proposed regulation final.

During the next two years, Congress considered numerous settle-
ment cost bills,\textsuperscript{36} which represented three different approaches to federal settlement cost regulation: (1) HUD regulation of maximum charges for settlement services for all federally related mortgages; (2) payment by mortgage lenders of all settlement costs attributable to the transfer and financing of the property; and (3) advance disclosure of settlement costs.\textsuperscript{37} In 1974, the House and the Senate passed similar advance disclosure bills, although, as in 1972, they differed as to whether or not to repeal HUD's authority to set maximum settlement charges for FHA-insured housing.\textsuperscript{38} This question had been the subject of heated floor debate in both houses of Congress.\textsuperscript{39} The House and Senate conferees, after recognizing that HUD was not using its regulatory authority, agreed to continue that authority for its deterrent effect. According to the conferees, nothing in the Act was "intended to preclude the Secretary's use of Section 701 authority at any time he finds it necessary to curb abuses in specific market areas."\textsuperscript{40} Once this issue was settled, the other differences were adjusted easily. The advance disclosure legislation compromise agreed to by the conferees was concurred in by both houses,\textsuperscript{41} and on December 22, 1974, President Ford signed the Real Estate Settlement Procedures Act of 1974.\textsuperscript{42}

RESPA, then, was the culmination of five years of congressional consideration of settlement costs. Its enactment did not, however, put an end to the controversy over how, if at all, such costs should be regulated. In fact, the most heated stage of the controversy had just begun.

The real estate settlement industry's interest centered on three provisions of RESPA, as originally enacted: (1) section 6, which obli-
gated a lender agreeing to make a federally related mortgage loan to disclose in writing, not later than twelve days prior to settlement, the amount of each charge for settlement services arising in connection with such settlement;\(^4\) (2) section 7, which prohibited a lender from making a commitment for a federally related mortgage loan on certain nonowner-occupied property unless the lender confirmed that the "purchase price of the last arm’s length transfer of the property" and the cost of subsequent improvements to it had been disclosed to the buyer;\(^4\) and (3) section 8, which prohibited the giving and accepting of kickbacks and other unearned fees in connection with settlement of federally related mortgage loans.\(^4\)

Mortgage lenders complained of the heavy paperwork burden imposed upon them by section 6 and of delays in settlement caused by the twelve day disclosure period.\(^4\) As to section 7, lenders pointed out that the timing was wrong. By the time a buyer would be seeking a loan commitment, he already had signed a sales contract. Any information that the buyer obtained, after signing the sales contract, about the previous sales price of the property ordinarily would not enable him to rescind.\(^4\) Real estate brokers were concerned that sec-

---

46. See, e.g., Hearings on the Real Estate Settlement Procedures Act of 1974: Hearings on H.R. 5352, S. 2327 and H.R. 10283 Before the Subcomm. on Housing and Community Development of the House Comm. on Banking and Currency, 94th Cong., 1st Sess. 132-36 (1975) [hereinafter cited as 1975 House Hearings] (testimony of William S. Mortensen on behalf of the Conference of Federal Savings & Loans); id. at 227-30 (testimony of Edwin Brooks, Jr., on behalf of the U.S. League of Savings Associations); id. at 284-86 (testimony of William A. Bressman, Jr., on behalf of the National Association of Mutual Savings Banks); id. at 338-40 (testimony of Herman Lerdal on behalf of the American Bankers Association). See also Oversight on the Real Estate Settlement Procedures Act of 1974: Hearings on S. 2327 and S. 2349 Before the Senate Comm. on Banking, Housing, and Urban Affairs, 94th Cong., 1st Sess. 74-80 [hereinafter cited as 1975 Senate Hearings] (reprints of sample letters in opposition to RESPA received from around the country).

Feelings about advance disclosure ran so high that Senator Proxmire, attending a Wisconsin-Michigan football game, was met by people parading around chanting "down with RESPA." Id. at 1. One lender told the story of a RESPA disclosure that created such hostility between buyer and seller that one of the sellers armed himself with a gun and left home in a rage to take revenge on the loan manager. In route, he went out of control and killed a man. 1975 House Hearings, supra, at 133-34.

47. See, e.g., 1975 Senate Hearings, supra note 46, at 140 (testimony of James D. Rowe on behalf of the Mortgage Bankers Association). Rescission may be available, however, where the difference between the value of the property and the sales price is so disparate as to give rise to a presumption of fraud in the transaction. See, e.g., Ramsey v. Mading, 36 Wash. 2d 303, 315, 217 P.2d 1041, 1048 (1950). See generally Kannavos v. Amino, 356 Mass. 42, 49-50, 247 N.E.2d 708, 712-13 (1969); Snell v.
tion 8 could have been construed to make criminal the traditional practices of broker cooperation through multiple listing services, out-of-state broker referral services, and the more recent development of real estate franchises, whereby small real estate offices join together under a common name, image, or sales format in order to strengthen their ability to compete.\footnote{Cornehl, 81 N.M. 248, 249-50, 466 P.2d 94, 95-96 (1970).} 

The enormous outcry against RESPA led the Senate Committee on Banking, Housing, and Urban Affairs to hold oversight hearings\footnote{The enormous outcry against RESPA led the Senate Committee on Banking, Housing, and Urban Affairs to hold oversight hearings after the law had been in effect only three months, and led the Subcommittee on Housing and Community Development of the House Committee on Banking, Currency, and Housing to hold similar hearings about six weeks later.} after the law had been in effect only three months, and led the Subcommittee on Housing and Community Development of the House Committee on Banking, Currency, and Housing to hold similar hearings about six weeks later.\footnote{Legislative action quickly followed the respective committee hearings.} By December, 1975, both the House and the Senate had

\footnote{Cornehl, 81 N.M. 248, 249-50, 466 P.2d 94, 95-96 (1970). Generally, such a presumption would arise only when the disparity is so great as to shock the conscience of the court. See Vossen v. Wilson, 39 Wash. 2d 906, 909, 239 P.2d 558, 560 (1952).} 

Furthermore, the "last arm's length transfer of the property" was not always clear. Since section 7 was a criminal statute, the Department of Justice had the responsibility for enforcement. HUD had no authority under RESPA to issue regulations under section 7. Lenders wanted more guidance than the government was willing to provide. For an illustration of the problems raised by section 7, see 1975 House Hearings, supra note 46, at 48-60 (testimony of Robert R. Elliott, HUD General Counsel); 1975 Senate Hearings, supra note 46, at 21-24 (same). 

\footnote{1975 House Hearings, supra note 46, at 252-57; (statement of Art S. Leitch, President, National Association of Realtors (N.A.R.)); 1975 Senate Hearings, supra note 46, at 313-18 (same). Since section 8 applied to all providers of settlement services, confusion as to what conduct was proscribed criminally was not limited to real estate brokers. As with section 7, since the Department of Justice had responsibility for enforcement, HUD had no authority to issue regulations under section 8. See note 47 supra.} 

\footnote{1975 Senate Hearings, supra note 46, at 1-3.} 

\footnote{Although RESPA was signed by President Ford on December 22, 1974, it did not become effective until 180 days thereafter. Pub. L. No. 93-533, § 19, 88 Stat. 1731 (1974). The 180-day period was designed to permit HUD to adopt implementing regulations and to give providers of settlement services time to adopt procedures in compliance with RESPA.} 

\footnote{1975 House Hearings, supra note 46, at 1-2.} 

\footnote{Most of the witnesses at the hearings spoke on behalf of trade associations that represent various providers of settlement services and testified strongly against RESPA. The strongest support for section 6 came from consumer representatives, who initially had been unenthusiastic about advance disclosure as a means of effectively reducing settlement costs. They recognized, however, that 12-day advance disclosure benefitted prospective homebuyers in at least two important ways: (1) it gave them a sound basis upon which to compare charges for settlement services; and (2) it enabled them to know how much cash would be required at settlement. These witnesses expressed the view that the complaints from lending institutions were greatly exaggerated and pointed out that delays have always been part of the settlement process. RESPA, in their view, provided lenders with a convenient scapegoat on which to blame}
passed legislation to amend RESPA. Among the key provisions were: (1) repeal of sections 6 and 7; (2) replacement of the twelve day advance disclosure of actual settlement costs requirement of section 6 with the provision that lenders make good faith estimates of likely settlement charges; and (3) amendment of section 8 to make it inapplicable to certain cooperative arrangements of real estate brokers and to give HUD the authority to promulgate regulations concerning section 8.53

The difference between the House and Senate provisions concerned the required disclosure of actual settlement costs—and this difference was minimal. The House provided that such information

such delays. These witnesses opposed any cut-back in the modest level of consumer protection provided by section 6 of RESPA. 1975 House Hearings, supra note 46, at 399-418 (testimony of Kathleen F. O'Reilly on behalf of the Consumer Federation of America); id. at 374-99 (testimony of Dale A. Whitman, Professor of Law); 1975 Senate Hearings, supra note 46, at 203-12 (testimony of Benny L. Kass); id. at 212-21 (testimony of Kathleen F. O'Reilly); id. at 231-42 (testimony of Dale A. Whitman).

Section 7's strongest defender was Congresswoman Leonor K. Sullivan. She argued that section 7 was necessary in order to prevent unscrupulous real estate speculators from buying old homes at very low prices, adding a few cosmetic touches but making no real repairs or improvements, and selling them to unsophisticated low and moderate income homebuyers at greatly inflated prices. See H.R. Rep. No. 667, 94th Cong., 1st Sess. 19-20, reprinted in [1975] U.S. CODE CONG. & AD. NEWS 2460-61 (dissenting views of Rep. Leonor K. Sullivan); 121 CONG. REC. 36,916-19 (1975) (remarks of Rep. Sullivan); 1975 House Hearings, supra note 46, at 159-62.

Several witnesses pointed out that the defective timing problem of section 7 could be remedied by making it apply directly to the seller rather than to the lender. See, e.g., 1975 House Hearings, supra note 46, at 48-60, 383-84; 1975 Senate Hearings, supra note 46, at 21-24. The General Counsel of HUD submitted a revised section 7 that made this change and, in addition, added further guidance as to the meaning of the term "last arm's length transfer." 1975 Senate Hearings, supra note 46, at 23-24. In addition, there was some testimony that section 7 was unnecessary because previous selling price should not be a factor in determining fair market value at time of sale, and because the abuses to which Congresswoman Sullivan referred were made possible by corrupt and inefficient FHA practices. 1975 House Hearings, supra note 46, at 160-61, 249-52; 1975 Senate Hearings, supra note 46, at 311-13, 343.

As to section 8, of course no one testified in favor of legalizing kickbacks and unearned fees. There was, however, considerable testimony as to confusion on the part of various providers of settlement services as to the precise meaning of section 8. See, e.g., 1975 House Hearings, supra note 46, at 61-67, 126, 191-93, 253-57, 273-74; 1975 Senate Hearings, supra note 46, at 129, 135-36, 313-18, 331-32.

53. On October 9, 1975, the Senate passed S. 2327, which would have suspended sections 4, 6, and 7 of RESPA for one year. Section 8 was left intact with the understanding that HUD would work to clarify it. 121 CONG. REC. 32,660-61 (1975). Section 4 of RESPA, 12 U.S.C. § 2603 (1976), required the use of a uniform settlement statement for all transactions involving federally related mortgage loans. On November 17, 1975, the House passed an amended version of S. 2327. 121 CONG. REC. 36,937-38 (1975). This is the version described in the text. The Senate considered the House amendment to S. 2327 on December 8, 1975 and made one significant amendment of its own. 121 CONG. REC. 39,049-51 (1975). See text accompanying note 54 infra.
be "made available for inspection by the borrower at or before settle-
ment." and the Senate provided that such information be "made
available for inspection to the borrower . . . at least one business day
prior to settlement . . . ." Yet, it took the conferees over a week to
resolve this difference. The compromise destroyed the last vestige of
advance disclosure of actual settlement costs. RESPA now provides
that the obligation of the settlement agent to make the information
available prior to settlement is to be triggered by the request of the
borrower, and that the settlement agent's sole obligation is to make
available only the information known to the settlement agent at the
time of disclosure. Even that information is not required to be made
available any sooner than sometime during the business day imme-
diately preceding the settlement.56

In the furor over the amendment of RESPA, what seems to have
been forgotten is the original question of how to lower settlement
costs. That question will, however, soon be considered again. RESPA
requires another study and report to the Congress by June, 1980, on
whether there is any necessity for further legislation.57 The history of
federal settlement cost regulations, therefore, is still in the making.

IV. BASIC PROBLEMS IN FEDERAL REGULATION OF
SETTLEMENT COSTS

Two basic problems traditionally have been viewed as impedi-
ments to federal regulation of settlement costs. First, as a legal mat-
ter, it has been assumed that the Constitution does not empower the
federal government to regulate a transaction as uniquely "local" as
the purchase of a home. Second, as a practical matter, it has been
assumed that the large number of services and providers involved in
the settlement process, and the local variations as to which provider
performs which services, would make federal regulation unworkable.
An analysis of these assumed problems, however, reveals that neither
should be an impediment to effective federal regulation of settlement
costs.

A. THE CONSTITUTIONALITY OF FEDERAL REGULATION

The decision of the United States Supreme Court in Goldfarb v.
Virginia State Bar58 established that the purchase of a home is not
simply a local matter. The Goldfarbs entered into a contract to pur-
chase a home in Reston, Fairfax County, Virginia. Their mortgage

lender required them to obtain title insurance, which required a title examination. In Virginia, only a member of the Virginia State Bar may provide that settlement service. The Goldfarbs asked 37 Fairfax County attorneys what their fee would be for title examination. Of the twenty attorneys who replied, not one indicated that he would charge less than one percent of the value of the property, the rate provided in the minimum fee schedule published by the Fairfax County Bar Association and enforced by the Virginia Bar Association.

After they paid the going rate for their title examination, the Goldfarbs brought a class action on behalf of themselves and all other persons who had purchased homes in Reston, Virginia between February 22, 1968 and February 22, 1972—about 2,000 homeowners in all. They alleged that the minimum fee schedule, as applied to fees for legal services relating to residential real estate transactions, constituted price fixing in violation of section 1 of the Sherman Act. They sought both injunctive relief and damages.

The district court held that there was a sufficient effect on interstate commerce to sustain jurisdiction under the Sherman Act because a significant portion of the funds and insurance involved in the purchase of homes in Fairfax County came from outside Virginia. The court of appeals reversed. On the issue of whether the minimum fee schedule was a restraint of interstate trade and commerce, the court of appeals held that "where the impact of the disputed trade practice upon interstate commerce is 'merely incidental to defendants' local activities' no jurisdiction exists under the Sherman Act."

The Supreme Court took a much more expansive view of interstate commerce. Rather than stressing the technical separability of the legal services from the interstate aspects of the transaction, as the court of appeals had done, it noted that a court must view an effect on interstate commerce in a practical sense. When it viewed the attorneys' title examination in that sense, the Supreme Court concluded that, since lenders require a title examination as a condition of making a mortgage loan, "a title examination is an integral part of an interstate transaction." And, "[g]iven the substantial volume of commerce involved," the Supreme Court held that interstate commerce...
commerce had been sufficiently affected to sustain jurisdiction under the Sherman Act.\textsuperscript{67}

Since the Sherman Act is based on the power of Congress to regulate interstate commerce,\textsuperscript{68} the decision in \textit{Goldfarb} as to the meaning of interstate commerce for the purpose of sustaining jurisdiction under the Sherman Act is authority for the scope of congressional regulatory power under the commerce clause.\textsuperscript{69} At the least, therefore, Congress has the power to legislate with respect to all settlement services required by the lender as a condition of making the loan. In addition to title examination, whether provided by an attorney or any other participant in the settlement process, such lender-required services may include any or all of the following: credit reports, appraisals, inspections, abstracts of title, surveys, title insurance, preparation of documents, and conduct of the settlement, either in person or by the use of an escrow—in short, all of the settlement services provided after the execution of the contract of sale.

One important settlement service that is not required by the lender and that takes place prior to the execution of the contract of sale is the service provided by the real estate broker from the time he lists the seller's property for sale until the time he brings buyer and seller together. RESPA, despite the efforts of real estate brokers to get this wording taken out of the statute, defines settlement services to include "services rendered by a real estate agent or broker . . . ."\textsuperscript{70} Congress has not, however, imposed any affirmative obliga-

\textsuperscript{67} The case was remanded to the district court for further proceedings. \textit{Id.} at 793. Following the remand, the Fairfax County Bar Association and the Virginia State Bar Association settled by agreeing to pay $20,000 and $200,000, respectively, to the homeowners. These amounts represent about $85 per homeowner, after deduction for legal fees and expenses. Goldfarb had estimated the overcharge per homeowner at $200. Washington Post, June 19, 1976, § D, at 1, col. 6.

\textsuperscript{68} See, e.g., \textit{Hospital Bldg. Co. v. Trustees of Rex Hospital}, 425 U.S. 738, 743 n.2 (1976); \textit{Apex Hosiery Co. v. Leader}, 310 U.S. 469, 495 (1940); \textit{Atlantic Cleaners & Dyers, Inc. v. United States}, 286 U.S. 427, 435 (1932).

\textsuperscript{69} U.S. CONST. art. 1, § 8.

\textsuperscript{70} 12 U.S.C. § 2602(3) (1976). As initially proposed, RESPA did not include real estate brokers' services in the definition of settlement services. This language was added during congressional consideration of the bill. One of the lobbyists for the National Association of Realtors has admitted that this inclusion caught the realtors by surprise. By the time they woke up to what had happened, it was too late for their efforts to be successful. See J. Berry, supra note 4, at 3-4.

Prior to RESPA, there was some doubt as to whether the real estate broker's commission was to be considered a settlement cost. When, in the Emergency Home Finance Act of 1970, Pub. L. No. 91-351, 84 Stat. 450, Congress used the term "settlement costs," that term did not have a precise meaning. Congress did, however, indicate that its purpose was to study ways to protect the "unsophisticated [single-family home] purchaser or seller who is often unfamiliar with the complex details of transferring real estate title." H.R. Rep. No. 1131, 91st Cong., 2d Sess. 13 (emphasis added), \textit{reprinted in} [1970] U.S. CODE CONG. & AD. NEWS 3488, 3506; S. Rep. No. 761,
tions on the real estate broker in connection with the sale of a home.

At present, real estate brokers are subject only to the antikickback provisions of RESPA. Should Congress deem it appropriate to extend affirmative obligations to real estate brokers in connection with the sales of residences, there no longer should be any doubt that


The HUD-VA report defines two categories of costs, “closing costs” and “settlement costs.” Closing costs include “all charges paid at settlement for obtaining the mortgage loan and transferring real estate title.” HUD-VA Report, supra note 8, at 7, reprinted in 1972 House Hearings, supra note 8, at 743. These costs are for the following items: title examination, title insurance, attorneys’ services, survey, preparation of documents, settlement, escrow, credit report, loan origination, inspections, appraisal, recording, state and local transfer taxes, and miscellaneous items such as disclosure statements, amortization schedules, photographs, and notary fees. Id. at 7-13, 1972 House Hearings at 743-49. “[T]he term ‘settlement costs’ is defined as the sum of closing cost items, loan discount payments (mortgage points), prepaid items, and sales commissions.” Id. at 7, 1972 House Hearings at 743. (emphasis added).

The distinction between closing costs and settlement costs made in the HUD-VA report was brought specifically to the attention of Congress. As originally introduced in the Senate, the Housing and Urban Development Act of 1972 used the term “closing costs.” S. 3248, 92d Cong., 2d Sess. § 712 (1972). In the 1972 Senate hearings before the Subcommittee on Housing and Urban Affairs, HUD Secretary Romney departed from his prepared statement to

call attention to the fact that in S. 3248, as reported, and in the report you refer to closing costs . . . . In light of the definition included for closing costs in our report, we are uncertain as to whether or not the use of the closing cost term in the bill and in the report is intended to exclude sales commissions, for example, from the regulation that we have proposed.

I raise that very specifically, because one of the questions we had to decide was whether or not the language in 701(b) did include sales commissions.

We concluded it did, because the language refers to costs affecting both the buyer and the seller, but I think this point ought to be clear in whatever action is taken.

That is why I direct your specific attention to it. Mortgage Settlement Costs: Hearings on Mortgage Settlement Costs Including S. 2775 Before the Subcomm. on Housing and Urban Affairs of the Senate Comm. on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess. 17 (1972) [hereinafter cited as 1972 Senate Hearings].

After some discussion among Secretary Romney, Senator Sparkman (then Chairman of the Committee on Banking, Housing and Urban Affairs) and Senator Proxmire (present Chairman of that committee) Senator Sparkman said,

I am glad you brought up that point. We will clarify it.

I can’t speak for the whole committee, but I should think that for the most part the members would be in agreement with the suggestions you have made.

I think that real estate commissions is one of the items that the committee should consider in connection with closing costs.

1972 Senate Hearings, supra, at 18.

All subsequent bills contained the term “settlement costs” rather than the term “closing costs.”

it has the power to do so under the commerce clause. Those who argue that real estate brokers are engaged in a local activity totally lacking in interstate characteristics contend that the immobility of land restricts the geographical range of brokers' activities. They note that brokers are licensed under state law to operate only intrastate and that a real estate transaction is subject to the law of the situs of the property. These arguments, however, take an unduly restrictive view of interstate commerce—and of the power of Congress under the commerce clause.

The Supreme Court has sustained the constitutionality, under the commerce power, of a variety of federal statutes that affect acts done wholly within a single state. The standards used by the Supreme Court are whether such acts either (1) are an integral part of interstate commerce, or (2) substantially affect interstate commerce. Acts done by real estate brokers in connection with the purchase and sale of single family homes meet both of these requirements.

The real estate broker's solicitation of the owner's listing sets the settlement process in motion. After the property is listed, the real estate broker may solicit buyers by interstate use of the mail, telephone, and advertisements in newspapers and magazines that are circulated outside the state. He may also participate in a nationwide multiple listing or relocation service. During the congressional hear-

---

72. Yet, even HUD, in a recent report to Congress, expressed such doubt. See U.S. DEPT. OF HUD, INTERIM REPORT TO THE CONGRESS ON SECTION 15 OF THE REAL ESTATE SETTLEMENT PROCEDURES ACT (1976) [hereinafter cited as INTERIM REPORT].

73. See Austin, Real Estate Boards and Multiple Listing Systems as Restraints of Trade, 70 COLUM. L. REV. 1325, 1332 (1970).


75. The Supreme Court's only treatment of the issue in the context of real estate broker's services consists of dictum in the case of United States v. National Ass'n of Real Estate Bds., 339 U.S. 485 (1950), an action to enjoin the Washington Real Estate Board and its members from fixing commission rates for their services in the District of Columbia. The Supreme Court opened its discussion of the legal issues involved in the case with the observation that "[t]he fact that no interstate commerce is involved is not a barrier to this suit." Id. at 488. The Washington Real Estate Board's actions were held to violate section 3 of the Sherman Act, 15 U.S.C. § 3 (1976), which prohibits conduct in restraint of trade in the District of Columbia.

ings on the proposed amendment of RESPA, it was the real estate brokers themselves who brought to the committees' attention the interstate nature of many of the cooperative activities of brokers.77

The real estate broker's involvement in interstate commerce does not end when he has found a buyer. Once the contract of sale is signed, the broker often assists the buyer in obtaining the necessary financing, the funds for which frequently come from outside the state.78 In addition, he may recommend the buyer's attorney, the title insurance company, the hazard insurance company, and the settlement agent. The real estate broker works closely with these providers and actually may conduct the settlement. It would be as artificial to separate the real estate broker's services from the interstate aspects of the home purchase transaction as it would have been in Goldfarb to so separate the lawyer's services.79

Real estate brokers' activities also "substantially affect" interstate commerce. Between 1970 and 1974, over 72,000,000 people moved, nearly 15,000,000 of them across state lines.80 Furthermore, a person who works in a single metropolitan area may have a choice of two or more states in which to live.81 The cooperative activities of real estate brokers are designed to facilitate the interstate movement of families by rendering significant assistance in the purchase of a new home in a different part of the country. The locations at which such families purchase their homes are, therefore, likely to be affected substantially by the nature of the available cooperative real estate brokers' services.

The real estate brokers' activities, after the contract of sale, in recommending providers of settlement services also have a substantial effect on interstate commerce. A broker's recommendation of a mortgage lender, for example, has nationwide implications. Not only may the lender's funds come from outside the state, but, after settlement, the lender may sell the mortgage loan on the secondary market.

77. This was done in connection with their successful efforts to have such activities specifically excluded from the antikickback provision. 1975 House Hearings, supra note 46, at 252-57 (statement of Art. S. Leitch, President, N.A.R.); 1975 Senate Hearings, supra note 46, at 313-18 (same).
79. See id. at 783-85.
81. Of the 159 SMSAs with a population of over 200,000, 29 include parts of two or more states and five include parts of three states. U.S. Dep't of Commerce, Statistical Abstract of the United States, 926-32 (1977). See note 36 supra.
to a permanent mortgage investor in another part of the country. The initial placement of a single family mortgage loan, at the recommendation of the real estate broker, may, therefore, determine whether such a mortgage loan subsequently is sold in interstate commerce, as well as where it is sold. The broker's recommendation of a title insurance company may also affect interstate commerce. Many title insurers are engaged in business in more than one state. In a given community, the real estate broker's power to recommend such interstate title insurers is likely to have an impact on whether title insurance goes to a local or national title insurance company.

In cases involving price fixing by establishing minimum fee schedules, several district courts have agreed that the activities of real estate brokers affect, and are an integral part of, interstate commerce. In three cases involving denial of membership in local boards

---

82. The secondary market refers to the various systems by which a mortgage loan changes ownership. Mortgage lenders sell mortgage loans originated by them in order to obtain funds with which to originate new mortgage loans. Purchasers of mortgages on the secondary market may be private investors, such as other lending institutions, insurance companies or pension funds; federally chartered corporations, such as the Federal National Mortgage Association (Fannie Mae or FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC); or a governmental entity such as the Government National Mortgage Association (Ginnie Mae or GNMA). Billions of dollars worth of conventional single family mortgages have been sold on the secondary market since 1970. For a description of the operation of the secondary market, see Wiggin, Doing Business in the Secondary Mortgage Market, 5 REAL ESTATE REV. 84 (1975). See generally text at pp. 414-21 infra.


Jack Foley Realty, Inc. was a criminal antitrust case in which the government alleged that six real estate companies and three individuals conspired to fix, raise, and maintain commission rates for sales of residential property in Montgomery County, Maryland. Defendants attempted to distinguish Goldfarb on the ground that their real estate activities were not necessary, essential, or inseparable components of any interstate transactions. In rejecting this argument, the court reasoned that, even if "no single part of the defendants' real estate business had a sufficient nexus to cause their activities to fall under the Sherman Act," the aggregate effect of their business did. [1977] 2 Trade Cas. at 72,790. Since the defendants were located in a large metropolitan area, dealt with buyers and sellers moving into and out of the state, arranged financing with out-of-state lending agencies, used a multistate referral service, and advertised in publications with interstate circulation, there was a substantial effect on interstate commerce. Id.

In Oglesby, the plaintiff, a Virginia real estate broker, alleged that the defendant corporation, a multiple listing service, had combined and continuously engaged in an unlawful conspiracy to fix commission fees and otherwise restrain competition in violation of section 1 of the Sherman Act. The court, using the following analysis and relying
of realtors, the Eighth and Tenth Circuit Courts of Appeals appear to have held to the contrary, but these cases are distinguishable. In *Diversified Brokerage Services, Inc. v. Greater Des Moines Realtors*, the only evidence introduced by the plaintiffs in support of the interstate character of defendant's business was that five out-of-state persons had been parties to real estate transactions in the community. The court held that this evidence, without more, was insufficient to establish jurisdiction under the Sherman Act.

On *Goldfarb*, found the defendant's business to involve interstate commerce and to have a substantial effect on it:

> The business of Metro MLS, Inc. and its brokers-members clearly involved interstate commerce in that 25 to 30 percent of the financing obtained by buyers to consummate sales were insured under the VA or FHA federal programs; that the funds available for mortgage loans, insured or otherwise, came in significant amounts from sources outside the State of Virginia; that the members of Metro MLS, Inc. advertised in media circulated widely beyond the limits of the State of Virginia . . . ; that many of the members of Metro MLS, Inc. belonged to national referral organizations located outside of the State of Virginia and which affected MLS sales to a significant degree; that a substantial number of the real estate purchasers dealing with MLS, estimated to be between 20-25 percent, were members of the armed services moving into Virginia from out of state and purchasing homes here, or conversely, selling as they moved from military bases in this area to other bases outside the State of Virginia.

[1976] 2 Trade Cas. at 69,797.

In *Mazur*, the plaintiffs, real estate sellers, filed a class action alleging antitrust violations by the defendant real estate brokers and two of their associations. On the defendants' motions to dismiss the complaint, grounded in part on the plaintiffs' alleged failure to set forth facts sufficient to afford a basis for federal jurisdiction under section 1 of the Sherman Act, the court noted that many of the defendants advertised and solicited buyers and sellers from outside the state. Therefore, some of the defendants represented out-of-state buyers or sellers in a substantial percentage of their transactions. Therefore, the court concluded, those defendants had voluntarily entered interstate commerce and were "clearly engaged in interstate commerce," [1974] 1 Trade Cas. at 96,788. On the issue of whether or not the brokers' activities substantially burdened or affected interstate commerce so as to be brought within the purview of the Sherman Act, the court stated that

> it is almost self-evident that the increase of a real estate commission from 6% to 7% (a 16% increase) necessarily burdens the movement of persons and their effects from state to state. This will also affect the transaction of interstate mortgage loans and insurance. It is not essential that an effect on interstate commerce be alleged or proved, however, since defendants are clearly engaged in interstate commerce.


85. 521 F.2d 1343 (8th Cir. 1975).

86. The plaintiffs conceded that they had "made no effort to present evidence that defendants' intrastate activities substantially affect[ed] interstate commerce and therefore [came] within the purview of the Sherman Act even though they [were] not interstate in character." 521 F. 2d at 1345 (citations omitted) (emphasis in original).

Since plaintiffs neither produced any evidence to establish the interstate character of the brokerage services nor offered any proof of further details concerning any trans-
In J.P. Bryan v. Stillwater Board of Realtors and Income Realty & Mortgage, Inc. v. Denver Board of Realtors, the court did not focus on the question of whether the real estate brokerage business, as engaged in by either the plaintiffs or the defendants, was an integral part of interstate commerce or affected interstate commerce. Instead, the court examined the activities of the respective real estate boards and their members in excluding the plaintiffs from membership and held that the activities complained of were entirely local in character and did not affect interstate commerce. The Bryan decision distinguished Goldfarb on the ground that Goldfarb involved a price fixing conspiracy, which, the court said, violates the Sherman Act whether the activity is interstate or intrastate in character. The court conceded that the plaintiffs' business was engaged in interstate commerce.

None of these cases, therefore, raises any significant constitutional argument, based on the commerce clause, against federal regulation of real estate brokers.

Actions in which the five out-of-state persons participated, the court considered its task to be limited to a determination of whether the movement of five individuals from one state to another in order to utilize particular services placed those services in interstate commerce within the meaning of the Sherman Act. The court referred to Goldfarb but held that even an expansive reading of the principles of that case would be insufficient to establish jurisdiction. Realizing, however, that their conclusion might appear at odds with that of the Supreme Court, the court painstakingly explained:

In the instant case, the plaintiffs offered no evidence such as that in Goldfarb that a "significant portion" (or indeed any) of the funds underlying these real estate transactions came from outside [the state]. Whereas in Goldfarb the federal government had guaranteed many of the loans made in Virginia, the plaintiffs in this case produced no evidence showing any guarantee of these loans by an out-of-state agency. Furthermore, plaintiffs introduced no evidence of any other interstate commercial aspect to these transactions such as interstate advertising.

We emphasize the limited nature of our holding. Services affecting real estate, such as brokerage services, may, depending upon the evidence presented, either constitute interstate activities or have no nexus with interstate commerce. In the instant case, plaintiffs presented extremely limited evidence and failed to show any interstate character to these real estate transactions. Additionally, plaintiffs chose not to attempt to show that the intrastate activities of defendants placed any substantial burden on interstate commerce.

Id. at 1346-47 (emphasis in second paragraph added).

87. 578 F.2d 1319 (10th Cir. 1977).
88. 578 F.2d 1326 (10th Cir. 1978).
89. 578 F.2d 1326, 1329; 578 F.2d 1319, 1325-26.
90. 578 F.2d 1319, 1324.
91. Id. at 1326.
B. THE PRACTICALITY OF FEDERAL REGULATION

Legislation concerning the real estate broker's role in listing property for sale and locating prospective purchasers could be in terms of direct regulation of the real estate brokers. Since they are the only providers of such finding services throughout the United States, local variation would not render such regulation unworkable.

With regard to other settlement services, however, the local variations as to who performs the services would make regulation of specific providers impracticable. Since the function of the various settlement services does not vary significantly from place to place, instead of framing the issue in terms of whether it should regulate specific providers, Congress could examine the settlement process to determine whether it should regulate specific settlement functions.

For example, the term "title assurance" can refer both to an attorney's written opinion to the lender and the buyer, and to a policy of title insurance issued by a title insurance company. In an examination of the settlement process with a view to legislation, Congress could focus on the function of title assurance in a real estate transaction, rather than on the question of whether it should regulate attorneys or title insurance companies. Such a functional approach would be a practical means of isolating problems in the settlement process that are capable of federal resolution, while preserving local customs.

V. THEORIES OF FEDERAL REGULATION OF SETTLEMENT COSTS

There are three basic theories of federal regulation of settlement costs:

1. Federal establishment of maximum settlement charges for settlement services;
2. Federal requirement that the lender pay all settlement costs attributable to the transfer and financing of the property; and
3. Federal requirement of advance disclosure of settlement costs.

RESPA follows the third approach but does not foreclose future congressional reliance on either of the first two theories. This section analyzes each of the three theories and concludes that the concept of advance disclosure, although not the manner in which the concept is carried out by RESPA, represents the best balance among the com-

92. See text accompanying notes 12-16 supra.
peting considerations of benefits to homebuyers and burdens imposed upon other participants in the settlement process.

A. FEDERAL ESTABLISHMENT OF MAXIMUM CHARGES FOR SETTLEMENT SERVICES

Congressional legislation embodying the theory of federal establishment of maximum charges for settlement services probably would authorize and direct HUD to establish the maximum charges. When, in 1972, HUD proposed to exercise its authority to establish maximum settlement charges with respect to FHA insured loans, its effort revealed that there are serious difficulties inherent in a rate-making approach to settlement costs. For the most part, these difficulties stem from the fragmented nature of the providers of settlement services and the local variations in the services furnished by each provider. This fragmentation and variation gives rise to the major problems of devising a formula with which to establish maximum charges under such market conditions, establishing an efficient means to collect and assemble cost data, and delineating geographic market areas to be used in setting maximum charges for specific services.

The difficulty of devising a formula with which to establish maximum charges arises from the differences between the settlement service industry and other industries that are subject to rate regulation. One important difference is that whereas there is little variation in the manner in which regulated industries operate throughout the geographic jurisdiction of the agencies that regulate them, the structure of the settlement service industry and the specific breakdown of the contents of the settlement service package vary substantially, according to custom, among geographic areas that often bear no relation to convenient regulatory boundaries.

Furthermore, many regulated industries are monopolistic, such as public utilities, or have high barriers to entry. Most often, such industries are capital intensive. The settlement service industry, by contrast, is composed of many different kinds of providers of settlement services. None of the markets for these services is monopolistic, nor are there high barriers to entry. Since most of the industry is


95. Several problems HUD encountered were attributable to the language of section 701 of the Emergency Home Finance Act. For instance, two important groups of providers of settlement services, real estate brokers and title insurance companies, contended that the language of the statute did not authorize maximums to be imposed on their charges. The real estate brokers argued that they were not covered because their commission was not a "settlement cost." See Memorandum Brief of the National Association of Real Estate Boards (April 24, 1972) (on file with the Minnesota Law Review). HUD, which originally considered real estate brokers to be covered, withdrew from its position.
service oriented, it is labor intensive. Rate regulation of capital intensive industries ordinarily seeks to establish a reasonable rate of return on invested capital. This objective would have little, if any, relevance to an attempt to establish maximum rates for settlement charges in the labor intensive settlement service industry.

Even if a formula could be devised with which to establish the maximum settlement charge for each settlement service, any such formula would require actual cost data for its results to be realistic. It would be necessary to have a substantial bureaucracy in order to identify, collect, and assemble all of the kinds of actual cost data that would be needed.

Title insurers argued that they were not covered because section 701 did not specifically refer to insurance. Under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1012 (1976), Congress declared the policy that the regulation of insurance is to be left to the states and that no act of Congress shall preempt state regulation unless it "specifically relates to the business of insurance." 15 U.S.C. § 1012(b) (1976). See A Memorandum on Behalf of the America Land Title Association 14-15 (Oct. 15, 1972) (on file with the Minnesota Law Review). HUD recognized that its attempt to regulate title insurance rates immediately would become mired in litigation, with no benefit to consumers in the interim. See Memorandum from Eugene A. Gullege, Assistant Secretary for Housing Production and Mortgage Credit-Federal Housing Commissioner, to George Romney, Secretary of HUD (Jan. 19, 1973) (on file with the Minnesota Law Review).

A further concern for HUD was the limitation of its power under section 701 to setting cost limits only with respect to FHA-insured mortgage loans. HUD feared that imposition of limits on FHA loans would only accelerate the shift of lenders and builders away from FHA and toward conventional (non FHA-VA) financing, with resultant loss of consumer protection and possible higher financing costs. Id. See also Whitman, supra note 28, at 1311, 1320. These concerns, coupled with adverse public and congressional reaction, caused HUD to abandon its effort. See notes 28-35 supra and accompanying text.

96. See generally Whitman, supra note 28, at 1324 n.65.

97. HUD's attempt to establish maximum settlement charges illustrates the difficulties involved when the regulatory agency lacks actual cost data about the regulated industry. Professor Dale Whitman, who participated extensively in HUD's 1972 rate-making proposal, has analyzed HUD's effort in light of traditional rate making. Whitman, supra note 28, at 1315-16, 1323-29. HUD took as its starting point the prices actually paid by consumers for settlement services. It developed an econometric model that attempted first to compare the general costs of doing business in areas of the country in which settlement charges were high with the general costs of doing business in areas of the country in which settlement charges were low. Then, based on this comparison, HUD attempted to establish "reasonable" charges for settlement services for areas of the country in which settlement charges were high. The model was seriously and justifiably criticized for taking insufficient account of all relevant differences between the areas in which charges were low and the areas for which maximums were proposed because charges were found to be unreasonably high. For example, although the model did contain a factor for wage rates in the various state real estate and insurance industries generally, it did not consider specific wage rate data from the title insurance industry. Nor did the model contain factors such as different costs of renting commercial space or differences in promotional expenses, as to which there might well be wide variation.
An agency that had all of the relevant cost data still would face the formidable task of establishing appropriate geographic boundaries for settlement services areas within which rates for specific services should apply. The initial burden of establishing the settlement services areas would be great because settlement services customs do not respect the boundaries of convenient political subdivisions. Although a statewide settlement services area may be appropriate in some states, there are other states in which settlement customs differ among Standard Metropolitan Statistical Areas (SMSAs) or among other political subdivisions within the state. An SMSA composed of two or more states, such as the Washington, D.C., SMSA—which includes several counties in Maryland and Virginia—would create additional problems. Furthermore, it is not reasonable to assume that just because one settlement services package is customary within a settlement services area, however defined, the rate fixed for each service within the package should be uniform throughout the area. For example, the cost of searching title might well vary from county to county within a single settlement services area, depending on the condition of the county's land records. It would be unfair to an otherwise efficient title search provider (whether an attorney, title insurance company, or abstracting company) who searches titles only in a county that has an inefficient recordkeeping system if the maximum charge for title search is based on actual costs of a title search in other, better organized, counties in the settlement services area.

A federal bureaucracy is unlikely to be able to engage successfully in the kind of "fine-tuning" that establishment of maximum charges for specific settlement services would require in order to protect homebuyers while, at the same time, being fair to providers. Consequently, Congress should reject the theory of federal establishment of maximum settlement charges for settlement services.

B. Federal Requirement That Lender Pay All Settlement Costs Attributable to the Transfer and Financing of the Property

Senator William Proxmire and Professor Dale Whitman are the principal proponents of federal legislation that would require the mortgage lender to pay all settlement costs attributable to the transfer of title and the financing of single family homes. Professor Whit-
man states the essential elements of the "lender pay" proposal in the following paragraphs:

(1) Mortgage lenders would be required by federal law to pay all costs, both those attributable to the transfer of the property and those related to financing.

(2) Mortgage lenders would be required to provide for home buyers title and settlement services equivalent in quality to those services obtained by lenders for their own benefit, and in all events meeting federally-prescribed quality standards.

(3) Mortgage lenders would not be permitted to charge to home buyers or sellers any fees, discounts, or other charges except simple interest. All loans would be required by law to be made "at par" from the borrower's viewpoint; the full face amount of the loan would be disbursed to the borrower to be applied toward the purchase of the property.101

The key to lender pay is the mutual interdependence of paragraphs (1) and (3)—paragraph (1) would require that lenders absorb or pay all the costs and paragraph (3) would prohibit lenders from collecting front-end fees and charges of any kind to compensate themselves for these costs.

Under paragraph (1), the costs that mortgage lenders would have to absorb or pay include all of their own expenses of loan origination plus the charges for settlement services required by the lender as conditions to making the mortgage loan, such as title search and assurance, survey and other inspection of boundaries, appraisal or other estimations of value, certification or inspection of the condition of structures, preparation of loan and title documents, provision of government or private mortgage insurance, and conduct of settlement.102 The costs of many of these lender required settlement services now are paid by homebuyers directly to the providers of the various services. In order to understand fully the significance of lender pay, however, it is necessary to consider those settlement service costs that the homebuyer now pays only indirectly, through the lender.

Some of the services for which costs are covered by paragraph (1)—particularly those relating to loan origination, such as taking an application and checking credit—ordinarily are performed by employees of the lender. Others of these services, such as appraising the property, preparing loan and mortgage documents, and conducting the settlement, may be performed either by employees of the lender or by third party providers of settlement services, depending on the custom in the area or the lender's method of doing business. Many lenders now impose a variety of fees and charges that are

---

101. Whitman, supra note 28, at 1346.
102. Id. at 1359.
intended as compensation for the services of their own employees in originating a mortgage loan and placing it on the books, and for settlement services that are performed in-house rather than by third party providers. Some lenders make no such charges while others collect separately for such things as applications, credit reports, appraisals, inspections, photographs, amortization schedules, preparation of documents, notarizations, handling escrows, and conducting settlements. Until specifically prohibited by RESPA, some lenders charged a separate fee for preparation of the truth-in-lending statement. Many lenders charge an origination fee in addition to, or in lieu of, the above described specific charges. This fee, which is in the nature of a charge for general overhead, is fixed as a percentage of the loan amount, usually between one and two percent. Paragraph (3) would prohibit mortgage lenders from charging all of the above described fees for lender overhead and for services performed for the lender by third party providers.

Paragraph (3) also would prohibit mortgage lenders from charging loan discount points, which are nothing more than a means by which the lender increases its rate of return on a mortgage loan. On conventional home mortgage loans, discount points are paid by the buyer-borrower. In the case of FHA-VA loans, however, regulations prohibit the lender from charging the borrower any points in excess of a one point origination fee. The situation is complicated by the maximum interest rates established by the federal government on FHA and VA loans, which ordinarily are below the market interest rate on conventional home loans. Since lenders will not lend at interest rates below the market, and since they cannot collect loan discount points from FHA-VA borrowers, they collect such points from sellers. The seller generally attempts to recoup these points paid on the borrower's loan by increasing the sales price of the property if the sale is with FHA-VA financing. Professor Whitman's lender pay proposal apparently would not prohibit lenders from col-

103. Id. at 1340-46.
105. See HUD-VA REPORT, supra note 8, at 13, 72, reprinted in 1972 House Hearings, supra note 8, at 749, 806.
106. A point is equal to one percent of the principal amount of the loan. Under the rule of thumb generally used by mortgage lenders, each point of discount collected in advance is the equivalent of an additional one-eighth of one percent interest over the life of the loan. See MORTGAGE INTEREST COMMISSION REPORT, supra note 20, at 28. This rule of thumb applies to mortgages on single family residences on which the interest rate is between seven and nine percent and for which the term is 25 to 30 years. It is based on the experience of mortgage lenders that such loans are paid in full at the end of twelve years.
lecting discount points from the seller, since he recognizes that his proposal might exacerbate the existing problem of distortions in the residential mortgage market caused by this practice.\footnote{109} Professor Whitman, \textit{supra} note 28, at 1350-51. It is not entirely clear from Professor Whitman's proposal whether mortgage lenders would be prohibited from collecting loan discount points from the seller as well as from the buyer. Section 3 of his proposed statute provides that "no lender who makes a federally-related mortgage loan shall impose upon the borrower any fees or 'points' at the time or as a condition of the making of the loan, or any charge for settlement services or any other services related to the origination of the loan." \textit{Id.} at 1360 (emphasis added). His summary of the elements of his proposal states that "mortgage lenders would not be permitted to charge to home buyers or sellers any fees, discounts, or other charges except simple interest." \textit{Id.} at 1346 (emphasis added).

If, under lender pay, mortgage lenders are not prohibited from collecting loan discount points from sellers, the distortion now existing in the FHA-VA mortgage market is likely to be aggravated with respect to that market and to be carried over into the conventional market as well.

In the FHA-VA mortgage market there is a distortion because the maximum allowable interest rate ordinarily is below the market interest rate on conventional home loans, and because the lender may not charge the borrower any points in excess of a one point origination fee. In order for a lender on an FHA-VA loan to bring its yield up to the market interest rate for conventional loans, it collects loan discount points from the seller of the home. Discounts of ten to twelve points or more are not uncommon. Obviously, a seller who must pay such points in order for his buyer to obtain financing does not absorb them; he adds them to the price of the house. Sellers often list two asking prices, a lower price if the buyer obtains conventional financing and a higher price if the buyer relies upon FHA-VA financing. The FHA-VA buyer does not pay the higher price as part of his downpayment; the lender's appraisal, which takes account of the purchase price, is stretched to accommodate the loan discount points included in the price within the "value" of the property upon which the loan-to-value ratio is based. Gutten
tag, \textit{Changes in the Structure of the Residential Mortgage Market: Analysis and Proposals}, in 4 I. Friend, \textit{Study of the Savings and Loan Industry} 1497, 1497-1501 (1969). Thus, the FHA-VA mortgage is distorted in two ways: (1) the mortgage interest rate is artificially low in relation to the market interest rate, and (2) the principal amount of the mortgage is artificially high in relation to the value of the property. If the lender already is lending at the maximum allowable FHA-VA mortgage interest, then in order for the lender to maintain the same rate of return under lender pay it would have to collect an additional two points from the seller. This would further distort the interest rate and principal amount of the borrower's mortgage loan.

In the conventional mortgage market, loan discount points ordinarily are paid by the homebuyer-borrower and the distortion is of another kind. If the lender calculates its yield and establishes its discount rate based on the assumption that the loan will be prepaid in full after twelve years, a borrower who prepays his mortgage loan prior to the end of twelve years will have paid the equivalent of interest at a rate above the market rate, when the loan discount points are added to the interest paid as part of his monthly installments. Lender pay would eliminate this distortion but, in order for the lender to maintain the same rate of return, it would have to either increase the interest rate paid by the borrower or collect loan discount points from the seller. An attractive alternative for the lender would be to collect such points from the seller because this would preserve for the lender all of the benefits of front-end fees and interest collected in advance. Therefore, unless lender pay prohibited lenders from collecting fees and loan discount points from sellers, the distortions in the borrower's
Whitman does, however, favor both the elimination of the FHA-VA interest rate ceilings and the prohibition of all discounts.\textsuperscript{10}

If all loan discount points were prohibited, no matter by whom they were paid, lender pay would have a two-pronged effect on mortgage lenders: (1) it would increase their initial costs of loan origination by the amounts they would be required to absorb or to pay for settlement services performed by third party providers, including amounts for items now paid by homebuyers directly to such providers, and (2) it would reduce to zero the amount attributable to loan origination and settlement costs that they could collect at the time of making the loan. The only means by which lenders could be compensated for such costs required to be absorbed or paid by them would be by interest collected over the life of the loan. It is inevitable that lender pay would cause long-term mortgage interest rates to rise. Professor Whitman estimates that the increase would be from one-quarter to three-eighths of one percent.\textsuperscript{11}

1. The Advantages and Disadvantages of Lender Pay: Professor Whitman's View

Professor Whitman's lender pay proposal deserves careful analysis and evaluation, since the consumer advantages he claims for it are appealing and his approach has the support of Senator William Proxmire, who chairs the Senate committee responsible for settlement cost legislation.\textsuperscript{12} The following summary of the advantages and disadvantages Professor Whitman sees in the proposal provides a convenient frame of reference for this analysis and evaluation.

Professor Whitman's vigorous promotion of lender pay is based on his belief that two major benefits would accrue to home buyers: (1) the opportunities for homeownership would be increased, and (2) interest rate and mortgage amount now existing in the FHA-VA mortgage market would be carried over into the conventional market. That is, to the extent that the seller has to pay loan discount points on the borrower's mortgage loan to reflect mortgage origination and settlement costs that the lender was unable to pass through directly to the borrower, the amount of such points would be included in the price of the house, in the appraisal, and, ultimately, in the amount of the buyer's mortgage loan.

\textsuperscript{10} Whitman, \textit{supra} note 28, at 1350-51.

\textsuperscript{11} \textit{Id.} at 1349, 1352; \textit{1975 House Hearings, supra} note 46, at 377. Professor Whitman arrived at this estimate by assuming that the aggregate of charges paid by the lender would amount to two percent of the mortgage loan. Whitman, \textit{supra} note 28, at 1349. Under the usual rule of thumb, then, the lender would have to increase the interest rate by one-quarter of one percent in order to recoup this amount over the life of the loan. See note 106 \textit{supra}. The two percent figure is likely to vary depending on customs in the locality and on the extent to which lenders can achieve reductions in the settlement costs payable by them.

\textsuperscript{12} \textit{See} note 100 \textit{supra}.
the total cost of homeownership would be reduced.¹¹³

Opportunities for homeownership would be increased, Professor Whitman says, because the initial cost of acquiring a home would be reduced by an amount approximately equal to the loan origination and settlement costs required to be paid or absorbed at the outset by mortgage lenders. Such a reduction would benefit those who otherwise would be unable to purchase a home because they do not have sufficient cash to pay loan origination and settlement costs in addition to the required downpayment, although they do have sufficient earnings to make the monthly payments on a mortgage loan at a rate of interest fixed to compensate the lender for such costs.

The total cost of homeownership would be reduced, according to Professor Whitman, because lenders would use their powers to reduce the cost of settlement services and would pass their savings on to home mortgage borrowers. Lenders would, he thinks, reduce settlement costs in several ways. Because lenders are in a position to bargain more effectively than homebuyers, they would obtain lower prices from settlement services providers. Lenders would realize further savings, Professor Whitman predicts, by making increased use of their own employees to perform settlement services now performed by third party providers.¹¹⁴ In addition, if lenders could not pass the cost of settlement services directly through to homebuyers, they would, he suggests, be likely to eliminate unnecessary services or services of a higher quality than necessary.¹¹⁵ He expects still more cost savings and increased efficiency as lenders press for reforms in land title recording systems.

Lenders would pass these settlement cost savings to homebuyers, in Professor Whitman's view, in order to compete with each other to make home mortgage loans. Since collection of all front-end discounts, fees, and charges would be prohibited, any price competition by lenders would be through interest rates charged to homebuyers, which rates would reflect the settlement cost savings. Therefore, Professor Whitman concludes, although interest rates would rise slightly to reflect the costs paid by lenders, such an increase, when paid by

¹¹³ Whitman, supra note 28, at 1346-49, 1351, 1356, 1357.
¹¹⁴ For example, lenders could hire staff attorneys, rather than outside counsel, to prepare mortgage documents and search titles. In some states, still further savings might be realized by permitting lay employees of the lender to prepare documents, although in some states such action would be considered the unauthorized practice of law. Compare State v. Pledger, 257 N.C. 634, 127 S.E.2d 337 (1962) (no unauthorized practice), with Kentucky State Bar Ass'n v. Central Ky. Enterprises, 503 S.W.2d 483 (Ky. 1972) (held unauthorized practice).
¹¹⁵ For example, a lender might not require a title search beyond the previous transaction if title had been searched and some form of title assurance obtained on such transaction; or a lender might not require a new survey when a visual inspection would suffice.
the homebuyer over the life of the loan, would be less than the settle-
ment costs now required to be paid in advance.

Professor Whitman sees some lesser benefits to lender pay, as
well. Homebuyers would be saved the inconvenience of shopping for
providers of settlement services,118 and they might be more likely
to retain independent counsel if their other front-end costs were re-
duced.117 As an extra sweetener, homebuyers would be able to deduct
for federal income tax purposes settlement costs and fees and charges
for lender services paid in the form of interest, whereas such sums are
not deductible if paid directly.118

Professor Whitman discusses two objections to lender pay: (1)
conflict with state usury laws,119 and (2) inequity between short-term
and long-term borrowers.120 The first he regards as something of a
blessing in disguise; the second he dismisses as insubstantial.

Conflict with state usury laws would occur because of the one-
fourth of one percent to three-eighths of one percent increase in long-
term interest rates necessary for lenders to recover the costs imposed
by lender pay. Professor Whitman regards usury laws as not in the
best interests of prospective mortgage borrowers because such laws
make mortgage credit unavailable as funds are diverted elsewhere
during periods of high interest rates.121 He therefore welcomes the
pressure for changes in the usury laws that lender pay would create.

The short-term and long-term borrowers between whom lender
pay would create inequity are those who pay off their mortgage loans
eye in the life of the loan, ordinarily upon the sale of the home, and
those who do not pay in full until the loans are close to or at maturity.
Since the short-term borrowers would prepay their loans before the
lender recovered its loan origination and settlement costs through the
increased interest, they would, in effect, be subsidized by the long
term borrowers who would pay the increment of mortgage interest
over a longer period of time. Professor Whitman notes that prepay-
ment penalties could alleviate this problem, but that such penalties
currently are in disfavor. He considers this inequity to be outweighed
by the social utility of reducing front-end costs.

2. The Advantages of Lender Pay: A Closer Look

Lender pay would have far reaching application and effects. It
would impose a uniform, nationwide rule on an industry in which

117. Id.
118. Id. at 1349 n.161, 1350.
119. Id. at 1352-53.
120. Id. at 1353-54.
121. Id. at 1352 n.171.
local customs historically have played an important role. This rule could precipitate substantial structural changes in the home mortgage lending market, both at the primary and secondary levels, and in the various markets for settlement services. Such changes might be justified if lender pay would, in fact, increase the opportunities for and reduce the costs of homeownership. There are, however, at least two substantial reasons to believe that opportunities for, and costs of, homeownership would remain unchanged. First, lenders would be likely to require larger downpayments in order to offset the increased risks to which they otherwise would be exposed. Second, costs of homeownership would be reduced only if lenders actually would compete to make loans by offering lower interest rates to homebuyers. Given the nature of the mortgage money market, however, price competition among lenders cannot be counted on to reduce consumer costs.

The homebuyer and the mortgage lender in effect are co-investors in the homebuyer's property, with the mortgage lender's investment by far the greater of the two. The amount of downpayment required of the borrower as his investment is determined by the loan-to-value ratio at which the mortgage lender is willing to lend. The loan-to-value ratio is the relationship between the amount of the mortgage loan and the purchase price or value of the property, expressed as a percentage. For any mortgage loan, the loan-to-value ratio depends upon the regulatory constraints to which the mortgage lender is subject and upon the mortgage lender's assessment of the risks of the borrower's credit and the security value of the property. As the loan-to-value ratio increases and the size of the downpayment correspondingly decreases, the lender's risks increase in two ways: (1) a higher loan-to-value ratio means higher monthly payments, which would increase the possibility that the mortgage loan might go into default; and (2) a smaller downpayment means that a small drop in the value of the property could eliminate the owner's equity and leave the lender with a secured property that, upon foreclosure and sale, would bring less than the unpaid balance of the mortgage loan.

Lender pay, by requiring that mortgage lenders initially absorb all loan origination and mortgage settlement costs, would further

---

122. This percentage will vary, of course, depending on which definition of the term "value" is used, for example, appraised value, cost, or replacement value. See C. Haar, FEDERAL CREDIT AND PRIVATE HOUSING 60 (1960).


124. On a loan term less than the maximum permissible, however, the loan term, instead of the monthly payments, could be increased.
increase both the above described risks: (1) the increase in the interest rate necessary to recover these costs over the life of the loan would mean still higher monthly payments; and, more importantly, (2) the amount of front-end costs absorbed would increase the amount that the lender had "invested" in the property to a sum in excess of the unpaid balance of the mortgage loan. This would result in a greater risk that upon foreclosure and sale the secured property would not bring enough for the lender to recover its investment. If, in the absence of lender pay, the loan-to-value ratio represents the lender's judgment as to the maximum risk it would be willing to take on a particular mortgage loan, then, in order to maintain the same level of risk under lender pay, the lender would have to increase the required downpayment by an amount approximating the loan origination and mortgage settlement costs absorbed.

This result, moreover, would be most apt to occur with respect to prospective homebuyers most in need of expanded opportunities for homeownership, because mortgage lenders already are lending at a loan-to-value ratio of as high as 95% on smaller mortgage loans. If the lender were required to absorb initially mortgage origination and settlement costs on the order of two percent of the mortgage loan, its margin of safety would be very thin, indeed.

Typically, mortgage loans made at loan-to-value ratios of 90% and 95% are covered by private mortgage insurance, which insures mortgage lenders against losses due to borrower default. The existence of private mortgage insurance should not, however, affect the above analysis. Since any increased risk of default on an insured loan would be borne by the private mortgage insurance company, it is reasonable to suppose that such companies would, under lender pay, require mortgage lenders, as a condition of obtaining private mortgage insurance, to increase their downpayment requirements in order to maintain the present level of risk.

Unless lender pay legislation contained provisions regulating downpayment requirements, it would not, for most homebuyers, reduce the amount of cash needed initially to purchase a home. The form that such legislation would take is hard to imagine since it

125. See Whitman, supra note 28, at 1349 n.158.

126. Most private mortgage insurance policies provide that, in the event of default, the insuring company either will pay the claim in full, take title to the property and arrange for its sale, or will require the lender to foreclose its lien on the property and then pay the lender's loss, up to a maximum of 20% or 25% of the amount of the insured loan. In 1975, a typical policy covering a 90% to 95% loan for losses up to 25% carried a first year premium of one percent of the loan plus $20. After the first year, the policy could be renewed for one-quarter of one percent of the loan. S. MAISEL & S. ROULAC, REAL ESTATE INVESTMENT AND FINANCE 214-15 (1976). The initial premium ordinarily is charged to the homebuyer as a settlement cost and therefore would be required to be absorbed initially by the lender under lender pay.
would have to override the lender’s assessment of risk.

It is reasonable to assume that the cost of settlement services would be reduced if lenders were required to absorb them initially since lenders are in a better position than homebuyers to bargain effectively with independent providers of settlement services. Lenders would be likely to eliminate unnecessary services or services of a higher quality than necessary, and would be likely to make increased use of their own employees to perform settlement services now performed by third party providers.\(^\text{127}\) But a reduction in the cost of settlement services would not reduce the costs of homeownership unless lenders passed their settlement cost savings through to homebuyer-borrowers.

Professor Whitman’s assertion that mortgage lenders would pass settlement cost savings to borrowers is based on the assumption that the market in mortgage interest rates is “quite competitive.”\(^\text{128}\) This assumption seems overly optimistic in light of the dearth of evidence about the competitive behavior of home mortgage lenders with respect to the lending side of their activities.\(^\text{129}\)

Over 22,000 major financial organizations make mortgage loans. They include such diverse institutions as savings and loan associations, mutual savings banks, commercial banks, mortgage banking companies, life insurance companies, pension funds, real estate investment trusts and various state and federal agencies.\(^\text{130}\) Of these institutions, the first four are the most significant lenders of mortgage money on one-to-four family homes. Three of these four institutions have only limited ability to compete in the home mortgage loan market, because their sources of funds are limited; and two of these four institutions have enough flexibility in their investment powers so that they need not compete to make home mortgage loans if other investments are more attractive. The ability or willingness of each of these four types of lending institutions to compete on the basis of interest rates charged to home mortgage borrowers must, therefore, be considered separately.

Since 1971, the thrift institutions—savings and loan associations and mutual savings banks—have originated approximately sixty-five percent of all conventional home mortgage loans.\(^\text{131}\) Both types of

\(^{127}\) See notes 114-15 supra.

\(^{128}\) Whitman, supra note 28, at 1348 & n.156.

\(^{129}\) There is, on the other hand, considerable empirical evidence that savings and loan associations and mutual savings banks, which together make most conventional home mortgage loans, are extremely competitive in their efforts to attract savings deposits. Everyone who reads the newspapers or listens to the radio is exposed to vigorous advertising for deposits by these thrift institutions, each claiming to pay the highest allowable interest rate on savings.

\(^{130}\) S. Maisel & S. Roulac, supra note 126, at 21-22.

\(^{131}\) Mortgage Bankers Association of America, Mortgage Banking 1976:
institutions, however, are able to compete in making such loans only within constraints that restrict their capabilities to obtain capital to lend. Savings and loan associations and mutual savings banks obtain most of their capital from numerous small savings account depositors and lend most of their funds on real estate mortgages. Their ability to attract deposits is hindered because of limitations on the amount of interest they may pay. These limitations are imposed by governmental regulations and, more fundamentally, by their asset structures. Even if there were no governmentally imposed deposit interest rate ceilings, thrift institutions still could not afford to raise their deposit interest rates significantly in order to attract new deposits. They would have to pay the higher interest rates on existing savings accounts as well as new savings accounts, but their interest earnings, derived from long-term mortgage loans made at an earlier time at fixed and generally lower interest rates, would remain relatively constant.

When interest rates on such short-term securities as United States Treasury Bills rise above interest rates on savings account deposits, not only are thrift institutions unable to attract new deposits, but existing depositors withdraw their deposits and invest directly in such higher yielding short-term securities. This process is known as disintermediation.

During periods of disintermediation,


134. See S. Maisel & S. Roulac, supra note 126, at 162. In order to ameliorate the effects of disintermediation, as of June 1, 1978, thrift institutions were authorized to offer savers nonnegotiable certificates with minimum deposits of $10,000 and maturities of six months at a rate of return equal to one-quarter of one percent above the discount yield on the most recently issued six-month United States Treasury Bills. 43 Fed. Reg. 21,436-38 (1978) (mutual savings banks); 43 Fed. Reg. 21,438-39 (1978) (to be codified in 12 C.F.R. § 526.5(a)(8)) (savings and loan associations); as of the same date, commercial banks were authorized to offer similar certificates at a rate of return equal to the Treasury Bill rate. 43 Fed. Reg. 21,435-36 (1978) (to be codified in 12 C.F.R. § 217.7(f)); 43 Fed. Reg. 21,436-38 (1978) (to be codified in 12 C.F.R. § 329.6(b)(5)).

Depending on the week in which they were issued and the method of compound-
the concern of thrift institutions is not how to compete to make home mortgage loans, but rather how to ration their limited funds. Occasionally, during such periods, mortgage money is unavailable from thrift institutions altogether.

The ability of mortgage banking companies to lend money also is limited by periodic shortages of funds. Mortgage banking companies' principal activities are making loans secured by mortgages on real estate, selling these loans in the secondary market to permanent investors, and then servicing the loans for these investors. Since 1971, mortgage banking companies have originated approximately seventy percent of all FHA insured and VA guaranteed home mortgage loans. Although mortgage banking companies disburse funds from their own accounts to close loans, these are borrowed funds. Mortgage banking companies do not provide savings deposit services and they have only a small amount of their own capital to lend. They

The highest rate will be paid at the maturity of certificates issued during the week beginning December 28, 1978, when the certificate rate was calculated with reference to an average Treasury Bill rate of 9.85%. The additional one-quarter of one percent paid by thrift institutions brought the rate up to 9.38% and continuous compounding increased the maximum rate payable to 10.4801%. Telephone conversation with Pierre Ellis, Research Department, U.S. League of Savings Associations, (Mar. 26, 1979). As of March 15, 1979, the regulatory agencies acted to reduce the profit squeeze on thrift institutions that has resulted from such high rates. For all certificates issued after that date, whenever the Treasury Bill rate exceeds nine percent, thrift institutions may not add an additional one-quarter of one percent interest and no compounding of interest is permitted on any certificates. 44 Fed. Reg. 15,476-77 (1978) (to be codified at 12 C.F.R. § 329.7(b) (7)) (mutual savings banks); 43 Fed. Reg. 15, 478-79 (1978) (to be codified at 12 C.F.R. § 526.3(a)(8)) (savings and loan associations). Although the certificates have "sold" well, only a small percentage of the money has been used to make new mortgages. There are two major reasons for the apparent failure of these certificates to provide additional funds for housing. First, the bulk of the money that has gone into these certificates at thrift institutions has come from regular savings accounts. Little "new money" has flowed into thrift institutions by virtue of the certificates. Second, many thrift institutions have placed the new money that did come in into large negotiable certificates of deposit at commercial banks at even higher interest rates in order to cover their own higher costs.


137. Mortgage Bankers Association of America, supra note 131, at inside front cover.

138. Id. at 5. During that same period, mortgage banking companies' share of conventional home mortgage loans was less than five percent.
obtain funds with which to make loans principally by borrowing short
term from commercial banks. When money is tight in general, such
short-term money often is unavailable, thereby limiting mortgage
banking companies as effective competitors in the mortgage market.

Commercial banks, in addition to providing short-term credit to
mortgage banking companies, also lend some home mortgage money.
Since 1971, they have originated over twenty percent of all conven-
tional home mortgage loans. Their effectiveness as competitors is,
however, limited for several reasons. Historically, commercial banks
have been involved principally in short-term commercial lending and
their governing regulations, particularly in the case of national banks,
severely restricted the amount and terms of real estate mortgage
loans they could make. Even though these restrictions now have
been eased, commercial banks tend to be more conservative in their
lending practices than other home mortgage lenders. They tend to
lend at a lower loan-to-value ratio and for a shorter term. Although
their interest rates, loan fees, and prepayment penalties are thus
generally less than those ordinarily charged by savings and loan
associations, a home mortgage loan from a commercial bank is feas-
ible only for a limited segment of the homebuying public: those who
have enough cash for a downpayment so that they do not need a loan
at the highest permissible loan-to-value ratio, and those who can
meet the higher monthly payments required by shorter amortization
periods. Commercial banks cannot, therefore, be viewed as effective
competitors in the market for mortgage loans to the homebuyers
about whom the supporters of lender pay are most concerned.

The flexibility that commercial banks and, to a lesser extent,
mutual savings banks have in their investment powers limits their
willingness to compete to make mortgage loans. In periods of rising
interest rates, putting money into single family mortgage loans be-
comes less attractive to them than other investments. Part of the
problem arises because of state usury laws and interest rate ceilings
imposed by the federal government on FHA insured and VA guaran-
teed loans. When interest rates obtainable on other investments are
above the rates that could be obtained from making home mortgages,
lenders who have alternative choices do not lend mortgage money.

139. S. MAISEL & S. ROULAC, supra note 126, at 211.
140. MORTGAGE BANKERS ASSOCIATION OF AMERICA, supra note 131, at 5.
141. S. MAISEL & S. ROULAC, supra note 126, at 197.
142. Id. at 197-98.
143. Id.
144. For a state-by-state survey of these laws, see [1978] 1 CONS. CRED. GUIDE
(CCH) ¶ 510.
(FHA ceiling 10%).
Even if there were no interest rate ceilings, however, commercial banks still would be unlikely to make many mortgage loans during periods of tight money. When businesses seek financing from their banks during such periods, it is reasonable to assume that lenders would prefer to lend their limited funds to their regular commercial customers, with whom they have ongoing relationships, rather than to home mortgage borrowers.\(^\text{146}\)

As the foregoing analysis demonstrates, the structural constraints upon the ability and willingness of mortgage lenders to compete to make home mortgage loans are strictest during periods of tight money. Unfortunately, in recent years such periods have been occurring with increasing frequency and their effect on the mortgage market has become increasingly severe. One commentary warns that the real estate industry can expect to encounter a depression about every three and one-half years.\(^\text{147}\) Since during periods of tight money there frequently is more demand for mortgage funds than there are funds available, mortgage lenders have no incentive to compete on the basis of price in order to make home mortgage loans. Under such circumstances, if lender pay were in effect, it is unlikely that mortgage lenders would pass settlement cost savings through to borrowers by reflecting such savings in the interest rate. Indeed, it seems more likely that mortgage lenders would retain such savings in an effort to cover the higher costs of obtaining funds during tight money periods.

Although the structural constraints on mortgage lending are ameliorated when home mortgage money is available more readily, it does not necessarily follow that mortgage lenders engage in price competition during such periods. Since the federal government lowers the maximum allowable interest rate for FHA insured and VA guaranteed loans when the money supply eases, that rate tends to become the floor as well as the ceiling. Borrowers are encouraged to believe that the government has set the rate rather than the maximum.


\(^{147}\) S. MAISEL & S. ROULAC, supra note 125, at 153. Lending on residential mortgages fell by more than fifty percent from the high to the low quarters in 1965-66, 1969-70, and 1973-74. Such periods also were characterized by increases in home mortgage interest rates—from 5.4% to 6.8% in 1965-66 and from 7.5% to 10.1% in 1972-74. Although some of the decline in lending may be due to a lessening of demand as interest rates increase, most of the decrease occurs because fewer funds are available from the various types of mortgage lenders. Id. at 163-64. The effect of an increase in mortgage interest rates on the demand for mortgages is unclear. Compare Dhrymes & Taubman, supra note 135 (one percent increase in mortgage rates is associated with a two percent decrease in demand), with Huang, Effect of Different Credit Policies on Housing Demand in 3 I. FRIEND, supra note 109, at 1211, 1236 (effect of the costs of mortgage borrowing appears to be insignificant).
There is very little information available to determine how lenders establish mortgage interest rates on conventional home mortgage loans. That there is some variation in conventional interest rates and that such rates are not always at the usury limit indicates that lenders could be engaging in some price competition. Economists have, however, attributed much of the interest rate variations to the urban—as opposed to rural—location of the property and the lending institution, the size of the lending institution, and the terms of the mortgage loan, most particularly the loan-to-value ratio. The higher the loan-to-value ratio, the less the interest tends to vary among lending institutions. There have been conflicting findings on the relationship between interest rates and the number of mortgage lending institutions in an area. Studies give no indication that lenders attempted to attract home mortgage borrowers by advertising lower rates.

It is not surprising that mortgage interest rates are not well ad-


149. Economists who have attempted to study credit conditions in the residential mortgage market have been hampered by lack of reliable data. See, e.g., J. GuttenTag & M. Beck, supra note 148, at 3-4, 88; S. Klaman, The Postwar Residential Mortgage Market, at xxiv, xxviii-xxix (1961); Benston, Savings Banking and the Public Interest, 4 J. Money, Credit & Banking 133, 200-01 (1972); Jung, Terms on Conventional Mortgage Loans on Existing Houses, 17 J. Finance 432, 432 n.1 (1962).


152. Id. at 435, 443; Jung, Terms on Conventional Mortgage Loans—1965 vs. 1960, 3 Nat’l Banking Rev. 379, 382-84 (1965).

153. Compare Friend, Changes in the Asset and Liability Structure of the Savings and Loan Industry, in 3 I. Friend, supra note 109, at 1355, 1384 (virtually no relationship), with Aspinwall, Market Structure and Commercial Bank Mortgage Interest Rates, 36 S. Econ. J. 374, 382 (1970) (strong statistical association between mortgage interest rates and both concentration and number of lenders). An interesting aspect of Jung’s findings in the studies cited at notes 149 & 150 supra, is that when, in 1960, commercial banks could pay only 3% on savings deposits and could lend only up to 75% of appraised value for no more than twenty years, they tended to charge lower mortgage interest rates than savings and loan associations; whereas, in 1965, when commercial banks were permitted to pay 4% on savings deposits and could lend 80% of appraised value for 25 years, the interest rate differential between commercial banks and savings and loan associations virtually disappeared. Jung, supra note 152, at 384.
vertised, since most homebuyers do not shop around for mortgage loans. Instead, they rely on other participants in the settlement process, principally real estate brokers and builders, to arrange mortgage financing for them. Some mortgage lenders have estimated that they receive between seventy-five and ninety percent of their home mortgage loan applications from real estate brokers and builders. Competitive efforts by mortgage lenders are, therefore, directed primarily at these persons, rather than at homebuyers. Prior to RESPA, such reliance on referrals rather than on price competition frequently involved “an elaborate system of referral fees, kickbacks, rebates, commissions and the like.” Although payment and receipt of such inducements now are illegal, given the cyclical nature of the mortgage lending industry, the referral of homebuyers to lenders by real estate brokers and builders is mutually beneficial even in the absence of payment. In periods of ready availability of mortgage money, real estate brokers and builders are likely to refer mortgage borrowers to particular lenders in the hope that such lenders will, during periods in which mortgage money is tight, make mortgage loans to borrowers “sponsored” by such real estate brokers and builders.

Recently, the official publication of the United States League of Savings Associations, whose members hold 99% of savings and loan association assets, extolled the virtues of aggressive, innovative techniques of competing for home mortgage loans. Most of the techniques discussed by senior marketing officials from various associations involved the means by which to establish closer relationships with real estate brokers and builders. Generally, the marketing officials downplayed the desirability and effectiveness of consumer advertising, particularly marketing by rate.

In light of the foregoing, it seems unlikely that lender pay would cause mortgage lenders to change their loan marketing procedures and engage in active price competition by passing settlement cost

---


155. Loan Marketing, supra note 154, at 91, 92.

156. HUD-VA REPORT, supra note 8, at 15-16, reprinted in 1972 House Hearings, supra note 8, at 751-52.


158. Loan Marketing, supra note 154.

159. Id. The vice president of one association expressed what appeared to be the prevailing attitude when she said, “If rates are the same and the deal is essentially the same, people want to do business with friends, people they are comfortable with and who give them the best service.” Id. at 92.
savings through to borrowers. Although lender pay would make it easier for a prospective borrower to compare costs because the long-term interest rate would be the only cost of borrowing, loan-to-value ratio and length of term differences would be likely to remain. The psychological barrier involved in approaching bankers for a loan would continue to deter comparison shopping, and homebuyers still would be likely to rely on real estate brokers and builders to arrange their mortgage financing.

Furthermore, in order to pass through settlement cost savings, lenders would have to make more precise adjustments in the home mortgage interest rate than is customary. Mortgage lenders seldom change interest rates by less than one-quarter of a percentage point. Since it is estimated that all the expenses that would be absorbed under lender pay would require an interest rate increase of between one-quarter and three-eighths of one percent, the savings that lenders could effect by dealing with providers of settlement services directly undoubtedly would be less than one-quarter of one percent. There would, therefore, be a very small margin within which to adjust interest rates to reflect settlement cost savings. Without a significant change in the shopping habits of homebuyers, lenders probably would not make this adjustment in order to attract borrowers. Unless such adjustment were made, lender pay would not reduce the total costs of homeownership.

Of the lesser benefits that Professor Whitman sees in lender pay, the deductibility for federal income tax purposes of settlement costs paid in the form of increased mortgage interest is the most troublesome. It is presented as an extra sweetener for homebuyers, without regard for its detrimental effects upon the income tax system as a whole. However innocent sounding, deductibility of settlement costs paid in the form of increased mortgage interest would increase revenue losses to the Treasury in an amount that would exacerbate existing tax inequities between homeowners and renters and between high-bracket and low-bracket homeowners.

160. S. KLAMAN, supra note 149, at 78.
161. See text accompanying note 111 supra.
162. Mortgage interest is deductible under I.R.C. § 163. When the borrower pays a fee to the lender at the time of obtaining the loan, its deductibility depends on whether it is a fee paid for the use of money, or a fee paid as compensation for services rendered by the lender. 28 C.F.R. § 1.163-1 (1978). The former is deductible as interest, Rev. Rul. 69-582, 1969-2 C.B. 29; Rev. Rul. 69-188, 1969-1 C.B. 54, while the latter is not. Rev. Rul. 67-297, 1967-2 C.B. 87. If lenders were not permitted to collect any fees at the time of origination, a portion of the mortgage interest collected over the life of the loan might be considered as nondeductible compensation for services rendered. Professor Whitman thinks that the administrative burden involved in determining the nondeductible component of interest makes it unlikely that the Internal Revenue Service would undertake partial disallowance of mortgage interest deductions. Whitman, supra note 28, at 1350 n.161.
Revenue losses from the deduction by individuals of mortgage interest on residences were estimated as averaging nearly five billion dollars per year for 1975 through 1977. This sum, sometimes categorized as a tax incentive or tax expenditure, is in effect a federal government subsidy to homeowners. Present tax law does not control the amount of revenue lost by virtue of this subsidy, since the deduction is available to all homeowners who finance their homes, regardless of their income levels, the cost of the homes, or the number of homes owned. An increase in mortgage interest of one quarter of one per cent to reflect origination and settlement costs required to be absorbed initially under lender pay would add to these revenue losses. Since the mortgage interest deduction is not available to renters, there is inequality of tax treatment between owners and renters who have similar gross incomes. The increased mortgage interest deduction available because of lender pay would exacerbate this inequality. The inequality between high-bracket and low-bracket homeowners would also be increased by these factors. First, each dollar of tax deduction is worth more to a higher-bracket taxpayer than to a lower-bracket taxpayer. Second, higher-bracket taxpayers are more likely to be homeowners and also are more likely to own higher-priced homes with higher mortgages. Finally, higher-bracket taxpayers are more likely to own more than one home. At the extremes, by permitting a deduction for interest that otherwise would have been non-deductible loan origination and settlement costs, the federal government would, in essence, subsidize seventy percent of these costs for the highest bracket taxpayer but absorb only fourteen percent of these costs for the lowest bracket taxpayer. Such a result hardly can be considered reasonable settlement cost reform.

3. The Disadvantages of Lender Pay: A Closer Look

Not only has Professor Whitman overstated the advantages of lender pay, but he also has minimized what he considers to be the

164. Id. See also Tax Institute of America, Tax Incentives 3-29 (1971); Surrey, Tax Subsidies as a Device for Implementing Governmental Policy, 3 Tax Adviser 196 (1972).
165. See I.R.C. § 163.
166. It may be, however, that the housing market has adjusted for these deductions. For example, landlords may have passed tax savings from their mortgage interest deductions through to their tenants in the form of lower rents. Alternatively, the price of homes may have increased to compensate for this tax benefit. See R. Goode, The Individual Income Tax 122 (1976).
disadvantages: possible conflicts with some state usury ceilings and inequity between short-term and long-term borrowers. These disadvantages should not be dismissed so lightly.

Although many states have raised their mortgage interest rate ceilings during recent periods of credit shortage, the newly raised ceilings still may not be high enough in some jurisdictions to avoid diversions of money from the home mortgage market during periods of generally high interest rates. To the extent that lender pay would cause an increase in home mortgage interest rates to account for initially absorbed origination and settlement costs, the maximum statutory interest rate would be reached sooner and the problem of home mortgage interest rate ceilings would be intensified. Although it may be argued that an increase in home mortgage interest rates would create additional pressure for changes in the usury laws, it is difficult to predict what effect such additional pressure might have. Even if the usury limits ultimately were raised, prospective buyers of homes would have suffered from the unavailability of mortgage credit in the interim. Because of the current dramatic increases in the cost of housing, when mortgage money finally became available, homebuyers likely would find not only that the interest rate had been raised, but that the price of housing had increased as well.

Professor Whitman's view—that the inequity of having long-term borrowers pay the increment of interest attributable to origination and settlement costs over a longer period of time than that of short-term borrowers is outweighed by the social utility of reducing front-end costs—cannot stand for several reasons. First, as was demonstrated previously, it is unlikely that front-end costs would be reduced in many instances, particularly for those homebuyers who already must borrow at high loan-to-value ratios.

Second, to the extent that homeowners sell their existing homes in order to "trade-up" to more expensive homes, the unrecovered settlement costs would be borne by the persons who are least able to


170. House Prices Are Marching to the Beat of Inflation, N.Y. Times, May 29, 1977, § 8 (Real Estate), at 1, cols. 4-5 (N.J. ed.).

171. See text accompanying notes 122-27 supra.
afford them. Consider the common situation of a new development in which many of the buyers are young families acquiring their first homes. The developer may have arranged for permanent mortgage financing with a particular lender at a stated interest rate for all homes in the development, which rate, under lender pay, would include an increment for origination and settlement costs. After a few years, those families whose incomes had risen the fastest probably would be the first to move. Their less financially successful neighbors who remained would continue to pay the loan origination and settlement costs increment throughout the life of the loan.\textsuperscript{172}

Finally, borrowers whose loans were terminated early by reason of default and foreclosure would be subsidized as to their origination and settlement costs by borrowers whose loans were in good standing. This inequity would be heightened because most foreclosures occur during the early years of a loan.\textsuperscript{173} The imposition by the lender of a prepayment penalty could not overcome this inequity because such a penalty is meaningless in the foreclosure context.

Although the disadvantages of lender pay mentioned by Professor Whitman and discussed above are important, the most significant disadvantage is one not mentioned by Professor Whitman: Lender pay could cause substantial structural changes in the primary and secondary home mortgage lending markets that could adversely affect the availability of mortgage money.

At the primary market level, there would be risks that commercial banks might curtail their home mortgage lending activities substantially and that mortgage banking companies might be driven out.

\textsuperscript{172} This inequity could be overcome by a variant of lender pay under which the lender would add the origination and settlement costs to the principal amount of the mortgage, rather than recover them by an increase in the mortgage interest rate. It should be noted, however, that this variant of lender pay also probably would cause a lender to increase its downpayment requirement, in order to keep its risk at an acceptable level in light of its increased investment in the security. In addition, this variant of lender pay might, for psychological reasons, add somewhat to the inflation of the cost of housing. Within market limitations, a homeowner who wants to sell his present home sets an asking price and decides whether or not to accept an offered price based in some measure on what he will net on the sale. If the homeowner’s mortgage balance included loan origination and settlement costs, he might well raise his asking price and his minimum acceptable selling price in order to achieve an acceptable level of net proceeds. The homeowner might be less likely to make such pricing decisions based on amounts paid for loan origination and settlement costs at the time of acquisition of the property, because under such circumstances his net cash proceeds at the time of sale would not be affected.

This inequity also could be overcome by use of a prepayment penalty fixed so as to approximate the unrecovered origination and settlement costs. But this, too, might cause a homeowner to increase the price of his home since the prepayment penalty reduces the seller’s net.

\textsuperscript{173} S. Maisel & S. Roulac, \textit{supra} note 126, at 302.
of the home mortgage market altogether. The departure of these two types of lenders from the home mortgage market would have a substantial negative impact upon the availability of money for home mortgages.

Commercial banks, which have the most flexible investment powers of the four types of home mortgage lenders, might curtail their home mortgage lending because, as the initial costs of home mortgage lending increased, commercial loans would become more attractive by comparison. The diversion of funds that otherwise would go into home mortgage loans would become most acute when money was generally tight and home mortgage interest rates were at the usury limits, since the commercial banks could not then recover the origination and settlement costs by an increase in the interest rate.

Funds taken out of home mortgage lending by commercial banks could not be replaced easily. Thrift institutions could put additional funds into the market only if they could obtain additional savings deposits or sell mortgages from their existing portfolios in the secondary market. The ability to attract new savings deposits would, however, be most difficult whenever they were most needed, during periods of tight money. The ability to sell mortgages in the secondary market in addition to mortgages already being sold by thrift institutions in that market would require either increased purchases by existing secondary market investors or the attraction of new types of investors to that market. Only if commercial banks were to purchase in the secondary market home mortgages equal in amount to those they otherwise would have originated, would the additional funds available to thrift institutions approximate the amount taken out of the primary market by the commercial banks.

Whereas commercial banks might leave the mortgage market voluntarily in response to lender pay by investing their funds elsewhere, many mortgage banking companies could be driven out of business altogether if they were required to absorb initially all origination and settlement costs. The disappearance of mortgage banking companies as a source of funds for home mortgages would have an effect on the mortgage market out of proportion to the percentage of single family loans originated by them. Although from 1970 through 1976, mortgage banking companies originated between 17% and 21% of all single family loans, these originations accounted for between 68% and 78% of all FHA insured loans, between 61% and 75% of all VA guaranteed loans, and only between 1.5% and 6.5% of all conventional loans. Since FHA and VA loans ordinarily are made to home-buyers of lower income than those who borrow on conventional loans, the impact of any decline in mortgage money available from mort-

gage banking companies would fall most heavily upon the very group of prospective homebuyers that lender pay was designed to assist.

Many mortgage banking companies might be forced out of business under lender pay, because without substantial changes in the way that these companies operate they would be unable to pass on the loan origination and settlement costs. Ultimately, therefore, they would have to bear these costs as increased operating expenses.

When a mortgage banking company originates mortgage loans with short-term funds it has borrowed from commercial banks, it pledges the mortgage loans as collateral to secure the short-term commercial bank credit. The mortgage banking company carries these closed mortgage loans in its inventory for a short period during which it arranges for their sale in the secondary market to a permanent investor. This is known as “warehousing.” As the mortgages are sold, the mortgage banking company uses the proceeds from the sale to pay off its commercial bank loans. The commercial banks may then advance new short-term credit and start the cycle again. During the term of the mortgage loans, the mortgage banking company administers or services them for the permanent investors. Servicing consists of collecting and accounting for the monthly payments, maintaining escrow accounts for payment of property taxes, handling foreclosures, and doing all other things with respect to the loan that otherwise would have to be done by the permanent investor.

There are four stages in the above described process at which the mortgage banking company has an opportunity to receive income: origination, warehousing, resale, and servicing. Origination income consists of loan origination fees and any other front-end fees charged by the lender for specific services such as appraisals, credit checks, or escrow or closing services performed by the lender. Warehousing income is the difference, if any, between the interest rate on the mortgages in the mortgage banking company’s inventory and the interest rate on its short-term commercial credit, the proceeds from which it used to originate the loans warehoused in its inventory. Resale income is a markup in the price of the loans sold to permanent investors. Servicing income is a fee on the order of three-eighths of one percent of the mortgage amount per year.\footnote{176}

On residential loans, origination fees usually are less than the cost of origination to the mortgage banking company, resulting in a loss on origination that must be recouped from other sources of income.\footnote{177} Since lender pay would prohibit home mortgage lenders from charging any front-end fees and would, at the same time, increase

\footnote{175. See text accompanying notes 137-42 supra.}
\footnote{176. Wiggin, supra note 82, at 93-95.}
\footnote{177. MORTGAGE BANKERS ASSOCIATION OF AMERICA, supra note 131, at inside front cover.
their origination expenses by requiring that they absorb initially all mortgage origination and settlement costs, mortgage banking companies' origination losses would increase substantially.

The first problem that mortgage banking companies would face under lender pay would be where to obtain the funds with which to pay the origination and settlement costs initially, since most of these companies do not have sufficient capital to pay these costs out of their own funds. Obtaining these funds from their short-term commercial lenders would not be a reasonable solution because it would only postpone the problem. If such short-term borrowing were relied upon, the mortgage banking company would have to borrow enough both to originate mortgage loans and to pay the origination and settlement costs associated with those loans. When the mortgage banking company sold the mortgage loans to permanent investors, unless the proceeds were sufficient to cover the origination and settlement costs in addition to the principal amounts of the mortgage loans sold, the mortgage banking company would have to find another source of funds with which to repay the portion of the short-term loans attributable to origination and settlement costs.

Even if an initial source of funds to pay origination and settlement costs could be found, the mortgage banking companies' problem would not necessarily be solved. Lender pay presupposes that, over time, mortgage lenders would recoup the amount of origination and settlement costs absorbed initially by collecting increased interest over the life of the mortgage loans. Mortgage banking companies, however, would be unable to pass these origination and settlement costs through to borrowers in this fashion since they do not retain in their own investment portfolios the mortgage loans that they originate. Higher interest rates on the loans would therefore accrue to the benefit of mortgage banking companies only if those incremental amounts were retained by them when the loans were sold to permanent investors in the same manner that the mortgage banking companies now retain the servicing fee of three-eighths of one percent, or if the permanent investor were willing to pay a higher price for the loan because it carried a higher interest rate. But the yield required by the permanent investor, which would determine the price at which the investors would buy the loans, bears no necessary relation to the origination and settlement costs incurred initially by the mortgage banking company. The problem is compounded because frequently the maximum allowable interest rate on FHA and VA mortgage loans is low in relation to market interest rates. There simply might not be enough of a difference between the rate of interest on the mortgage loans and the yield required by the permanent investor to allow either for retention by mortgage banking companies of the right to sufficient interest to compensate for origination and settlement costs over the life of the loan, or for a price high enough to en-
able the mortgage banking company to recoup the origination and settlement costs upon resale.

In addition to the increased losses upon origination that mortgage banking companies could incur under lender pay, these companies also might incur losses on resale of loans to permanent investors. Mortgage banking companies now may make a profit on the sale of loans to permanent investors by originating the loans at a discount and selling the loans at a lesser discount, but because of the requirement that all home mortgage loans be originated at par, no such discount points would be permitted under lender pay.

Assume, for example, that the maximum allowable interest rate on FHA-VA mortgage loans is eight and one-half percent and investors require a yield of nine percent before they are willing to invest in mortgage loans. Apart from the costs to the mortgage banking company of originating the loans, if it is to break even on the sale of the loans it will calculate the discount at which it must originate the loans as follows: The first step in the calculation is to determine the price, expressed as a percentage of the par value of the loans, that a permanent investor would be willing to pay for the loans in order to earn his required yield. For purposes of this calculation, each point of discount from the par value of the loans would increase the permanent investor's yield by one-eighth of one percent over the life of the loans. This is the same rule of thumb used by mortgage lenders when they charge loan discount points upon origination of a loan. Since the mortgage loans bear interest at the rate of eight and one-half percent and the mortgage banking company will retain three-eighths of one percent as a servicing fee, the investor who requires a yield of nine percent will pay a price of only 93% of par for the loans. Of the seven points of discount, three points represent the mortgage banking company's servicing fee and four points represent the amount necessary to increase the permanent investor's rate of return from the eight and one-half percent interest rate on the mortgage notes to the nine percent yield required by him in order to invest in home mortgage loans. If the mortgage banking company is to break even on sale of the mortgage loans, it must charge the borrowers seven discount points at the time it originates the loans, and, if it is to make any profit, it must originate the loans at less than 93% of par.


179. See note 106 supra.
Under lender pay, since the mortgage banking company would have to originate all home mortgage loans at par, it would make a profit on the sale of loans only if it could sell the loans to investors at a premium. This would never happen so long as the maximum allowable interest rate on FHA-VA mortgages were at or below the yield required by investors before they would purchase such mortgage loans.\textsuperscript{180} If, as is likely, investors continued to purchase such loans at a discount, mortgage banking companies would incur losses on sale of the loans in addition to incurring losses on origination.

Of the four stages in the operation of a mortgage banking company at which it has an opportunity to receive income, two of them—origination and resale—would result in losses under lender pay. Servicing and the income received therefrom likely would remain unchanged. Warehousing might result in increased income to mortgage banking companies under lender pay, if the mortgages in inventory bore interest at an increased rate that reflected the origination and settlement costs required to be absorbed and if the cost of short-term credit were unaffected.

If such warehousing income were insufficient to offset the origination and resale losses, changes in the secondary market, particularly with respect to the operations of the Federal Home Loan Mortgage Association (Fannie Mae or FHLMCA) and the Government National Mortgage Association (Ginnie Mae or GNMA), might be required in order for mortgage banking companies to continue to have a role in home mortgage lending. Secondary market purchasers, because they have capital to invest and because they generally hold mortgages in their investment portfolios over the terms of the mortgages, are in a position to absorb initially the costs of home mortgage loan origination and settlement and to recoup such costs through the increased rate of interest on the mortgages. A major obstacle to this possible solution, however, is the requirement under lender pay that all home mortgage loans be originated at par. If the mortgage banking companies must originate the loans at par, in order for the secondary market purchasers to absorb the settlement costs, they would have to buy such loans at a premium. Ginnie Mae regulations now prohibit purchase of mortgage loans at a premium\textsuperscript{181} and Fannie Mae will not purchase mortgage loans at a price in excess of par.\textsuperscript{182}

As noted above,\textsuperscript{183} buying loans at a premium would be a problem so long as the maximum allowable interest rate on FHA-VA mort-

\begin{footnotes}
\item 180. There are additional problems involved when mortgage loans are purchased at a premium. These problems are discussed in the text accompanying notes 181-87 infra.
\item 182. FNMA, SELLING AGREEMENT SUPPLEMENT § 207(a) (Feb. 23, 1976).
\item 183. See text accompanying note 180 supra.
\end{footnotes}
gages were at or below the yield required by investors before they would purchase such mortgages. The problem would not be solved even if the interest rate on the mortgages were high enough to cover the mortgage origination and settlement costs and to assure the secondary market purchaser an adequate yield. Secondary market purchasers would continue to resist buying loans at a premium because they would incur a loss on a loan whenever it was paid in full at a time earlier than the average life of the loan that was used to calculate the premium. This loss would occur in the year that the loan was paid in full because the secondary market purchaser would not have fully amortized the premium. Thus, the amount that the investor would receive upon payment of the loan in full would be less than the amount at which the loan was carried on the investor's books.

In effect, if the secondary market purchaser must buy loans at a premium, its risk on each loan is increased because it has a greater investment in each loan than it would have if it were to buy the same loan at par or at a discount. When a loan purchased at a premium goes into default, even if a foreclosure sale were to bring an amount equal to the outstanding principal balance, the permanent investor nevertheless would sustain a loss equal to the unamortized premium. Secondary market purchasers might demand an additional yield in order to compensate for this risk, which would put an upward pressure on home mortgage interest rates.

Another way in which secondary market purchasers could compensate for this risk would be to shift part of it to the borrower under the terms of the loan. In the event the loan were paid in full prior to maturity, the borrower could be required to pay an amount equal to the unamortized premium; in the event the loan went into default, the amount of the unamortized premium could be added to the principal balance. Under this system, although the permanent investor would be protected against loss from prepayment, it would still bear the risk that a foreclosure sale would not bring enough to pay the augmented principal balance. If the mortgage were insured by FHA or guaranteed by VA, unless changes were made in those programs, the portion of the loss attributable to unamortized premium would not be covered by the insurance or guarantee. This, too, is an additional risk that could cause secondary market purchasers to demand an additional yield.\textsuperscript{184}

Even if the secondary market were to adjust to compensate for the increased risks involved in buying home mortgage loans at a

\textsuperscript{184} The requirement that the borrower pay an amount equal to the unamortized premium upon prepayment of the loan also would have the same inflationary effect on the resale price of existing housing as would the addition at the outset of origination and settlement costs to the principal amount of the mortgage or the imposition of a prepayment penalty. See note 172 supra.
premium, the question of how to calculate that premium raises an additional difficulty. Through a variety of programs, Fannie Mae and Ginnie Mae are involved in the purchase of over half of the home mortgage loans originated by mortgage banking companies.\(^\text{185}\) An important aspect of these programs is that they operate on a nationwide basis. The price at which mortgage loans or mortgage backed securities are purchased depends upon the interest rate on the mortgages; it does not vary according to the location of the underlying properties. Since settlement costs vary from locality to locality,\(^\text{186}\) if Fannie Mae and Ginnie Mae were to absorb them initially by setting a uniform nationwide premium, mortgage banking companies in higher cost areas would be disadvantaged even if they were operating as efficiently as possible, and mortgage banking companies in lower cost areas would receive a windfall that would not necessarily reflect the efficiency of their operations. If, on the other hand, Fannie Mae and Ginnie Mae were to fix different premiums for different geographical areas, in addition to the complications that this inevitably would cause for an otherwise uniform nationwide market, unless these premiums were calculated on the basis of reasonable costs in each area there would be no incentive for mortgage banking companies to reduce settlement costs. To establish premiums based on reasonable costs would require an effort much like HUD's ill-fated attempt to establish maximum settlement charges,\(^\text{187}\) which the secondary market institutions are even less equipped to undertake.

Even if a satisfactory means of establishing the premium were found and mortgage banking companies continued to operate in the home mortgage market with the secondary market purchasers absorbing initially the loan origination and settlement costs, the amount of home mortgage money made available through the resources of the secondary market would, under lender pay, either purchase fewer home mortgage loans or purchase the same number of mortgage loans at lower loan-to-value ratios than under the present

\(^{185}\) For description of the various programs, see Wiggin, \textit{supra} note 82, at 84-95. Both Fannie Mae and Ginnie Mae purchase mortgages to hold in their own portfolios. In addition, Ginnie Mae guarantees the payment of principal and interest on home mortgages that underlie mortgage backed securities issued by mortgage banking companies. Under this program, the lender packages a pool of FHA or VA home mortgages bearing the same rate of interest that has an aggregate face amount of at least one million dollars. After obtaining Ginnie Mae approval, it sells securities to investors, in face amounts of at least $25,000, which are backed up by the principal and interest payments on the underlying mortgages and the Ginnie Mae guarantee. \textit{Id.} at 90. In 1976, over forty percent of the mortgage loans originated by mortgage banking companies were purchased by investors in pools of mortgage backed securities. \textit{Mortgage Bankers Association of America, supra} note 131, at 9.


\(^{187}\) See notes 28-35 supra.
system. Because lender pay would in no way increase the amount of money available from the secondary market, the funds used as premiums to pay origination and settlement costs would be funds that otherwise would have been available to purchase additional mortgage loans.

Mortgage money available from savings and loan associations and mutual savings banks would be affected similarly, although lender pay would not necessarily require a change in the relationship of the thrift institutions to their secondary market purchasers. Since savings and loan associations and mutual savings banks receive deposits that they lend as mortgage money, these institutions would not be faced with the necessity of finding a source of funds with which to pay the costs of loan origination and settlement. In order to meet these front-end costs, however, they would have to use funds that otherwise would be available to make home mortgage loans. The result would be either fewer home mortgage loans or the same number of home mortgage loans at lower loan-to-value ratios.

Since it appears that lender pay would neither increase the opportunities for homeownership nor lower the costs of homeownership, but could reduce the amount of money otherwise available for home mortgage loans, Congress should reject the theory of settlement cost regulation by enacting a federal requirement that the lender pay all costs attributable to the transfer and financing of the property.

C. Federal Requirement of Disclosure of Settlement Costs

The third alternative means of regulating home mortgage settlement costs—a federal requirement of disclosure of such costs—is the approach embodied in RESPA. An analysis of RESPA shows, however, that the present provisions of the Act make a mockery of the term "disclosure." Experience to date under RESPA, therefore, does not provide an accurate basis on which to evaluate the efficacy of a disclosure approach to federal settlement cost regulation. In light of the steps a prospective homebuyer must take as part of the settlement process, if federal regulation of settlement costs based on the concept of disclosure is to be of any assistance to him, it should serve the following purposes:

1. It should enable a prospective homebuyer to determine, based on estimates of loan origination fees and settle-
ment costs, whether he can afford to buy a particular home with the amount of cash he has initially available.

2. It should provide the prospective homebuyer with sufficient information to determine whether he should hire an attorney to negotiate the contract of sale on his behalf. If he decides not to hire his own attorney, it should provide him with enough information to negotiate the contract of sale effectively on his own behalf, including negotiation as to which party will bear any specific loan origination and settlement costs.

3. After the contract of sale has been entered into, it should facilitate comparison shopping by the homebuyer for a mortgage loan and for settlement services. It should facilitate evaluation by the homebuyer of any recommendation of mortgage lender or settlement services provider made by the real estate broker or builder and any requirement imposed by a mortgage lender that the homebuyer pay the fees for settlement service providers selected by the lender.

4. Reasonably in advance of settlement, it should require that the homebuyer be told the amount of actual settlement costs he will be required to pay at settlement and, if that amount is significantly in excess of the amount of estimated settlement costs, it should contain a mechanism that will enable the homebuyer to complete the transaction and pay the excess settlement costs at a later time.

5. It should reduce loan origination and settlement costs.

RESPA, in its present form, serves none of these purposes well, if at all. This does not mean, however, that cost disclosure cannot be an effective means of regulating settlement costs.

The next section of this Article points out the fundamental deficiencies of RESPA disclosure. The section following it proposes changes in the RESPA scheme that will correct its deficiencies. The changes proposed would serve well each of the first four purposes described above. In addition, to the extent that high settlement costs are the result of inefficient and non-competitive practices by providers of settlement services, the proposal should help to stimulate price competition in the markets for various settlement services in which such competition previously has not existed. The proposal also would avoid the substantial federal interference with local methods of doing business that is inherent in both federal establishment of maximum settlement charges and a federal requirement of lender pay.
VI. RESPA: THE REFORM THAT NEVER WAS

RESPA entitles a homebuyer to four different disclosures: (1) a special information booklet; 189 (2) good faith estimates of charges for specific settlement services; 190 (3) actual settlement costs known on the business day immediately preceding settlement; 191 and (4) settlement costs actually paid. 192

The lender must provide the first two disclosures—the special information booklet and the good faith estimates—within three business days 193 after the homebuyer submits an application for a federally related mortgage loan. 194 The special information booklet, entitled Settlement Costs, was prepared by HUD. 195 Part I of the booklet describes the settlement process and the nature of settlement charges and suggests questions for the homebuyer to ask the various settlement services providers. 196 It also contains information about the homebuyer's rights—such as the right to good faith estimates—and remedies under RESPA, and alerts the homebuyer to unfair or illegal practices. 197 Part II of the booklet is an item-by-item explanation of settlement services and costs, with sample forms and worksheets to assist the homebuyer in making cost comparisons.

The good faith estimates may be given "as either a dollar amount

189. 12 U.S.C. § 2604(a), (b) (1976); 24 C.F.R. § 3500.6(a) (1978).
194. RESPA is applicable to every transaction that involves a "federally related mortgage loan," the definition of which depends on both the nature of the property secured by the loan and the existence of a "federal connection" with respect to either the lender or the loan. 12 U.S.C. § 2602 (1976); 24 C.F.R. § 3500.5 (1978). The loan must be secured by a first lien on residential real property, including individual units of condominiums and cooperatives, that is principally for the occupancy of from one to four families. 12 U.S.C. § 2602(1)(A) (1976). The requisite federal connection of the lender may be that its deposits are insured by the federal government, that it is regulated by any agency of the federal government, or that it is a creditor as defined in the Consumer Credit Protection Act. See 12 U.S.C. §§ 1602(f), 2602(1)(B)(i), (iv) (1976). The requisite federal connection of the loan may be that it is insured, guaranteed, or assisted in any way by any agency of the federal government, or that it is intended to be sold ultimately to Fannie Mae, Ginnie Mae, or Freddie Mac. 12 U.S.C. § 2602(1)(B)(ii), (iii) (1976). The vast majority of home purchases are financed with federally related mortgage loans. Telephone Interview with Richard Patterson, HUD Real Estate Practices Staff (June 21, 1978).
196. Id. at 4-10.
197. Id. at 11-16.
or range for each charge" for a settlement service that the homebuyer is likely to incur. These estimates cover: the real estate broker's commission, in the event that the commission is an obligation of the buyer; items payable in connection with the loan, such as loan origination fee, loan discount, appraisal fee, credit report, lender's inspection fee, and mortgage insurance application fee; items required by the lender to be paid in advance, such as interest that accrues on the mortgage loan from date of settlement until the beginning of the period covered by the first monthly payment and mortgage insurance premium; title charges, such as settlement fee, abstract or title search, title examination, title insurance, preparation of documents, notary fees, and attorney's fees; government recording and transfer charges; and miscellaneous additional settlement charges, such as survey, pest and fungus inspection, structural soundness inspection, and homeowner's warranty coverage.

The good faith estimates do not, however, cover all items that the homebuyer will be required to pay in cash at settlement. Among the items not required to be disclosed as part of the good faith estimates are various deposits required by the lender itself. These items include any hazard insurance premium required by the lender to be paid in advance and any reserves required to be deposited with the lender for such things as hazard and mortgage insurance premiums, property taxes, and special assessments. Other items for which no amounts are required to be disclosed, although the homebuyer may have to pay some of them in cash at settlement, are adjustments between the buyer and seller for property taxes and special assessments paid by the seller in advance.

If the lender requires that a particular provider be used to provide legal services, title examination, or title insurance, or to conduct the settlement, and requires the homebuyer to pay the cost of such services regardless of the interests represented by the provider, the lender must base its good faith estimate upon its knowledge of the amount charged by such provider and must state whether or not the provider has a business relationship with the lender. In the common situation in which the lender selects an attorney to represent its interests, the homebuyer is advised to select his own attorney to protect his interests. There is no requirement for disclosure of what such independent representation is likely to cost.

The last two disclosures—the actual settlement costs known on

198. Id. at 11.
199. Id. at 11, 24-29.
200. Id. at 11, 27.
201. Id. at 36-37.
202. Id. at 12.
203. Id. at 12-13.
the business day immediately preceding settlement and the settlement costs actually paid—are given to the homebuyer by the person conducting the settlement. If the buyer so requests, the person conducting the settlement must permit the homebuyer to inspect the settlement statement, completed to the extent of those items known by the person conducting the settlement, on the business day immediately preceding the date of settlement. There is, however, no requirement that any settlement cost items be known and available for inspection on that day. The completed settlement statement must be delivered to the homebuyer at settlement, unless the homebuyer waives in writing the right to such delivery, the homebuyer or his agent does not attend the settlement, or the person conducting the settlement does not require a meeting.

When measured against the purposes that a properly drawn scheme of federal regulation of settlement costs based upon the concept of disclosure should serve, the RESPA disclosures are inadequate for two reasons: they come too late in the settlement process and they are too incomplete to be of significant assistance to the homebuyer.

From the standpoint of the homebuyer, the settlement process begins when he first thinks about purchasing a home. One of the first decisions he must make is whether he can afford to buy a home with the amount of cash he has available. If he has not purchased a home previously and is not otherwise familiar with the settlement process, he is likely to calculate his initial cash requirements by reference to the amount of down payment he would have to make at the prevailing loan-to-value ratio, without taking into account any loan origination and settlement costs. Although undoubtedly many real estate brokers give prospective homebuyers some information about the initial costs involved in purchasing a home, a real estate broker who is eager to consummate a sale might well fail to volunteer information about the magnitude of the total costs until the prospective homebuyer has entered into a contract of sale. The special information booklet and the good faith estimates now required by RESPA would enable the prospective homebuyer to calculate some of the front-end costs, but

---

204. These disclosures must be made on the Uniform Settlement Statement (HUD-1), which is the standard real estate settlement form required to be used in all transactions that involve federally related mortgage loans. 12 U.S.C. § 2603 (1976); 24 C.F.R. §§ 3500.8-.10, app. A (1978). HUD-1 contains all of the settlement costs as to which good faith estimates are required, plus hazard insurance premiums required by the lender to be paid in advance, reserves required to be deposited with the lender, and adjustments between the buyer and seller.

205. 24 C.F.R. § 3500.10 (1978). In these situations, the person conducting the settlement must mail or deliver HUD-1 as soon as practicable after settlement. SETTLEMENT COSTS, supra note 195, at 11.

206. See text at pp. 421-22 supra.
RESPA does not require that this information be made available until after the homebuyer has signed the contract of sale and applied for a mortgage loan.

Even if RESPA required these disclosures to be made at the precontract stage, they still would be inadequate because the good faith estimates do not include all items that the homebuyer will have to pay in cash at settlement. The items as to which good faith estimates are not required, such as hazard insurance premiums, reserves required to be deposited with the lender for future hazard and mortgage insurance premiums, property taxes and special assessments, adjustments between buyer and seller for property taxes and special assessments paid by the seller in advance, and legal fees for independent representation of the buyer, easily could total in excess of a thousand dollars.

Although the special information booklet does contain descriptions of the items not required to be disclosed and instructions on how to calculate them, RESPA puts the task of obtaining the figures and making the calculations on the homebuyer. This allocation of responsibility is inconsistent with the concept of disclosure regulation. RESPA is, therefore, wholly inadequate to serve the first purpose of disclosure regulation: It does not enable a prospective homebuyer, prior to the time he becomes contractually bound, to determine whether he can afford to buy a particular home with the amount of cash he has available.

Once the prospective homebuyer has found a home, typically he will ask the real estate broker for advice as to how much below the listing price the owner actually is willing to sell. This puts the real estate broker in an awkward position. He may have worked closely with the prospective homebuyer over an extended period of time trying to find a suitable property, but he is the agent of the owner. Although he has an obligation to deal fairly with the buyer, the real estate broker may be considered to have breached his duty to the owner if he discloses the owner's minimum acceptable price.

The homebuyer may realize quickly that he is on his own with respect to price negotiations, but he is less likely to be cognizant of all the factors other than price that he should consider before making an offer to buy. Often, the homebuyer has been told that certain settlement costs are the obligation of the buyer but has not been told

---

207. Settlememst Costs, supra note 195.
that he can negotiate with the seller as to who will pay any specific cost. It is almost certain that the homebuyer will be given a standard form sales contract to sign. Such a form contract will have been drafted by the local bar association and adopted by the local real estate association. It is therefore likely to be seller oriented. Since there is no one in the picture who represents the homebuyer's interests, he will have no independent advice as to whether the contract adequately protects him unless he obtains his own counsel before signing.

The RESPA special information booklet contains some important points for the homebuyer to consider regarding the contract of sale, including the suggestion that the homebuyer may want to ask an attorney to review the proposed agreement.210 This section of the booklet is prefaced with the statement: "If you have obtained this booklet before you have signed a sales contract with the seller of the property, here are some important points to consider regarding the contract."211 The concluding paragraph tells the homebuyer that "once signed, the contract is binding on [him] and the seller."212 This information, when provided by the lender in accordance with the RESPA timetable, gives the homebuyer nothing more than hindsight and may well leave him thinking that he got a bad deal—an unhappy thought with which to begin the process of ownership of a new home. RESPA, then, is wholly inadequate to serve the second purpose of disclosure regulation: It does not provide the homebuyer with sufficient information in time for him to determine whether he should hire an attorney to negotiate the contract of sale on his behalf, including negotiation as to which party will bear any specific loan origination or settlement costs.

After the homebuyer has entered into the contract of sale, he generally has, under the agreement, a limited period within which he must obtain financing. If mortgage money is tight, his source of funds may be limited to a lending institution with which he has a relationship or (particularly if the new home is in a new locality) with which the real estate broker or builder has a relationship. If mortgage money is readily available, the homebuyer who shops among mortgage lenders for the best terms is likely to find—in addition to any differences in interest rate, loan-to-value ratio, and length of mortgage term—considerable variation in loan origination fees and settlement cost requirements. Frequently, these variations make it extremely difficult for the homebuyer to determine which lender's financing arrangements are the most favorable.

211. Id. at 5.
212. Id. at 7.
The RESPA special information booklet contains a section on comparing lender costs that illustrates how to convert front-end costs, such as loan origination and settlement costs, into the equivalent of interest over the life of the loan in order to determine which lender offers the best terms. Unfortunately, however, by the time the homebuyer receives this information under RESPA, he already has made an application for a loan and, in many localities, he has paid an application fee that typically ranges from $50 to $100 but may reach as high as $150. At this point, the homebuyer will not be eager to shop further, since any savings that could be realized would be reduced by the additional application fee.

Furthermore, when a homebuyer selects a particular lender, ordinarily he will be required to pay for settlement services rendered to the lender by a provider of services chosen by the lender. RESPA does not prohibit the common practice of lender selection of various settlement services providers, usually an attorney and a title insurance company.

When the lender requires a particular attorney and title insurance company, they represent the interest of the lender, not the interest of the homebuyer, even though the work done by them may be of some benefit to the homebuyer. The homebuyer, therefore, as a condition of the mortgage loan, pays the cost of the lender’s attorney and title insurance company. The lender does not, as is sometimes erroneously believed, require that the homebuyer employ a particular attorney or title insurance company to represent the homebuyer’s own interest. As a practical matter, however, once the lender selects its attorney and title insurance company, the lender has determined a large percentage of the homebuyer’s title related costs.

In a locality in which it is the custom for an attorney to examine and certify title to a title insurance company, the lender’s attorney ordinarily performs three title related services: title examination and certification, preparation of documents, and conduct of the settle-
The title insurance company, based on the attorney's certification, issues a title insurance policy insuring the lender's interest in the property. The lender charges the homebuyer for the lender's attorney's fee and the lender's title insurance premium. Yet, the homebuyer does not have any control over the amount of these costs once he has selected the lender. Since they do not have to compete for the homebuyer's business, the lender's attorney and title insurance company, have no incentive to reduce their fees.

In this situation, the homebuyer could not obtain any economic advantage by selecting his own attorney and title insurance company. If the homebuyer had his own attorney to represent his interests, the lender's attorney would nevertheless examine title, prepare documents, and conduct the settlement. The protection of the homebuyer's interest by his attorney would be limited to review of the work performed by the lender's attorney and attendance at the settlement. Since the presence of the homebuyer's attorney would not change the tasks to be performed by the lender's attorney, there would be no effect on the latter's fees. Notwithstanding the additional cost, it may, of course, be reasonable for the homebuyer to have his own attorney to protect his interest.217

If the homebuyer wants a title policy insuring his interest in the property as owner, he has no realistic choice but to obtain it from the title insurance company selected by the lender. Otherwise, an additional title search and examination would be required, unless the lender's attorney were willing to certify title to the buyer's title insurance company, based on the attorney's completed title examination. Even if he were willing to do so, the cost of a mortgagee's policy and an owner's policy issued at the same time by the same title insurance company is substantially less than the cost of the two policies issued separately by different title insurance companies.218

The homebuyer cannot obtain any significant reduction in title related costs unless he is able to select both the attorney who will examine and certify title and the title insurance company that will insure both the owner's and the lender's interest. RESPA does not give the homebuyer this right. Instead, the regulations thereunder expressly recognize the practice of lender specification of service providers. They require only that, as part of the good faith estimates, the lender identify the provider, estimate its costs, and state whether or not such provider has a business relationship with the lender.219

Moreover, the homebuyer is not entitled to even this limited

217. See HUD-VA Report, supra note 8, at 10-11, reprinted in 1972 House Hearings, supra note 8, at 746-47.
218. See id. at 9, 1972 House Hearings, supra note 8, at 745.
disclosure until after he has applied for the loan and thereby committed himself to paying the charges of the related provider. Even though the special information booklet and good faith estimates might be of some assistance to the homebuyer in shopping for settlement services providers other than those required by the lender, to the extent that the selection of a lender determines the providers to be used, such disclosure comes too late to make shopping worthwhile. This same criticism applies to the inadequate opportunity RESPA provides to the homebuyer to evaluate any recommendations he receives as to a mortgage lender or settlement services provider from the broker or builder. The homebuyer does not obtain the special information booklet and good faith estimates until he accepts the recommendations and applies for a loan.

RESPA is, therefore, inadequate to serve the third purpose of disclosure regulation: It does not facilitate comparison shopping by the homebuyer for a mortgage loan and only partially facilitates comparison shopping for other settlement service providers. Nor does it adequately facilitate evaluation of any mortgage lender or settlement service providers recommended by the real estate broker or builder or of settlement service providers required by the mortgage lender. RESPA should be amended to give the homebuyer the initial choice of settlement service providers without sacrificing the mortgage lender's legitimate interest in the security of its mortgage loan.229

The inadequacies of the special information booklet and the good faith estimates as the means of disclosure are attributable to the adoption of the concept of the federally related mortgage loan as the basis upon which to exercise federal power over mortgage settlement costs221 and the consequent selection of the lender as the appropriate participant in the settlement process to make the disclosures. Congress adopted the concept of the federally related mortgage loan to overcome objections to federal regulation of settlement costs by those who argued that the purchase of a home is a local transaction that cannot be constitutionally subjected to federal regulation. At the time RESPA was originally under consideration, this view found support in the language of the Court of Appeals for the Fourth Circuit in Goldfarb v. Virginia State Bar.222 Although that decision dealt specifically with attorneys' fees for title examination, the court discussed other aspects of the home purchase transaction as though each aspect could be analyzed separately for purposes of determining whether it constituted or had an effect upon interstate commerce.223

220. See text at pp. 445-49 infra.
221. See note 193 supra.
222. 497 F.2d 1 (4th Cir. 1974), rev'd, 421 U.S. 773 (1975); see text accompanying notes 58-69 supra.
223. For example, although the court conceded that a significant portion of the
With that background, selection of the lender as the party upon which to impose affirmative settlement cost disclosure obligations undoubtedly was considered to be the federal regulatory format best able to withstand any constitutional challenge. A large percentage of home mortgage lenders have one or more of the requisite federal connections enumerated in RESPA, so that making them subject to additional federal requirements must have seemed reasonable. As earlier discussed, however, selection of the lender as the party to make settlement cost disclosures inevitably meant that the disclosures would come too late in the settlement process to serve their purposes. Now that the decision of the United States Supreme Court in Goldfarb makes it clear that the settlement process must be treated as an integrated whole when determining the effect on interstate commerce of a single aspect of the process, RESPA should be amended to give the homebuyer the necessary estimated settlement cost disclosures before he becomes bound.

As the time for settlement approaches, the homebuyer has no further need for estimated settlement costs but must turn his attention to actual settlement costs. As the special information booklet warns: "Once you have obtained these estimates from the lender be aware that they are only estimates. The final costs may not be the same. Estimates are subject to changing market conditions, and fees may change . . . . Remember that the lender's estimate is not a guarantee." Yet, despite this recognition of the potential disparity between estimated settlement costs and actual settlement costs, RESPA makes no provision for disclosure to the homebuyer of all of the actual settlement costs at any time prior to settlement. The only presettlement disclosure of actual settlement costs to which the homebuyer is entitled is the right to inspect the Uniform Settlement Statement (HUD-1) on the business day immediately preceding the day of settlement. At that point the statement need be completed only to the extent of those costs known on such day to the person conducting the settlement.

Inspection of an incomplete settlement statement is of minimal utility to a homebuyer who must know the precise amount of money he will be required to pay on the following day. Even if the settlement statement were required to be completed for inspection on the busi-

---

226. See text at pp. 435-43 infra.
ness day immediately preceding settlement, the disclosure still would be inadequate. The good faith estimates are not required to include all settlement items that the homebuyer will be required to pay in cash; hence, even if the estimates were accurate, the total cash required at settlement still could be significantly in excess of the good faith estimates. Under such circumstances the buyer could have an insufficient opportunity to obtain the funds necessary to complete the transaction on time. This might cause the settlement to be postponed, with resulting inconvenience to all parties. RESPA is, therefore, inadequate to serve the fourth purpose of disclosure regulation: it does not provide the buyer, reasonably in advance of settlement, with accurate information as to the amount of actual settlement costs he will be required to pay at settlement, nor does it contain a mechanism that will facilitate the buyer's prompt completion of the transaction when the amount of actual settlement costs is significantly in excess of the amount of the estimated settlement costs.

Deciding whether RESPA serves the fifth purpose of settlement regulation—reduction of loan origination and settlement costs—requires consideration of provisions of RESPA in addition to the disclosure provisions. RESPA's disclosure provisions, as has been seen, do little to stimulate price competition that would exert downward pressure on loan origination and settlement costs. To the extent that high loan origination and settlement costs are the result of inefficient and noncompetitive practices by mortgage lenders and settlement service providers, RESPA fails to promote cost reduction. If disclosure were required before the homebuyer selects a lender, mortgage lenders and settlement service providers would have more incentive to compete by reducing their fees and charges.

The antikickback provision of RESPA is designed to eliminate the high costs resulting from loan origination and settlement charges that may be inflated in order to cover referral fees, kickbacks, rebates, commissions, and the like that are used as inducements to those firms and individuals who direct the placement of business.
Section 8 of RESPA prohibits, in connection with a federally related mortgage loan, the giving or accepting of anything of value for the referral of business and the giving or accepting of any part of any settlement services charge except for services actually performed. This provision prohibits practices that directly or indirectly, expressly or impliedly, have the effect of conferring a benefit of any kind on a person who, in connection with settlement of a federally related mortgage loan, refers business or performs either no services or services not commensurate with the benefit conferred. Furthermore, the conferring and receipt of a benefit is prohibited even if "does not result in an increase in the charge made for the settlement service by the payor" of the benefit.

Although RESPA probably has eliminated most of the more straightforward referral and unearned fee arrangements that existed previously and perhaps some of the indirect arrangements as well, it does not necessarily follow that homebuyers have benefitted from a commensurate reduction in charges. There is nothing in either the statute or the regulations to prevent a settlement service provider who previously received referral or unearned fees from another participant in the transaction from increasing his own fees to the buyer so that his income attributable to each settlement remains the same as it was prior to RESPA. If, for example, the custom is for the lawyer to examine a commercially prepared abstract of the title records and certify the state of the title to a title insurer, and prior to RESPA the title insurer paid the lawyer a commission of a portion of the premium for each title insurance policy initiated by him, following RESPA the lawyer may simply increase his fee for title examination by an amount equal to the commission formerly received.

There also is nothing in either the statute or the regulations requiring the title insurer to reduce its premium by the amount of the commission it paid prior to RESPA. If, following RESPA, the attorney increases his fee and the title insurer maintains its premium at the same rate, the homebuyer's total title related costs will have increased by the amount of commission previously paid, rather than decreased. Elimination of kickbacks and unearned fees, however desirable as a matter of public policy, cannot, in and of itself, lower settlement costs.

Commission ordinarily is the obligation of the seller. Presumably he believes that sellers would pass their savings on to buyers by lowering selling prices.

232. 12 U.S.C. § 2607 (1976). Violation of this section subjects a person to criminal penalties of a fine of up to $10,000 or up to a one year imprisonment, as well as civil liability for three times the amount paid or received plus costs and attorney's fees.


235. One form of referral arrangement that was common prior to RESPA was a
To the extent that high settlement costs had been attributable to excessive reserve deposit requirements imposed by mortgage lenders, RESPA has been effective in reducing such costs. The HUD-VA Report on Mortgage Settlement Costs revealed that there were substantial unexplained variations in mortgagee requirements for the prepayment of real estate taxes at settlement.\(^{236}\) In some localities, mortgage lenders were requiring homebuyers at settlement to deposit one year's property tax into the reserve account in addition to an initial deposit that, together with monthly payments into the reserve account, would enable the lender to pay the property tax when it became due. Under this system, the amount in the reserve account would never drop below one year's property tax. RESPA limits the cushion in the reserve account to no more than one-sixth of the estimated amount of yearly property tax.\(^{237}\) In some jurisdictions, therefore, RESPA has dramatically lowered the buyer's cash outlay at settlement by an amount equal to five-sixths of the yearly property tax.

RESPA is, therefore, adequate to serve the fifth purpose of settlement cost regulation in only one respect: it establishes a reasonable limitation on the initial deposits that the lender may require the homebuyer to put into reserve accounts at settlement. In other respects, however, RESPA is inadequate to reduce loan origination and settlement costs because it does not give mortgage lenders or settle-

---

\(^{236}\) HUD-VA REPORT, supra note 8, at 72, reprinted in 1972 House Hearings, supra note 8, at 806.

ment service providers sufficient incentive to compete on the basis of price. By the time a homebuyer has paid his loan application fee and thereby has become entitled to receive the special information booklet and the good faith estimates, it is too late for him to compare lenders' loan origination costs and requirements for settlement service providers. So long as the homebuyer does not have the right to select either the attorney who will examine and certify title and prepare documents or the title insurance company, he has no opportunity to reduce his major title related costs. Finally, prohibition of kickbacks and unearned fees will not cause providers who previously paid such fees to reduce their charges to the homebuyer unless there are economic reasons for them to do so. The RESPA scheme gives them no such incentive.

VII. RESPA REVISED: RECOMMENDATIONS FOR FURTHER CONGRESSIONAL ACTION

RESPA's inadequacies, particularly with respect to its disclosure provisions, require further congressional action if homebuyers are to realize any benefits. This section contains recommendations for legislation within the basic framework of RESPA that would serve, as RESPA does not, the five purposes of regulation of home mortgage settlement costs based upon the concept of disclosure. The recommendations would change RESPA in two ways. First, disclosure of loan origination and settlement costs would be required prior to the signing of the contract of sale. Second, lenders would be prohibited from selecting settlement service providers.

A. Disclosure of Estimated Settlement Costs

RESPA should be amended to impose upon the real estate broker the obligation to disclose all loan origination and settlement costs prior to the contract of sale. In the case of the sale by the builder of a new home, the builder should have this obligation. Only in the case of the sale of an existing home without the services of a real estate broker should the present scheme of postcontract disclosure by the mortgage lender continue to apply.

1. Real Estate Broker Precontract Disclosure

Approximately ninety percent of the sales of existing homes are made by real estate brokers. Since loan origination and settlement costs are as much an integral part of the purchase of a home as is the

238. See text at pp. 421-22 supra.
239. Kerin Interview, supra note 9 (figure based on local statistics submitted to N.A.R. by local boards of realtors).
purchase price, precontract disclosure of these costs properly is to be considered an integral part of the real estate broker's presentation of information to the homebuyer. It is reasonable to expect the real estate broker to be knowledgeable about mortgage loan terms and settlement costs in his community. Furthermore, of all the participants in the settlement process, the real estate broker is in the best position to make precontract disclosure of the nature of the settlement process and the accompanying loan origination and settlement costs.

As to disclosure of the nature of the settlement process, section 5(a) of RESPA should be amended to require HUD to distribute the special information booklet to all real estate brokers who are engaged in the sale of one-to-four family homes in addition to all lenders that make federally related mortgage loans. The real estate broker should be required to give the prospective homebuyer a copy of the special information booklet at their initial meeting. This is the most logical time for the prospective homebuyer to obtain information about the nature of the settlement process. After reading the booklet, the homebuyer would have some idea as to whether he wants to hire an attorney to represent him during the negotiation of the contract of sale or whether he wants to conduct negotiations on his own.

Prior to the time that the real estate broker accepts from the prospective homebuyer an offer to purchase a home, to be submitted to the seller, the real estate broker should be required to disclose all of the estimated loan origination and settlement costs that the prospective homebuyer would have to pay in connection with the purchase. This precontract disclosure should meet the following requirements:

(1) It should be made in a separate document;
(2) it should cover all loan origination and settlement costs, including prepaid items, payments into reserve accounts, and adjustments between buyer and seller; and,
(3) it should list actual interest rates and fees charged by named mortgage lenders and other named providers of settlement services doing business in the same locality as the real estate broker.

This precontract disclosure of estimated settlement costs should be made on the same settlement statement form now prescribed under section 4 of RESPA. This would enable a prospective home-
buyer to compare the initial costs of acquiring various homes, even if the homes were located in areas in which settlement service customs differ. It also would enable a homebuyer eventually to compare actual settlement costs with estimated settlement costs.

The precontract disclosure should cover all loan origination and settlement costs listed in section L, Settlement Charges, of the Uniform Settlement Statement (HUD-1), as well as all adjustments listed in section J for items paid by the seller in advance and for items unpaid by seller (adjustments between buyer and seller). Since the size of the downpayment is an important consideration, the disclosures made with respect to mortgage lenders should include the loan-to-value ratio at which each lender customarily makes home mortgage loans. Calculation of items required by the lender to be paid in advance, initial deposits into reserve accounts, and buyer-seller adjustments should be based on an estimated settlement date stated on the form.

It should not be burdensome for real estate brokers to make the disclosures outlined above. Local real estate brokers’ boards or associations could assist their members in compiling local information as to loan origination fees and other lender requirements, fees charged by various settlement service providers, and government charges. Once a real estate broker had this information, it would be a simple matter to prepare a basic precontract disclosure statement for each new listing. If the broker were a member of the local multiple listing service, this basic precontract disclosure statement could become an

buyer and should contain a statement that the homebuyer has received a copy of the special information booklet.

243. The precontract disclosure should not cover the real estate broker’s commission (line 700 of section L) unless it is the obligation of the buyer. It should cover lines 800 through 1400, which are: items payable in connection with the loan, such as loan origination fee, loan discount (points), appraisal fee, credit report, lender’s inspection fee, and mortgage insurance application fee; items required by the lender to be paid in advance, such as interest from settlement to first regular monthly payment, mortgage insurance premium, and hazard insurance premium; initial deposits into reserve accounts required by the lender for such things as hazard insurance, mortgage insurance, property taxes, and assessments; title charges, such as settlement fee, abstract or title search, title examination, title insurance, preparation of documents, and notary fees; government recording and transfer charges; and additional settlement charges, such as survey and pest inspection.

244. Factors in addition to loan-to-value ratio, loan origination fees, and rate of interest also are important to the homebuyer. These include length of the loan term and rate of amortization, both of which affect the size of the monthly payment. Disclosure of these items in the precontract disclosure statement would be too cumbersome since the lender may have various plans available. Instead, the portions of the special information booklet advising the homebuyer on the selection of a lender, Settlement Costs, supra note 195, at 5-6, and on the comparison of lender costs, id. at 29-30, should be revised to assist the homebuyer in evaluating the effect of these factors on the monthly payment.
integral part of the listing, available to all brokers who might sell the property. Prospective homebuyers could see this information along with the information about the property that traditionally is contained in the multiple listing statement. When the prospective homebuyer is prepared to make an offer to purchase a particular home, the selling broker could prepare the statutorily required precontract disclosure form using the information from the listing. The only calculations necessary would be for items that change in amount depending upon the date of settlement, such as deposits into reserve accounts and adjustments between buyer and seller.

Although disclosure of estimated settlement costs is crucial in order to enable a prospective homebuyer to determine whether he can afford the initial costs of acquiring a home, it is insufficient to enable him to comparison shop for a mortgage loan and settlement services on the best available terms. In addition to precontract disclosure of estimated settlement costs, therefore, RESPA should also require that real estate brokers furnish prospective homebuyers with information as to actual loan-to-value ratios, and interest rates and fees charged by named mortgage lenders and other named providers of settlement services doing business in the community. At least three mortgage lenders and three providers of each type of settlement service, whose fees are representative of the range of fees available in the community, should be required to be named. Additional mortgage lenders and providers could be named at the option of the real estate broker and should be required if the mortgage lender or provider furnished the real estate broker with a written request for a listing containing a description of the mortgage lender's or provider's services and fees. This recommendation would shift the responsibility for comparison shopping from the homebuyer, who, because of unfamiliarity with the community and with settlement customs is least able to shop effectively, to the real estate broker, who, because of his 'special knowledge of the community and of settlement customs, is best able to shop effectively.245

245. Section 15 of RESPA, 12 U.S.C. § 2613 (1976), requires the Secretary of HUD to prepare and include in the special information booklets statements of the range of costs for specific settlement services in selected housing market areas. In its interim report to Congress on the feasibility of preparing and including settlement cost range statements for all housing market areas in the special information booklets for such areas, HUD appears to have proceeded on the assumption that any range-of-cost information would not identify any actual settlement service providers whose fees comprised the range-of-costs. See INTERIM REPORT, supra note 72. HUD also assumed, as does section 15, that homebuyers would receive range information from lenders immediately upon application for a loan, although it recognized that other means of distribution, particularly distribution through real estate brokers, would be more efficacious. Id. at 21. HUD's range-of-costs demonstration program, as proposed in the Interim Report, id. at 26, is inadequate to provide comprehensive answers to all of the
It is as reasonable to require real estate brokers to disclose actual interest rates and fees charged by named mortgage lenders and settlement service providers as it is to require them to disclose estimated settlement costs, since both disclosures are based on the same information. In addition to the likelihood that local real estate brokers' boards or associations would assist their members in obtaining this information, it also is likely that providers of settlement services would be eager to furnish real estate brokers with information as to their services and fees so as to be assured of being brought to the attention of homebuyers. This would act as a check on brokers who otherwise would prefer listing only their favored providers despite the requirement that listings be representative of the available price range.

The only settlement service provider as to which there might be some problem in obtaining information is the attorney. Following the decision of the United States Supreme Court in Bates v. State Bar of Arizona, however, such information should now be available more readily than it previously has been. Attorneys, like other providers, now should be able to supply real estate brokers with an accurate estimate of their legal fees for settlement services performed in connection with a routine home purchase transaction.

Policy issues posed therein. Id. at 14. For example, in connection with the issue of what impact range data has on consumer attitudes and behavior, the Interim Report poses a series of questions designed in part to determine what types of information may help consumers to shop more effectively. Yet, the Interim Report never suggests disclosure of the information that would be most useful to the homebuyer—the identities of the providers whose services are available at specific prices within the disclosed range-of-costs. It seems apparent that homebuyers who have the names and prices of settlement service providers are more likely to comparison shop than are those who are given a price range and are told, in effect, to go see what they can find.

247. Prior to Bates, and the 1977 amendments to the Code of Professional Responsibility, an attorney who followed the recommendation that providers of settlement services submit their names, description of settlement services, and fees to real estate brokers for disclosure to homebuyers, might have faced disciplinary action on the ground that he had engaged in advertising. See ABA Code of Professional Responsibility EC 2-9, 2-10; DR 2-101, 2-102 (1976) (current version in August 1978 edition). In Bates, the Supreme Court struck down, on first amendment grounds, the total prohibition on attorney advertising, holding that a state may not prevent the publication of a truthful advertisement concerning the availability and terms of routine legal services. 433 U.S. at 384. Representation of the buyer in connection with the purchase of a single family home, including negotiation of the contract of sale, performance of title-related services customarily provided by attorneys in the community, and conduct of the settlement, may not be as uncomplicated as the services involved in Bates. Nevertheless, they may be described as sufficiently routine to permit an attorney to set a fee for such services and submit a written statement of the services and fee to a real estate broker for disclosure to homebuyers. Such "advertising," if specifically authorized by the proposed amendment to RESPA and defined by regulations
So long as it is difficult for homebuyers to comparison shop for mortgage lenders and settlement service providers because of untimely and inadequate disclosure of information about the nature and cost of loan origination and settlement services, and so long as mortgage lenders and settlement service providers can continue to rely on referrals of business by real estate brokers, even in the absence of the payment of referral fees, there will be no incentive for mortgage lenders and settlement service providers to compete on the basis of lower costs to the homebuyer. The proposed amendment to RESPA requiring real estate brokers to disclose actual loan origination and settlement service fees charged by named mortgage lenders and settlement service providers would not only facilitate comparison shopping, but also would make it difficult for the real estate broker to refer the homebuyer to a mortgage lender and to settlement service providers without regard to cost. The proposed amendment would thus provide an incentive for mortgage lenders and settlement service providers to compete on the basis of lower costs to the homebuyer.

2. **Builder Precontract Disclosure**

Although a few builders of new homes use the services of real estate brokers to sell their homes, most builders rely upon their own employees to sell their homes. Many builders of new homes pay all or a portion of their buyers' loan origination and title related costs, presumably including these costs in the selling price. Other builders do not pay any of these costs, so that their buyers pay the same loan origination and settlement costs that they would have to pay in the case of the purchase of an existing home. As part of the proposed revision of RESPA, whenever a builder of new homes uses the services of a real estate broker, the real estate broker would be subject to all of the disclosure obligations set forth above, except that no disclosure of providers would be required with respect to title related services, the costs of which were borne by the builder. In the case of the sale by the builder of a new home, RESPA should be amended...
to provide that the builder has the obligation to make these disclosures.250

Requiring builders who sell their homes without the services of a real estate broker to be responsible for obtaining information on loan origination and settlement costs and disclosing it to homebuyers would not be unreasonably burdensome. Builders who construct homes in a particular community undoubtedly familiarize themselves with the costs of obtaining home mortgage financing in that community as a matter of sound business planning. As to title related settlement costs, when the builder is considering whether or not to

250. There can be little doubt that Congress has the power under the commerce clause to impose this disclosure obligation on the builder. The construction of single family homes by a builder, even if such construction occurs wholly within a single state, is an integral part of, and substantially affects, interstate commerce.

With respect to the integral nature of the builder's activities with interstate commerce, the builder's position as the seller of a newly constructed house is, in many ways, analogous to that of the real estate broker, whose constitutional amenability to federal regulation has already been discussed. See text accompanying notes 70-91 supra. Just as an owner's decision to list an existing home for sale with a real estate broker sets the settlement process in motion, so a builder's decision to construct single family homes for sale by his employees sets that process in motion. The builder seeks prospective purchasers in many of the same ways as does the real estate broker. He may, for example, attempt to attract buyers from other states by advertising his houses for sale in newspapers and magazines that are circulated outside the state. Like the real estate broker, the builder's involvement in interstate commerce does not end when he has found a buyer. Frequently, the builder arranges for a particular lending institution to make mortgage loans to all purchasers from the builder, the funds for which may come from outside the state. The builder also may pay some or all the costs of title related services required by the lender, such as search, examination and assurance of title; preparation of documents; and conduct of the settlement. It would be artificial to separate the builder's activities from the interstate aspects of the home purchase transaction, just as it would be artificial to so separate the real estate broker's services, and just as it was held to be artificial in Goldfarb to so separate the attorney's services, 421 U.S. 773, 785 (1975); see text accompanying notes 38-83 supra.

The builder's activities, both before and after the contract of sale, also substantially affect interstate commerce. The health of the single family housing sector is an important factor in the health of the national economy. Even a builder whose construction activities take place within a single state uses materials supplied by various industries throughout the country. If the high initial costs of purchasing and financing a new single family home deter large numbers of potential homebuyers, the consequent decline in housing starts would affect the industries supplying construction materials nationwide. To the extent that high loan origination and settlement costs contribute to the high costs of acquiring a home, it is reasonable for Congress to enact legislation imposing disclosure obligations on builders for the purpose of lowering such costs. Such legislation would have a positive effect on interstate commerce by increasing the flow of construction-related materials in interstate trade. Cf. Katzenbach v. McClung, 379 U.S. 294 (1964) (application of federal civil rights legislation held constitutional under the commerce clause where racial discrimination in small restaurant with an intrastate clientele affected flow of food products in interstate commerce).
“pay” these buyer costs by including them in the price of the home, he would become aware of the identities of local settlement service providers and could easily determine their costs. If the builder decided to “pay” these costs, he would have no obligation to disclose the identities and fees of any settlement service providers. If, on the other hand, the builder decided that the buyer would have to bear these costs directly, it is likely that settlement service providers would be eager to furnish the builder with information about their services and fees so that homebuyers could learn their identities.

Disclosure of information by builders to homebuyers would be a simple matter. The builder could make the special information booklet and the form containing estimated settlement costs available to all prospective homebuyers, along with his promotional literature. Prior to the time that the builder and the homebuyer enter into the contract of sale, they both would be required to sign the precontract disclosure statement and, if the buyer is to pay title-related settlement costs, the builder would be required to furnish the buyer with the list of providers and their fees at the same time.

Precontract disclosure by the builder of loan origination and settlement costs in connection with the purchase of a newly constructed home is an important supplement to real estate broker precontract disclosure. It would enable prospective homebuyers to compare the initial costs of acquiring a new home as opposed to an existing home, as well as enable them to compare the purchase arrangements available from various builders. It also would strengthen the pro-competitive effect of precontract disclosure by ensuring that a substantial segment of the homebuying public has access to information about the identities and costs of mortgage lenders and settlement service providers.

3. Mortgage Lender Postcontract Disclosure

Under the proposed revision of RESPA, only the purchasers of existing homes who buy directly from the owners would not be entitled to precontract disclosure of loan origination and settlement costs. As a practical matter, such disclosure could not be made prior to the time of loan application. The present RESPA scheme of postcontract disclosure by the mortgage lender should be retained in order to provide such purchasers with information about loan origination and settlement costs.

The special information booklet and the disclosure of estimated settlement costs still would come too late for the homebuyer to be able to determine whether he could afford to buy a particular home with the amount of cash he had available initially. But if the pre-

251. See text accompanying notes 206-07 supra.
sent RESPA postcontract disclosure scheme supplemented a precontract disclosure system, the untimeliness would be less likely to harm the homebuyer as seriously as it does now. If the homebuyer previously had looked at other existing homes with a real estate broker, he already would have received a copy of the special information booklet and would have seen the basic estimated disclosure forms accompanying the various listings of available properties. He would, therefore, have obtained enough information to determine whether or not to hire an attorney and would have a general idea of loan origination and settlement costs for houses in his price range.

The mortgage lender would determine whether or not it was obligated to make postcontract disclosure by asking, on its loan application, whether a real estate broker was involved in the transaction. If so, the mortgage lender would have no further disclosure obligation. It should not have to determine whether the real estate broker's obligation under RESPA has been fulfilled, but should be entitled to so assume.

Postcontract disclosure by the mortgage lender should be strengthened by requiring the lender to make disclosures not now required under RESPA, but which would be required of real estate brokers and builders under the proposed precontract disclosure amendments. To enable the homebuyer to comparison shop for settlement service providers effectively, the mortgage lender also should have the same obligation as the real estate broker and the builder to disclose actual fees charged by named providers of settlement services in the community. The mortgage lender should not, however, be required to disclose interest rates and loan origination fees charged by other mortgage lenders. Such disclosure would be of little value because the homebuyer, by making a mortgage loan application, already would have selected a lender. Failure to disclose interest rates and loan origination fees would not be a prejudicial to a homebuyer who purchased an existing home directly from the owner as it would be in the case of a homebuyer who utilized the services of a real estate broker, since the former is likely to have done some comparison shopping for a loan prior to selecting a mortgage lender, whereas the latter might well have been steered to the lender by a real estate broker.

B. DISCLOSURE AND PAYMENT OF ACTUAL SETTLEMENT COSTS

Ultimately, the value to the homebuyer of disclosure of estimated settlement costs depends on whether or not the estimates bear

---

252. See text at p. 426 supra.
253. See text accompanying notes 240-45, 249-50 supra.
254. See text at pp. 443-45 infra.
a reasonable relation to actual settlement costs. If RESPA were amended, as suggested, to include in the disclosure of estimated settlement costs all items that the homebuyer would have to pay in cash at settlement, disclosure of estimated settlement costs would be much more useful to the homebuyer for financial planning purposes than it is now. But, as settlement approaches, even the more complete estimates proposed above should be superseded by a statement of the actual amount that the homebuyer will need in order to complete the transaction. The homebuyer should be given this information sufficiently in advance of settlement to enable him to make the necessary financial arrangements. If the actual settlement costs are reasonably related to the estimated settlement costs, one week should be adequate for this purpose. If, however, actual costs are significantly in excess of estimated settlement costs, the homebuyer, who should be entitled to rely on the estimated costs in his financial planning, might not be able to raise the difference within that time. Under those circumstances, neither the homebuyer nor the seller should have his expectations disrupted by the postponement of the settlement.

RESPA should, therefore, be amended to provide that the person conducting the settlement shall make disclosure of actual settlement costs not less than one week prior to the date of settlement. To facilitate comparison of actual settlement costs with estimated settlement costs, both should be disclosed on the same form. If actual settlement costs, including deposits into reserve accounts, prepaid items, and buyer-seller adjustments, exceed estimated settlement costs by more than ten percent, the person responsible for making the disclosure of estimated settlement costs—the real estate broker, the builder, or the mortgage lender—should be required under RESPA to advance to the homebuyer the excess over ten percent in order to enable him to complete the transaction as planned. The amount of the advance should become payable by the homebuyer thirty days after settlement.

In the event the person conducting the settlement is unable to obtain this information on time, the homebuyer could be given the

255. A similar situation arises in the estimation of tariff charges by a motor common carrier engaged in the transportation of household goods. The actual charges for the transportation of such goods are based on the actual weight of the goods. At the request of the shipper of the goods, the carrier is required to give the shipper an estimate of the charges for proposed services. Ordinarily, the carrier requires payment in full of actual charges upon delivery of the goods. Under a regulation promulgated by the Interstate Commerce Commission, however, whenever the total actual charges exceed the estimate of charges made by the carrier by more than ten percent, the carrier must, upon request of the shipper, relinquish possession of the goods upon payment of the amount of the estimated charges plus ten percent. See 49 C.F.R. § 1056.8(b) (1977).
option of waiving his right to timely disclosure of actual costs or postponing the settlement. The statute should, however, prohibit waiver of the right to the advance of excess settlement costs. So long as the homebuyer could not be required to pay at settlement an amount in excess of ten percent over the estimated settlement costs, he would not be prejudiced by waiving his right to timely disclosure of actual costs.

The proposed compulsory advance of excess settlement costs is designed to serve two important purposes: (1) to enable the homebuyer to complete the transaction on time and (2) to encourage accuracy by the persons responsible for making disclosure of estimated settlement costs.

Timely settlement of the purchase of a home is important to the buyer as well as other persons. If, as is often the case, the buyer of an existing home also has sold his present home, postponement of the buyer's settlement could disrupt not only the buyer's plans, but also the plans of his seller and his buyer. Since settlements often are timed to coincide with commencement of a new job or a new school term, even a relatively short delay can cause serious inconvenience. A homebuyer who has relied on the estimated settlement costs in his financial planning should not have to suffer this inconvenience when the actual costs exceed the estimated costs by more than ten percent.

This proposal would be an effective means of assuring that cost estimates are kept accurate and current. To avoid having to make an advance, the persons responsible for making the disclosure would be careful not to underestimate the settlement costs. Overestimates also would be discouraged because too high an estimate might deter a prospective homebuyer from purchasing a home, even though he actually could afford it with the initial amount of cash he had available. The incentive for accuracy that would result from the tension between the effects of underestimation and the effects of overestimation should make unnecessary any other means of enforcing the proposed precontract disclosure requirements.

C. Restrictions on Selection by Mortgage Lenders of Settlement Service Providers

Many settlement services, such as title search, examination and assurance, preparation of documents, and the conduct of the settlement, whether in person or by the use of an escrow, are or could be performed for the benefit of all three parties to the transaction—the buyer, the seller, and the lender. To the extent that each of these settlement services furthers the interest of the lender in assuring the validity of its loan and mortgage or deed of trust, it is appropriate for the lender to be concerned about the integrity and competence of the providers of these services.
The way in which lenders act upon this concern, however, increases the buyer's settlement costs without any corresponding increase in the protection afforded to the lender. Lenders, as a condition of making the mortgage loan, usually require that their attorney: search and examine the title; certify it to the title insurance company; prepare the deed, note or bond, and mortgage or deed of trust; and conduct the settlement. In addition, they require that a title insurance company selected by the lender insure the lender's interest in the property. These lenders then charge the homebuyer for the fees of the attorney and title insurance company selected by the lender to represent the lender's interest.256

As noted earlier, once the lender has selected an attorney and a title insurance company, most of the homebuyer's title related settlement costs have been determined.257 Thus, legislation requiring disclosure of the names and fees of local mortgage lenders and settlement service providers would be of limited use so long as lenders were permitted to condition their mortgage loans on the above described requirements. Comparison shopping effectively would be limited to the selection of a lender. Attorneys and title insurance companies who rely on a flow of business resulting from lender requirements imposed without regard to cost would continue to have little incentive to compete on the basis of price. If settlement cost regulation based upon the concept of disclosure is to be more fully effective in meeting the objective of lowering settlement costs, it is necessary to impose some restrictions on the selection of settlement service providers by the mortgage lender.

RESPA should be amended to provide that the buyer has the right to select the settlement service providers that will perform the following functions: title search, examination and assurance; preparation of documents; and the conduct of the settlement, whether in person or by the use of an escrow. Only one exception should be recognized to the buyer's right of selection: in those communities in which title assurance consists of the attorney's written opinion certifying the state of the title, and that opinion is not supplemented by title insurance, the lender should have the right to select the attorney who will certify the state of the title to it. To protect the lender's interest in the state of the title when title assurance is provided by a policy of title insurance, the buyer's or seller's selection of a title insurance company should be limited to a company that is on the approved lists of the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac).258 Protection of the lender's interest in the

257. See text accompanying notes 210-13 supra.
258. FHLMC, Seller's Guides 9 (1977) (FHA-VA Mortgages § 3.202); id. at 125
validity of its loan and mortgage or deed of trust should be effected by permitting the lender to select an attorney to review the documents prepared by the buyer's attorney and to charge this attorney's fee to the buyer.

The proposed amendment would affect three types of settlement services providers: title insurance companies, attorneys, and escrow companies. 259

An analysis of the effect of the proposed amendment on title insurance companies requires distinguishing between title insurance companies that issue policies based upon a title search and examination conducted by their own employees and title insurance companies that issue policies based upon an attorney's written certification of title to the title insurance company. 260

As part of the disclosure of named settlement service providers required to be made by the real estate broker, builder, or lender, the buyer would be given a list of local title insurance companies and statements concerning their fees for title insurance, whether an attorney's opinion of title is required, and whether the insurance company was approved by Freddie Mac. If the title insurance company used its own employees to search and examine titles, the buyer would simply select an approved company to insure his ownership interest in the property. The lender would then be required to use the same title insurance company to insure its interest in the property. The buyer would thus be able to select the approved title insurance company that offered the lowest price. 261

If the title insurance company relied on written opinions of title by attorneys, the situation would be somewhat more complex. Such a title insurance company should have the right to refuse to issue a policy of title insurance based upon an opinion of title from an attorney who is unacceptable to it. There might, therefore, be some possibility that title insurance companies, by refusing to accept opinions from certain attorneys, would be able to restrict buyers in their choice

---

259. The proposed amendment might also affect an abstracting company if it is customary in its locality for buyers or sellers to deal directly with such companies to obtain an abstract of title. Ordinarily, however, the settlement service provider that examines title obtains the abstract of title from the abstracting company.

260. In some states, all title insurance companies fall into the latter group because title examination is considered the practice of law and may be done only by an attorney. See, e.g., Virginia State Bar Comm. on the Unauthorized Practice of Law and Judicial Ethics, Opinions, No. 17, at 239 (1965), cited in 421 U.S. at 775 n.1.

261. It would be unnecessary for the lender's attorney to review the title search, examination, and certification to the title insurance company because once the title insurance company issued a title insurance policy, the lender's interest in the title would be protected. The lender's attorney could, of course, attend the settlement conducted by the buyer's attorney.
of attorneys to examine title. But a title insurance company that would be unable to rely on a flow of business based on lender selection of the title insurer might be hesitant to reject an attorney, since a buyer whose attorney was disapproved could select another title insurance company. As a result, title insurance companies would have little incentive to be overly restrictive in their acceptance of attorneys.

The attorneys who would be most affected by the proposed amendment would be those who now act as attorneys for lenders and who, in that capacity, search and examine title, render title opinions to title insurance companies, prepare documents, and conduct settlements, since the buyer would have the right to select the attorney to perform these functions. Attorneys who participated in the settlement process only in the capacity of attorney for the lender would, therefore, be limited to reviewing work performed by buyers' attorneys.262

If, after RESPA's amendment as proposed, an attorney who formerly had performed settlement services on behalf of the lender desired to perform those same settlement services, he would have to be selected by a buyer for those purposes. To bring himself to the attention of buyers, so that they would select him, he could, under the amended RESPA disclosure scheme, give written notice to real estate brokers, builders, and mortgage lenders in his community of his name, the settlement services offered by him, and his fees for such services. This information then would be given to buyers as part of their precontract disclosure. Unless the attorney's fees were competitive, however, a buyer would have no reason to select him over any other attorney.263

262. Under the proposed amendment, the lender would be permitted to charge this attorney's fee to the buyer as a cost of the settlement. As part of the required disclosure of named mortgage lenders, the real estate broker or builder must give the buyer a statement as to each lender's loan origination fees, including the fee it would charge to the buyer for its attorney's review of documents prepared by the buyer's attorney. Since the necessary documents—deed, note or bond, and mortgage or deed of trust—ordinarily are standard printed forms, they are not difficult to prepare. The attorney need only insert dates, names of the parties, legal descriptions of the property, and terms of the loan. In addition, the forms of note or bond and mortgage or deed of trust often are those adopted by the mortgage lender. Review by the lender's attorney should, therefore, be a simple matter for which only a nominal fee should be charged.

263. Currently, many homebuyers are willing to permit the lender's attorney to represent their interest as well. This is permissible so long as the attorney has complied with the provisions of the Code of Professional Responsibility concerning dual representation. ABA Code of Professional Responsibility Canon 5; EC 5-14 to 5-16, 5-19; DR 5-105 (as amended 1978). Similarly, under the proposed revision of RESPA, many lenders might well be willing to accept the buyer's attorney as their attorney and to make no additional charge for review of documents prepared by an attorney "approved" by the lender. This information could be made available to buyers as part
Escrow companies would be affected by the proposed amendment in those communities in which it is customary for a separate company to handle the settlement, usually without a meeting of the parties. The escrow company receives instructions from the buyer, the seller, and the lender as to what documents and sums of money to collect from and distribute to each party. When all of the documents and monies have been collected, the escrow company records the deed in the name of the buyer and makes the necessary distributions in settlement of the transaction. Escrow companies may be formed by real estate brokers, mortgage lenders, attorneys, or title insurance companies to handle, for a separate fee, settlements of home purchase transactions in which their creators otherwise are involved as the providers of the mortgage loan or other settlement services. To the extent that any of these participants in the settlement process now requires use of its "captive" escrow company, the buyer is unable to obtain the lowest price for this service. The proposed amendment would give the buyer this freedom of choice.

VIII. EVALUATION OF DISCLOSURE PROPOSALS

A. ADVANTAGES OF DISCLOSURE PROPOSALS

Of the five purposes to be served by requiring disclosure of home mortgage settlement costs, the proposed amendments to RESPA would directly serve the first four. Disclosure of the identities of and fees charged by local mortgage lenders and settlement service providers has the potential for serving the fifth purpose—the reduction of loan origination and settlement costs—to the extent that high costs of their precontract disclosure. Under such circumstances, buyers would have an incentive to choose an attorney on the lender's "approved" list whenever that attorney's fee was less than the combined fees of "a non-approved" attorney and the lender's reviewing attorney. A buyer who did not have an attorney to represent him at the stages of negotiating and drafting the contract of sale also might choose an attorney on the lender's approved list simply because he did not know any of the attorneys who were disclosed as having lower fees. Although one can sympathize with a homebuyer in this situation, he is in no worse position than he would have been if he did not know which attorneys were approved by the lender, since he does have an opportunity to make a choice based on cost. The solution to the homebuyer's problem is to make him more aware of the availability of legal services than can be done simply by the proposed RESPA disclosure. Perhaps the decision in Bates v. State Bar of Arizona, 433 U.S. 350 (1977), will cause attorneys to make more information available to the public about their services than they have done in the past. See note 247 supra.

264. Escrow practices and charges vary greatly throughout the country. In the study made by HUD and VA, fewer than five percent of the cases along the eastern seaboard reported escrow fees, but in the southwest and far west over seventy percent of the cases showed a separate escrow fee. HUD-VA Report, supra note 8, at 12, reprinted in 1972 House Hearings, supra note 8, at 748.

265. See text at pp. 421-22 supra.
are the result of inefficient and noncompetitive practices.

Such disclosure may have less of an effect on loan origination costs than on settlement costs because there may be less potential for effective competition among mortgage lenders than among settlement service providers. During periods of tight money it seems unlikely that disclosure of mortgage interest rates and loan origination fees would induce lenders to compete on the basis of price. During periods when home mortgage money is more readily available, however, such disclosure would make it more difficult for real estate brokers and builders to steer homebuyers to particular lenders without regard to price. At least during these latter periods, if mortgage lenders could not rely on the patronage of borrowers referred to them and if, by notifying the real estate brokers and builders in their primary lending area of their interest rates and loan origination fees they could have this information brought to the attention of homebuyers in that area, they would have an incentive to engage in price competition.

As to title related settlement costs, there is no inherent structural reason analogous to the periodic shortages of home mortgage money that occur in the home mortgage lending market that would prevent the various settlement services markets from becoming more competitive. Settlement service providers, unlike home mortgage lenders during periods of tight money, do not need to turn away potential customers because of excess demand for services. On the contrary, during periods of tight money, when fewer home mortgages than usual are made, settlement service providers should be particularly eager to attract what limited business is available. Settlement service providers no longer may compete for such business by offering inducements to real estate brokers and others for the referral of settlement service business. Under the proposed amendment to RESPA, attorneys and title insurance companies would not be able to rely on business based on the lender’s requirements that a specific attorney examine title and that a specific title insurance company insure title.

Finally, settlement service providers no longer would be able to rely on the ignorance of homebuyers about the nature of the settlement process and the identities of and fees charged by various settlement service providers, which ignorance otherwise would cause homebuyers to accept unquestioningly the recommendations of providers made by real estate brokers and builders. Under such circumstances, the climate for price competition among settlement service providers should be improved. Settlement service providers should be eager to inform real estate brokers, builders, and mortgage lenders of their services and fees in order to assure that this information would be brought to the attention of homebuyers.

Any reduction in settlement costs by virtue of increased competition among settlement service providers would inure directly to the
homebuyer, since he would pay such costs directly to the providers. The result under this system, therefore, would more probably be beneficial to the homebuyer than would be the result under lender pay. Under that proposal, any reduction in settlement costs would inure first to the mortgage lender, which might or might not pass the savings through to the homebuyer.

In addition to creating conditions under which settlement service providers would be encouraged to engage in price competition, the proposed amendments to RESPA also should encourage real estate brokers and builders to support efforts to reduce settlement costs. Real estate brokers and builders now have no incentive to support such efforts because the homebuyer does not learn about the magnitude of the required loan origination and settlement costs until after he is bound under the contract of sale. If real estate brokers and builders were required to disclose the amounts of all loan origination and settlement costs at the precontract stage, the existence of high front-end costs would be likely to make it more difficult than it now is to persuade a prospective homebuyer to enter into a contract of sale. Under such circumstances, it would be in the interests of real estate brokers and builders to support efforts to lower these costs.

266. Such efforts might include attempts to reduce title search costs by modernizing local recording systems or attempts to eliminate real estate transfer taxes. The real estate transfer tax ordinarily is a percentage of the price of the property assessed against the buyer. In some localities, it may be the largest settlement cost paid by the buyer, adding hundreds of dollars to the amount of cash required at settlement. See, e.g., Del. Code Ann. tit. 30, § 5402 (1974) (two percent apportioned equally between grantor and grantee); Md. Ann. Code art. 81, § 278A (Supp. 1978) (.65% state transfer tax exclusive of local transfer taxes, which may be as high as 1.5% such as the tax imposed by Baltimore City; see Baltimore City Code, art. 28, § 68 (1976), cited in VII Martindale-Hubbell Law Directory 1126 (1979)); Pa. Stat. Ann. tit. 72, § 3285 (1964) (one percent state transfer tax exclusive of local taxes, which generally are also one percent). For a discussion of the Pennsylvania realty transfer tax, see Ominsky, Adventures in the World of the Realty Transfer Tax—The Pennsylvania Experience, 44 Temple L.Q. 73 (1970).

Prior to January 1, 1969, the federal government imposed a Documentary Stamp Tax on transfers of real property at the rate of $.55 for each $500 of property value. Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, § 401 (b), 79 Stat. 148 (1965) (repealed 1968). Thereafter many states adopted a similar tax. The real estate transfer tax, in some localities, may be the largest settlement cost paid by the buyer, adding hundreds or even over a thousand dollars to the amount of cash required at settlement.
substance of transactions. According to these commentators, proponents of disclosure regulation assume that such regulation will, among other things, cause consumers to comparison shop for goods or services so that sellers will be forced to compete concerning the disclosed aspects of the transaction. Such assumptions are wrong, the commentators say, because consumers do not learn the disclosed information or, if they do, they do not use it in making their purchase decisions. The bulk of this criticism has been in the context of truth-in-lending, but the value of disclosure also has been questioned in the context of settlement cost regulation.

With respect to truth-in-lending, Professor Whitford's comprehensive article evaluates the criticisms of disclosure regulation and discusses "ways in which disclosure regulation might be formulated so as to fulfill its potentially achievable purposes better than it generally has in the past." An important aspect of Whitford's article is his theory that the success of precontract disclosure regulation should not necessarily be determined by whether, without further prompting, consumers actually use the disclosed information. According to Whitford, precontract disclosure regulation is not based so much on a prediction that consumers would use the disclosed information in making their purchasing decisions as on the belief that consumers should make use of the disclosed information, whether or not they naturally are inclined to do so. On the assumption that it is possible to persuade consumers to act in ways other than they would absent the persuasion, the task of the policymakers is to formulate precontract disclosure regulation so as to have persuasive impact, rather than to formulate it as though consumers would search for and use the disclosed information on their own.

Whitford notes, however, that it is possible that disclosure regulation providing for disclosure in the written contract or in a similarly inadequate manner has little impact on shopping behavior, not because consumers do not want the disclosed information but because


269. Id. See also note 267 supra.

270. 1975 House Hearings, supra note 46, at 374-75, 377 (testimony of Dale Whitman); 1975 Senate Hearings, supra note 46, at 1-2 (opening remarks by Sen. Proxmire), 232 (testimony of Dale Whitman); Berry, supra note 4, at 2, 11.

271. Whitford, supra note 268.

272. Id. at 404.

273. Id. at 423-27, 435-40.
the costs to them of discovering that information exceed the value to them of the information. On this assumption, if disclosure regulation allowed consumers to obtain and use the information at little cost to themselves, it would have substantial impact on shopping behavior because it would make available to consumers information that they want and would, therefore, use without further persuasion.\footnote{274}

Professor Whitford's analysis provides a useful framework within which to consider the potential effect on the home mortgage and settlement service markets of loan origination and settlement cost regulation based upon the concept of disclosure. When the disclosures that would be required under the proposed amendments to RESPA are compared with the disclosures required under truth-in-lending, it is apparent that the proposed RESPA amendments would avoid many of the weaknesses of truth-in-lending.

The basic strategy that Professor Whitford proposes for enhancing the persuasive impact of seller disclosure is to make the manner and timing of disclosure such that it is as unlikely as possible that consumers will reach purchase decisions without having the disclosed information brought to their attention.\footnote{275} The same basic strategy would, of course, also apply if the disclosed information were information that consumers themselves wanted rather than information that consumers would have to be persuaded to use. In the latter case, if only a few consumers previously had used such information because it was disclosed in an inconvenient manner that made its discovery and use difficult and time consuming, many more consumers could be expected to use such information if it were more conveniently disclosed, even without any persuasion.

The information that would be required to be disclosed under the proposed amendments to RESPA is more likely to be information that consumers want than is the information now required to be disclosed under truth-in-lending. The basic truth-in-lending disclosures required in the case of the purchase of a consumer item on credit are the total amount of the finance charge and the finance charge expressed as an annual percentage rate (APR).\footnote{276} Studies have shown, however, that consumers are much more concerned about the size of the downpayment and monthly payments than they are about interest rates.\footnote{277} The proposed RESPA disclosure of the identities of

\footnote{274} Id. at 437 n.123. 
\footnote{275} Id. at 442. 
and fees charged by mortgage lenders and settlement service providers would be analogous to disclosure of the downpayment, since these fees must be paid in cash at settlement.\textsuperscript{278} Furthermore, under the proposed RESPA disclosure of the identities of and fees charged by mortgage lenders, there would be no cost to homebuyers, in terms of shopping time and effort, of obtaining the disclosed information prior to making their purchase decisions. More homebuyers would, therefore, be likely to use this information.

The identities of and fees charged by mortgage lenders and settlement service providers also is information that homebuyers should have before reaching their purchase decisions. If some homebuyers do have to be persuaded to use this information, the special information booklet is a form of disclosure that specifically is designed to have persuasive impact. Since under the proposed RESPA amendments real estate brokers and builders would give prospective homebuyers the special information booklet at their first meeting, and since prior to entering into the contract of sale both the homebuyer and the real estate broker or builder would have to sign a disclosure form that included a confirmation of receipt of the special information booklet, it is extremely unlikely that most homebuyers would reach purchase decisions without first having been given an opportunity to learn fundamentals of effective homebuying.\textsuperscript{279} Truth-in-lending disclosures, by contrast, contain nothing designed to educate consumers as to the most advantageous use of credit.

The manner and timing of the truth-in-lending disclosures also contribute to the relative ineffectiveness of truth-in-lending in encouraging consumers to comparison shop for credit. Typically, truth-in-lending disclosures are made in the contract to be signed by the consumer and the consumer first sees this contract when he is told to sign it in order to complete the transaction. This manner and timing of disclosure is inadequate for three reasons: (1) it is unlikely that the disclosed information will be called to the consumer’s attention; (2) since the consumer has made his purchase decision, psychologically he feels committed to buy and is unlikely to be influenced by the disclosed information; and (3) even if he might be inclined to postpone buying in order to comparison shop, the time and effort involved might be disproportionate to any potential savings.

\textsuperscript{278} In selecting a home mortgage lender, a homebuyer also might be more interested in loan-to-value ratio than in interest rate or loan origination fees.

\textsuperscript{279} Only homebuyers who purchased existing homes directly from their owners would not receive precontract disclosure. See text accompanying notes 251-54 supra. Even they, however, would receive disclosure of the identities of and fees charged by settlement service providers from the lender before purchasing settlement services from such providers.
The proposed RESPA disclosures are designed to avoid these inadequacies. The disclosed information would be called specifically to the prospective homebuyer's attention because disclosure of estimated settlement costs and of the services and fees of named mortgage lenders and settlement service providers would be made in a separate document signed by both the person making the disclosures and the prospective homebuyer.

As to whether the homebuyer already would have, in effect, made his purchase decision and feel committed to buy at the time disclosure is made, it is necessary to separate the decision to purchase the home from the decisions to seek financing from a specific mortgage lender and settlement services from specific settlement service providers. In the case of the decision to purchase the home, the relevant disclosure is the disclosure of estimated loan origination and settlement costs. It is likely that the homebuyer would have received this information prior to having made his purchase decision. Under the proposed revision of RESPA, loan origination and settlement cost information easily could be incorporated into the listings for existing homes and into the promotional literature for new homes. Furthermore, whenever the disclosures are required to be made by a real estate broker, they would be made before the prospective homebuyer submitted an offer to the seller. If the prospective homebuyer decided that, based upon the disclosure of estimated loan origination and settlement costs, he could not afford the particular home with the amount of cash he had available, he would not feel psychologically committed to the seller to make the offer because he would have had no prior direct dealings with the seller. There might, however, be some of this pressure when the disclosures were required to be made by the builder, with whom the prospective homebuyer had been dealing directly, although inclusion of the estimated loan origination and settlement costs in the builder's promotional literature would alleviate this problem.

In the case of the decisions to seek financing from a specific mortgage lender and settlement services from specific settlement service providers, the relevant disclosure is the disclosure of the services and fees of named mortgage lenders and settlement service providers. Since the prospective homebuyer would receive this information prior to entering into the contract of sale, he would not yet have dealt with any mortgage lenders or settlement service providers. He would not, therefore, feel psychologically committed to a particular lender or to particular settlement service providers before obtaining information about their fees.

Based on the foregoing, traditional criticisms of disclosure regu-
lation, most of which have been made in the context of truth-in-lending, do not provide a sound basis on which to judge the proposed revisions to RESPA.

IX. CONCLUSION

Congress enacted RESPA because it found 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. More than four years and one modification later, however, prospective homebuyers still do not have adequate information about the nature and costs of the settlement process at the time they need it most—before they obligate themselves under a contract to purchase a home. Although the prohibition of kickbacks and unearned fees may have protected homebuyers from unnecessarily high settlement charges caused by these abusive practices, homebuyers still must pay unnecessarily high charges caused by the noncompetitive nature of the settlement services industry.

The amendments to RESPA proposed in this Article would ensure that the vast majority of homebuyers, those who purchase new or existing homes with the assistance of a real estate broker and those who purchase newly constructed homes directly from the builder, would have information about the settlement process and all loan origination and settlement costs prior to becoming legally bound to purchase a home. To the extent that high loan origination and settlement costs are the result of inefficient and noncompetitive practices by mortgage lenders and settlement service providers, the proposed amendments would put an end to one of the most anticompetitive of these practices, the selection by the mortgage lender of the settlement services providers to search, examine, and insure title; prepare loan and title documents; and conduct the settlement. By shifting the burden of comparison shopping from the homebuyer to the persons who would make disclosure and by requiring those persons to identify local mortgage lenders and settlement service providers together with their fees, the proposed amendments would give homebuyers the information they want and need in order to obtain home mortgage loans and settlement services at the lowest possible cost.