

9. Appendix E is removed and Appendix F is redesignated as Appendix E.

Dated: May 31, 1996.

Nicolas P. Retsinas,  
*Assistant Secretary for Housing-Federal  
Housing Commissioner.*

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## 24 CFR Part 3500

[Docket No. FR-3638-N-03]

### Office of the Assistant Secretary for Housing-Federal Housing Commissioner; Real Estate Settlement Procedures Act (RESPA); Statement of Policy 1996-1, Regarding Computer Loan Origination Systems (CLOs)

**AGENCY:** Office of the Assistant  
Secretary for Housing-Federal Housing  
Commissioner, HUD.

**ACTION:** Statement of Policy 1996-1:  
Computer Loan Origination Systems  
(CLOs).

**SUMMARY:** This Statement of Policy sets forth the Department's interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) and its implementing regulations with regard to the applicability of RESPA to payments for services from certain computer systems, frequently called CLOs, used by settlement service providers in connection with the origination of mortgage loans or the provision of other settlement services covered by RESPA. This statement explains the statutory and regulatory framework for HUD's treatment of payments to CLOs.

In reading this policy statement, the reader should be aware that HUD's RESPA rule was recently streamlined through a separate rulemaking. 61 FR 13232 (Mar. 26, 1996). This streamlining caused several provisions of the RESPA rule to be renumbered. Except as is otherwise indicated in the context of the policy statement, this policy statement refers to provisions by their current section number, incorporating all revisions to date as a result of the streamlining and today's rulemaking, published elsewhere in the Federal Register.

**FOR FURTHER INFORMATION CONTACT:** David Williamson, Director, Office of Consumer and Regulatory Affairs, Room 5241, telephone (202) 708-4560; or, for legal questions, Kenneth Markison, Assistant General Counsel for GSE/RESPA, or Grant E. Mitchell, Senior Attorney for RESPA, Room 9262, telephone (202) 708-1550. (The telephone numbers are not toll-free.) For

hearing- and speech-impaired persons, this number may be accessed via TTY (text telephone) by calling the Federal Information Relay Service at 1-800-877-8339. The address for the above-listed persons is: Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410.

#### SUPPLEMENTARY INFORMATION:

Individuals and firms have developed and are developing various systems that employ computer technology to assist consumers in finding a lender, selecting a mortgage product, originating a mortgage, or choosing among other settlement service providers and products. These systems are sometimes called computer loan origination systems (hereafter "CLOs"), although other terminology may be used, such as computer loan information systems. These systems differ in the way they interact with consumers, in the way they collect and display information on mortgage options, in the range of choices of products and services they provide to consumers, and in the extent to which they share work with other providers in the settlement service process. HUD expects product diversity to increase as technology evolves and new telecommunication options become available.

The following exemption was set forth in the November 2, 1992 final rule, effective December 2, 1992: Section 8 of RESPA does not prohibit \* \* \* any payment by a borrower for computer loan origination services, so long as the disclosure set forth in Appendix E of this part is provided to the borrower. 24 CFR 3500.14(g)(2)(iii).

This exemption from Section 8 was for "any payment by a borrower for computer loan origination services," as long as certain disclosures were provided. This rule did not address payments made by lenders, thus leaving such payments subject to Section 8 scrutiny. Although the term "CLO exemption" is frequently used, including in the preamble of the 1992 final rule, the exemption was not for the CLO itself, but only for payments made for CLO services by borrowers. The 1992 final rule did not speak to other issues; notably it did not define a CLO or explain how RESPA applies to payments by lenders to CLOs for CLO services. The November 2, 1992 rule also withdrew all previous informal legal opinions, including those stating the Department's views on various CLO issues.

In response to numerous expressions of concern about the new exemption and other aspects of the revised regulations, HUD requested public

comments in a Federal Register Notice on July 6, 1993, and held public hearings on August 6, 1993.

On July 21, 1994, HUD issued proposed regulations that would repeal the general CLO exemption for borrower payments and, in its place, establish an exemption for borrower payments to certain "qualified CLOs", that is, CLOs having characteristics that HUD considered beneficial to consumers. The proposed exemption would apply only to payments by borrowers, but HUD did solicit public comments on whether to provide a similar exemption for payments by lenders to qualified CLOs. Under the proposed rule, payments by borrowers to CLO systems that did not qualify for the exemption were subject to scrutiny under section 8 of RESPA. HUD also invited those with active CLOs or those developing CLOs to demonstrate their systems at a Technology Demonstration Fair on September 30, 1994. Twenty-one CLO operators accepted the invitation and participated in this all-day demonstration in Washington, D.C.

The public comments in response to the proposed rule raised a number of specific questions about the proposed exemption for payments to qualified CLOs, and generally displayed skepticism or uncertainty about the usefulness of the proposal. Concerned that the comments did not adequately address all the issues, HUD held two informal meetings with industry and consumer groups to seek additional individual input on the likely future development of CLOs. These meetings were held on August 11, 1995, and September 21, 1995. While HUD learned many things from the public comments and the meetings with industry and consumer groups, one message seemed to predominate. All parties wanted clearer guidance from HUD on how RESPA's disclosure and anti-kickback provisions apply to borrower and lender payments for CLO services.

Both the 1992 and the proposed 1994 exemptions for borrower payments to CLOs were offered because of concern that uncertainty about how RESPA applied to payments to CLOs might be impeding the development or use of potentially beneficial technology. However, by limiting the exemptions to borrower payments, in both cases, HUD did not address the primary issue of how RESPA's anti-kickback provisions applied to lender payments to CLOs.

Many participants in the informal meetings urged that it was impossible to

create a useful safe harbor or exemption for "qualified CLOs", because changes in technology and in its use in the market would repeatedly make that safe harbor obsolete. CLO service providers would take their chances of running afoul of RESPA, rather than develop systems to meet the "qualified CLO" criteria. More helpful, many participants argued, would be if HUD explained clearly how RESPA's anti-kickback prohibitions and disclosure requirements applied to various sorts of CLO payments.

After considering the public comments and informal meetings, HUD has decided: (1) To eliminate the exemption for borrower payments to CLOs and the associated disclosure; (2) to abandon the idea of establishing a similar or broader exemption for qualified CLOs; and (3) to issue this policy statement to help those developing and using CLOs to understand better how RESPA applies to their activities.

HUD does not think it is useful to continue a modest exemption or to develop a separate and elaborate regulatory structure for a still emerging industry. However, clarification of certain matters in the form of a policy statement would be useful to the industry and consumers. The effect of this action is to subject payments to CLOs to the same RESPA provisions as payments for any other service; however, HUD is providing specific guidance on how HUD will apply these provisions in the CLO context.

Today HUD is simultaneously issuing a revision to the 1992 rule. The preamble to this new final rule contains a fuller discussion of the decision-making process leading from the November 2, 1992 rule to the withdrawal of the exemption and the issuance of this guidance.

To the extent this guidance interprets rules that become effective 120 days from the date of this publication, then this guidance will be applicable as of the effective date of such rules.

#### Statement of Policy—1996-1

To give guidance to interested members of the public on the application of RESPA and its implementing regulations to these issues, the Secretary, pursuant to Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii), hereby issues the following statement of policy.

For purposes of this statement of policy, a CLO is a computer system that is used by or on behalf of a consumer to facilitate a consumer's choice among alternative products or settlement

service providers in connection with a particular RESPA-covered real estate transaction. Such a computer system: (1) may provide information concerning products or services; (2) may pre-qualify a prospective borrower; (3) may provide consumers with an opportunity to select ancillary settlement services; (4) may provide prospective borrowers with information regarding the rates and terms of loan products for a particular property in order for the borrower to choose a loan product; (5) may collect and transmit information concerning the borrower, the property, and other information on a mortgage loan application for evaluation by a lender or lenders; (6) may provide loan origination, processing, and underwriting services, including but not limited to, the taking of loan applications, obtaining verifications and appraisals, and communicating with the borrower and lender; and (7) may make a funding decision.

This definition is not meant to be restrictive or exhaustive; it merely attempts to describe existing practices of service providers. With the use of technology evolving so rapidly, however, it is difficult for the Department to provide guidance on future unspecified practices in the abstract.

This statement of policy provides guidance on how RESPA applies to service providers and interprets existing law. It does not add any new restrictions on business practices.

Section 3 of RESPA defines "settlement services" to include:

[A]ny service provided in connection with a real estate settlement including, but not limited to \* \* \* the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans), and the handling of the processing, and closing or settlement. 12 U.S.C. 2602(3).

The regulations define a "settlement service" to mean "any service provided in connection with a prospective or actual settlement." 24 CFR 3500.2. This definition specifically includes the providing of any services related to the origination, processing, or funding of a federally-related mortgage loan. 24 CFR 3500.2. To the extent that a CLO performs "settlement services", it is a settlement service provider. Conversely, if a CLO does not perform settlement services, it is not a settlement service provider.

NOTHING IN THIS POLICY STATEMENT SHOULD BE READ AS A HUD ENDORSEMENT OF ANY CHARGE TO CONSUMERS OR AS A

#### REQUIREMENT FOR ANY CHARGE TO CONSUMERS.

##### 1. Payments by Consumers to CLOs

CLOs that provide services to consumers may charge consumers for services performed. 12 U.S.C. 2607(c)(2). RESPA requires that all charges for settlement services be reported on the Good Faith Estimate and the HUD-1 or HUD-1A; however, the regulations do not address the exact timing of the payment. 12 U.S.C. 2603(a) and 2604(c). Similarly, any payment for CLO services that is paid outside of closing must be so identified on the HUD-1 or HUD-1A settlement statement. 24 CFR 3500, App. A, General Instructions. In addition, settlement service providers whose products are made available on CLOs may reimburse consumers for any fee charged them by the CLO.

##### 2. Payments by Settlement Service Providers to CLOs

Section 8(a) of RESPA prohibits payments for the referral of a consumer to a settlement service provider; however, Section 8(c)(2) permits payments for goods or facilities actually furnished or for services actually performed. 12 U.S.C. 2607(c)(2).

The definition used in this policy statement encompasses various types of CLOs. Regardless of the type of CLO, compensable goods, facilities, or services must be provided by the CLO in return for payments by settlement service providers. Any such payment must bear a reasonable relationship to the value of the goods, facilities, or services provided. 24 CFR 3500.14(g)(2). A charge for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee. 24 CFR 3500.14(c). For example, if a CLO lists only one settlement service provider and only presents basic information to the consumer on the provider's products, then there would appear to be no or nominal compensable services provided by the CLO to either the settlement service provider or the consumer, only a referral; and any payment by the settlement service provider for the CLO listing could be considered a referral fee in violation of section 8 of RESPA. Note, however, that a new provision of HUD's RESPA rules at 24 CFR 3500.14(g)(1)(ix), discussed at Section 4 below, allows employees who do not perform settlement services to market settlement services or products of an affiliated entity and to receive employer payments for these referrals. A company may not pay any other company for the

referral of settlement service business. 24 CFR 3500.14(b).

RESPA places no restrictions on the pricing structure of CLOs as long as the payments are not referral fees and are reasonably related to the value of the services provided. However, the value of a referral is not to be taken into account in determining whether the payment exceeds the reasonable value of the goods, facilities, or services. 24 CFR 3500.14(g)(2). If these requirements are met, CLOs may charge settlement service providers a fixed or periodic fee or a fee for each closed transaction arising from the use of the CLO. However, if a CLO charges different fees to different settlement service providers in similar situations, an incentive may exist for the CLO to steer the consumer to the settlement service provider paying the highest fees. HUD may scrutinize these circumstances to determine if the differentials constitute referral fees.<sup>1</sup>

Settlement service providers may pay CLOs a reasonable fee for services provided by the CLO to the settlement service provider, such as, having information about the provider's products made available to consumers for comparison with the products of other settlement service providers. If a CLO elects to act as a mortgage broker, as that term is defined in 24 CFR 3500.2, then all RESPA rules related to compensation of mortgage brokerage services apply to the CLO. On December 13, 1995, HUD convened a negotiated rulemaking that could result in changes to these RESPA rules. CLOs should review carefully any changes in the regulations applicable to mortgage brokers and others that result from this rulemaking.

### 3. CLOs in a Controlled Business Context

When a CLO is used in a controlled business arrangement, the RESPA regulations relating to controlled business arrangements apply. Section 3(7) of RESPA (12 U.S.C. 2602(7)) defines a controlled business arrangement in terms of an affiliate relationship or a direct or beneficial ownership. The regulations provide definitions of affiliate relationship, beneficial ownership, and direct ownership. 24 CFR 3500.15(c). Separate entities are a necessary component of the controlled business arrangement definitions. For example, if a real estate brokerage firm uses a CLO within its

own business structure and there is no separate affiliated business entity involved, then the CLO is not being used in a controlled business arrangement with the real estate brokerage firm.

A controlled business arrangement does not violate RESPA if three conditions are met. 12 U.S.C. 2607(c)(4)(A)–(C). Section 3500.15(b) of the regulations elaborates on the three requirements. First, when consumers are referred from one business entity to an affiliated business entity, a written disclosure of the affiliate relationship must be provided. For example, if a real estate firm has an affiliate relationship with a company providing CLO services and an agent of the real estate firm refers a customer to the CLO company, then the real estate agent must provide the required disclosure to the customer at the time of the referral. Similarly, if the CLO company has an affiliate relationship with one of the settlement service providers listed on the CLO, then the CLO operator must provide the customer with the required disclosure before the consumer uses the CLO. Second there can be no required use, i.e., the referring entity cannot require the consumer to use the CLO and the CLO cannot require the consumer to use an affiliated company listed on the CLO. Thirdly, the only thing of value that is received by one business entity from other business entities in the controlled business arrangement, other than payments permitted under 24 CFR 3500.14(g) for services actually performed, is a return on an ownership interest or franchise relationship.

#### 4. Payments of Commissions or Bonuses to Employees

CLOs are subject to the same RESPA provisions regarding employee compensation as any service provider. For example, a settlement service provider listed on the CLO may not pay a CLO employee a referral fee or commission if the consumer selects that settlement service provider. 24 CFR 3500.14(b). Employees of a CLO may receive a *bona fide* salary or compensation from the CLO—their employer. 24 CFR 3500.14(g)(1)(iv). Compensation from CLOs to their employees may include commissions for transactions closed on the system. 24 CFR 3500.14(g)(1)(vii). However, if a CLO pays commissions for transactions closed with some settlement service providers but not for transactions closed with other settlement service providers, HUD may scrutinize these payments to determine if the commissions constitute referral fees or are exempt under other provisions (see below).

HUD established two new exemptions related to compensation of employees in a final rule published today and effective 120 days from their publication. The first exemption (24 CFR 3500.14(g)(1)(viii)) allows an employer to pay managerial employees who do not routinely deal with the public bonuses related to the referral of settlement service business to a business entity in a controlled business arrangement. The CLO employee who routinely deals with customers is not considered a managerial employee within the meaning of 24 CFR 3500.2. A CLO may have managerial employees within the meaning of 24 CFR 3500.2, such as a district manager who oversees several CLO operators who work in different locations. Such a managerial employee may receive bonuses based on criteria related to the performance of a business entity in an affiliate relationship, such as profitability, capture rate, or other thresholds. However, the amount of such bonus may not be calculated as a multiple of the number or value of referrals of settlement services business to a business entity in a controlled business arrangement. 24 CFR 3500.14(g)(1)(viii).

The second exemption (24 CFR 3500.14(g)(1)(ix)) allows employer payments to their own bona fide employees for referrals of business to affiliated entities if the employee does not perform settlement services in any transaction and provides the consumer with a written disclosure in the format of the Controlled Business Arrangement Disclosure Statement. Employer payments to a CLO employee who does not perform settlement services may qualify for this exemption. This exemption permits employer payments to employees who do not perform settlement services for referrals to affiliates. Under this exemption, the employee may market a settlement service or product of an affiliated entity, including collecting and conveying information and taking an application or order for the services of an affiliated entity. Marketing also may include incidental communications with the consumer after the application or order, such as providing the consumer with information about the status of an application or order; marketing may not include serving as the ongoing point of contact for coordinating the delivery and provision of settlement services. Under the exemption, a CLO employee who takes an application and collects information for an affiliate but performs no other settlement services, may receive a payment from his or her

<sup>1</sup> Depending upon the circumstances of the referrals and the design of the CLO system, this steering of consumers may violate the Fair Housing Act, as may selective marketing of CLO systems.

employer for a referral to an affiliated entity.

**5. Neutral Display of Information on Settlement Service Providers and Their Products**

Section 8(a) of RESPA prohibits compensated referrals. HUD may scrutinize non-neutral displays of information on settlement service providers and their products because favoring one settlement service provider over others may be affirmatively influencing the selection of a settlement service provider which could constitute a referral under RESPA. 24 CFR 3500.14(f). An agreement or understanding for the referral of business incident to or part of a settlement service may be established by a practice, pattern, or course of conduct. 24 CFR 3500.14(e). For example, if one lender always appears at the top of any listing of mortgage products and there is no real difference in interest rates and charges between the products of that lender and other lenders on a particular listing, then this may be a non-neutral presentation of information which affirmatively influences the selection of a settlement service provider. Furthermore, if there is an affiliate relationship between the CLO and a favored settlement service provider, the non-neutral presentation of information under certain circumstances could constitute a required use in violation of 3500.15(b)(2). This guidance on neutral displays should not be read to discourage CLOs from assisting consumers in determining which products are most advantageous to them. For example, if a CLO consistently ranks lenders and their mortgage products on the basis of some factor relevant to the borrower's choice of product, such as APR calculated to include all charges and to account for the expected tenure of the buyer, HUD would consider this practice as a neutral display of information.

Authority: 12 U.S.C. 2617; 42 U.S.C. 3535(d).

Dated: May 31, 1996.

Nicolas P. Retsinas,  
Assistant Secretary for Housing-Federal  
Housing Commissioner.

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**24 CFR Part 3500**

[Docket No. FR-3638-N-04]

**Office of the Assistant Secretary for Housing-Federal Housing Commissioner; Real Estate Settlement Procedures Act (RESPA); Statement of Policy 1996-2 Regarding Sham Controlled Business Arrangements**

**AGENCY:** Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

**ACTION:** Statement of policy 1996-2, sham controlled business arrangements.

**SUMMARY:** This statement sets forth the factors that the Department uses to determine whether a controlled business arrangement is a sham under the Real Estate Settlement Procedures Act (RESPA) or whether it constitutes a *bona fide* provider of settlement services. It provides an interpretation of the legislative and regulatory framework for HUD's enforcement practices involving sham arrangements that do not come within the definition of and exception for controlled business arrangements under Sections 3(7) and 8(c)(4) of the Real Estate Settlement Procedures Act (RESPA). It is published to give guidance and to inform interested members of the public of the Department's interpretation of this section of the law.

**FOR FURTHER INFORMATION CONTACT:** David Williamson, Director, Office of Consumer and Regulatory Affairs, Room 5241, telephone (202) 708-4560. For legal enforcement questions, Rebecca J. Holtz, Attorney, Room 9253, telephone: (202) 708-4184. (The telephone numbers are not toll-free.) For hearing- and speech-impaired persons, this number may be accessed via TTY (text telephone) by calling the Federal Information Relay Service at 1-800-877-8339. The address for the above-listed persons is: Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410.

**SUPPLEMENTARY INFORMATION:**

**General Background**

Section 8 (a) of the Real Estate Settlement Procedures Act (RESPA) prohibits any person from giving or accepting any fee, kickback, or thing of value for the referral of settlement service business involving a federally related mortgage loan. 12 U.S.C. § 2607(a). Congress specifically stated it intended to eliminate kickbacks and referral fees that tend to increase unnecessarily the costs of settlement services. 12 U.S.C. § 2601(b)(2).

After RESPA's passage, the Department received many questions asking if referrals between affiliated settlement service providers violated RESPA. Congress held hearings in 1981. In 1983, Congress amended RESPA to permit controlled business arrangements (CBAs) under certain conditions, while retaining the general prohibitions against the giving and taking of referral fees. Congress defined the term "controlled business arrangement" to mean an arrangement:

[I]n which (A) a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a *provider of settlement services*; and (B) either of such persons directly or indirectly refers such business to *that provider* or affirmatively influences the selection of *that provider*.

12 U.S.C. 2602(7) (emphasis added).

In November 1992, HUD issued its first regulation covering controlled business arrangements, 57 FR 49599 (Nov. 2, 1992), codified at 24 CFR 3500.15.<sup>1</sup> That rule provided that a controlled business arrangement was not a violation of Section 8 and allowed referrals of business to an affiliated settlement service provider so long as: (1) The consumer receives a written disclosure of the nature of the relationship and an estimate of the affiliate's charges; (2) the consumer is not required to use the controlled entity; and (3) the only thing of value received from the arrangement, other than payments for services rendered, is a return on ownership interest.

Section 3500.15(b) sets out the three conditions of the controlled business arrangement exception. The first condition concerns the disclosure of the relationship. The rule provides that the person making the referral must provide the consumer with a written statement, in the format set out in appendix D to part 3500. This statement must be provided on a separate piece of paper. The referring party must give the statement to the consumer no later than the time of the referral. 24 CFR 3500.15(b)(1).

The second condition involves the non-required use of the referred entity. Section 3500.15(b)(2) provides that the person making the referral may not require the consumer to use any particular settlement service provider, except in limited circumstances. A

<sup>1</sup> All citations in this Statement of Policy refer to recently streamlined regulations published on March 26, 1996 (61 FR 13232), in the Federal Register (to be codified at 24 CFR part 3500).