

## **Yield Spread Premiums for Mortgage Brokers: *Culpepper v. Irwin Mortgage Corporation* and the 2001 HUD Policy Statement**

Lately, when the Eleventh Circuit Court of Appeals talks, the mortgage brokerage industry listens. In the latest decision handed down in the case of *Culpepper v. Irwin Mortgage Corporation (Culpepper III)*,<sup>1</sup> the Eleventh Circuit Court of Appeals certified a class action<sup>2</sup> challenging the legality of yield spread premiums<sup>3</sup> under section eight of the Real Estate Settlement Procedures Act of 1974 (RESPA).<sup>4</sup> Yield spread

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1. *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001). Note that Irwin Mortgage Corporation was previously referred to as Inland Mortgage Corporation.

2. The class is composed of

[a]ll persons who, from April 11, 1995, until this class is certified, [June 22, 1999], inclusive, obtained an FHA mortgage loan that was funded by Irwin Mortgage Corporation wherein the broker was paid a loan origination fee of 1% or more and wherein Irwin paid a “yield spread premium” to a mortgage broker.

*Id.* at 1326.

3. According to the Department of Housing and Urban Development (HUD),

Yield spread premiums permit homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate. Because the mortgage carries a higher interest rate, the lender is able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference. The payment allows the broker to recoup the up front costs incurred on the borrower’s behalf in originating the loan. Payments from lenders to brokers based on the rates of borrower’s loans are characterized as “indirect” fees and are referred to as yield spread premiums.

RESPA Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed. Reg. 53,052, 53,054 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500) [hereinafter 2001 Statement of Policy].

4. Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §§ 2601-2617 (2000). Section 2601 (a) sets out the purpose of RESPA:

The Congress finds 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

premiums are a form of mortgage broker compensation paid by the lender but passed on to the borrower in the form of higher monthly payments.<sup>5</sup> The courts, with the help of the Department of Housing and Urban Development (HUD), are now faced with the task of determining whether this form of compensation is permissible in light of the anti-kickback provision of RESPA.<sup>6</sup>

Although not the first yield spread premium case, *Culpepper III* is the most recent and most successful challenge to the issues surrounding the legality of yield spread premiums. Given the Eleventh Circuit's unique analysis of the legality of yield spread premiums, it is not surprising that class certification in *Culpepper III* has caught the attention of mortgage brokers across

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are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country.

12 U.S.C. § 2601(a).

5. See Real Estate Settlement and Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10,080 (March 1, 1999) (to be codified at 24 C.F.R. pt. 3500) [hereinafter 1999 Statement of Policy]. A definition explaining the mechanics of yield spread premiums in relation to the *Culpepper* litigation is as follows:

Inland, like other lenders, sends Premiere [the broker] daily rate sheets that show the types of loans Inland will make to qualified borrowers. Each type of loan has a benchmark interest rate called the "par rate." This is the lowest interest rate at which Inland will make loans without charging the borrower "discount points." If Premiere as the mortgage broker brings Inland a loan at a "below par rate," then Inland requires Premiere, who then requires the borrower, to pay discount points for the loan. However, if Premiere brings Inland a loan with interest at an "above par rate," then Inland pays a "yield spread premium" to Premiere.

*Culpepper v. Inland Mortgage Corp.*, 132 F.3d 692, 694 (11th Cir. 1998). An example of the additional expense which homebuyers pay in the form of yield spread premiums is best exemplified by a look into the facts of Beatrice Hiers' case. Sandra Fleishman, *Sarbanes to Air Concerns About HUD Loan Reforms*, WASH. POST, Jan. 8, 2002, at E1. A broker told Beatrice, one of the borrowers covered by the *Culpepper* class, that a 7% fixed rate loan was her best option. *Id.* Beatrice took that loan only to later discover that she could have qualified for a loan carrying a 5.5% interest rate with no yield spread premium attached. *Id.* Beatrice discovered that her broker received \$4,538 from the lender in addition to the \$1,544 origination fee and \$4,736 in loan discount points she paid. *Id.*

6. 12 U.S.C. § 2617. HUD, through the authority of its Secretary, is granted the power "to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes" of RESPA. *Id.*

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the country.<sup>7</sup> The class certification has also caught the attention of HUD, which answered the prayers of mortgage brokers and recently issued a new statement of policy clarifying the department's stance on the legality of yield spread premiums. Potentially, this will limit the effect that the *Culpepper III* decision will have on the mortgage brokerage industry.<sup>8</sup>

This Note discusses the legality of mortgage broker compensation in light of *Culpepper III* and the recent statement of policy issued by HUD. After providing background information regarding the purpose of RESPA and the history of the *Culpepper* litigation,<sup>9</sup> the Note will discuss the potential effect the grant of class certification will have on both the mortgage industry and homebuyers.<sup>10</sup> Next, the Note will address the manner in which HUD's 2001 Statement of Policy limits the reach of the *Culpepper* litigation.<sup>11</sup> Finally, the Note will discuss the future success of class actions challenging the legality of yield spread premiums in light of the 2001 Statement of Policy.<sup>12</sup>

## I. RESPA AND YIELD SPREAD PREMIUMS

The legality of yield spread premiums is governed by section eight of RESPA<sup>13</sup> as well as supplemental statements and

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7. See *infra* notes 56-59 and accompanying text.

8. 2001 Statement of Policy, 66 Fed. Reg. 53,052 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500). The 2001 Statement of Policy was issued in an effort "to eliminate any ambiguity concerning the Department's position with respect to those lender payments to mortgage brokers characterized as yield spread premiums" in *Culpepper v. Irwin Mortgage Corporation. Id.*; see also David R. Donaldson, *Mortgage Brokers Unfounded Plea for Reasonable Spreads*, AM. BANKER, Sept. 7, 2001, at 8 (stating that the mortgage brokers were "demanding" that HUD "clarify" its stance regarding the legality of yield spread premiums); Krissah Williams, *Loan Brokers' Fees Under Attack*, WASH. POST, July 14, 2001, at H1 (stating that the mortgage brokers are "in a panic over the possibility of losing this revenue stream" following *Culpepper III* and have been meeting with HUD officials).

9. See *infra* notes 13-55 and accompanying text.

10. See *infra* notes 56-67 and accompanying text.

11. See *infra* notes 68-88 and accompanying text.

12. See *infra* notes 89-124 and accompanying text.

13. 12 U.S.C. § 2607(a) (2000). The anti-kickback provision of RESPA states that "[n]o person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." *Id.*

interpretative rules issued by the Secretary of HUD.<sup>14</sup> RESPA, best described as a statute requiring disclosure to benefit homebuyers, was enacted in 1974 to provide information to homebuyers regarding the settlement process as well as to protect them from “unnecessarily high settlement charges.”<sup>15</sup> Specifically, RESPA was enacted in order “to effect certain changes in the settlement process for residential real estate . . . .”<sup>16</sup> While the purposes of RESPA are fourfold, this Note will focus on the Act’s goal of eliminating kickbacks and referral fees that “tend to increase unnecessarily the costs of certain settlement services” for homebuyers.<sup>17</sup>

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14. *See generally* Real Estate Settlement Procedure Act (Regulation X), 57 Fed. Reg. 49,600 (Nov. 2, 1992) (to be codified at 24 C.F.R. pt. 3500) (revising Regulation X to conform to section 461 of the Housing and Urban-Rural Recovery Act of 1983); Real Estate Settlement Procedures Act (RESPA): Disclosure of Fees Paid to Mortgage Brokers (Retail Lenders), and Notice of Consideration of Negotiated Rulemaking, 60 Fed. Reg. 47,650 (Sept. 13, 1995) (to be codified at 24 C.F.R. pt. 3500) (addressing the disclosure of indirect fees paid to mortgage brokers and whether such disclosure should continue to be required for the benefit of the consumer); Mortgage Broker Fee Disclosure Rule: Intent to Establish a Negotiated Rulemaking Advisory Committee and Notice of First Meeting, 60 Fed. Reg. 54,794 (Oct. 25, 1995) (to be codified at 24 C.F.R. pt. 3500) (discussing the creation of an advisory committee to be charged with the analysis of indirect mortgage broker compensation as it relates to RESPA); Real Estate Settlement Procedures Act (RESPA) Disclosure of Fees Paid to Mortgage Brokers: Proposed Rule and Notice of Proposed Information Collection Requirements, 62 Fed. Reg. 53,912 (Oct. 16, 1997) (to be codified at 24 C.F.R. pt. 3500) (proposing a rule which would both inform consumers of the function and fees charged by mortgage brokers and protect consumers from illegal fees under RESPA).

15. 12 U.S.C. § 2601(a) (2000); *see also* 1999 Statement of Policy, 64 Fed. Reg. 10,080, 10,081 (March 1, 1999) (to be codified at 24 C.F.R. pt. 3500) (emphasizing that Congress enacted RESPA to protect homebuyers entering into mortgage agreements). The value placed on the protectionist measures enacted in favor of homebuyers is evident in the strong language used in section eight of RESPA prohibiting kickbacks and unearned fees as sources of compensation for mortgage brokers. *See* 12 U.S.C. § 2607. The hefty penalties for violation of this section of the Act, including a fine of up to \$10,000 and possible imprisonment for up to a year, emphasize HUD’s dedication to the interests of the consumer in the process of purchasing a home. 12 U.S.C. § 2607(d)(1).

16. 12 U.S.C. § 2601(b).

17. 12 U.S.C. § 2601(b)(2). The other purposes of RESPA which this Note will not address are: “more effective advance disclosure to home buyers and sellers of settlement costs; . . . a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payments of real estate taxes and insurance; and . . . significant reform and modernization of local recordkeeping of land title information.” 12 U.S.C. § 2601(b)(1), (3), (4).

In order to clarify the language of RESPA and the reach of the provisions contained therein, HUD promulgated Regulation X pursuant to powers granted by 12 U.S.C. § 2617.<sup>18</sup> Elaborating on the requirements associated with the settlement process of residential real estate as laid out in RESPA, Regulation X is an important interpretative tool for analyzing issues arising under RESPA.<sup>19</sup> Since the advent of the *Culpepper* litigation, it is section 3500.14 of Regulation X that has received significant attention.<sup>20</sup> This regulatory section reiterates the prohibition on kickbacks and unearned fees stated in section eight of RESPA.<sup>21</sup>

In addition to Regulation X, HUD has also issued a series of policy statements throughout the 1990s that have helped the courts, mortgage brokers, mortgage lenders and consumer advocates define the parameters of RESPA's prohibition against kickbacks and unearned fees.<sup>22</sup> From this series of statements, the 1999 Statement of Policy and, most recently, the 2001 Statement of Policy are the most relevant to an analysis of the *Culpepper*

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18. Real Estate Settlement Procedures Act, 24 C.F.R. § 3500 (2001) (Regulation X).

19. See 24 C.F.R. § 3500.14.

20. *Id.* Section 3500.14 defines terms and situations covered in section eight of RESPA in an effort to clarify what types of activities and fees are regarded as kickbacks and, therefore, violate section eight of RESPA. *Id.*

21. 24 C.F.R. § 3500.14(a). Section 3500.14(a) of Regulation X states that “[a]ny violation of this section is a violation of section 8 of RESPA (12 U.S.C. 2607).” *Id.*

22. See generally Real Estate Settlement Procedure Act (Regulation X), 57 Fed. Reg. 49,600 (Nov. 2, 1992) (to be codified at 24 C.F.R. pt. 3500) (revising Regulation X to conform to section 461 of the Housing and Urban-Rural Recovery Act of 1983); Real Estate Settlement Procedures Act (RESPA): Disclosure of Fees Paid to Mortgage Brokers (Retail Lenders), and Notice of Consideration of Negotiated Rulemaking, 60 Fed. Reg. 47,650 (Sept. 13, 1995) (to be codified at 24 C.F.R. pt. 3500) (addressing the disclosure of indirect fees paid to mortgage brokers and whether such disclosure should continue to be required for the benefit of the consumer); Mortgage Broker Fee Disclosure Rule: Intent to Establish a Negotiated Rulemaking Advisory Committee and Notice of First Meeting, 60 Fed. Reg. 54,794 (Oct. 25, 1995) (to be codified at 24 C.F.R. pt. 3500) (discussing the creation of an advisory committee to be charged with the analysis of indirect mortgage broker compensation as it relates to RESPA); Real Estate Settlement Procedures Act (RESPA) Disclosure of Fees Paid to Mortgage Brokers: Proposed Rule and Notice of Proposed Information Collection Requirements, 62 Fed. Reg. 53,912 (Oct. 16, 1997) (to be codified at 24 C.F.R. pt. 3500) (proposing a rule which would both inform consumers of the function and fees charged by mortgage brokers and protect consumers from illegal fees under RESPA).

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litigation<sup>23</sup> and the current debate in courtrooms across the country regarding the legality of yield spread premiums under RESPA.<sup>24</sup>

HUD's 1999 Statement of Policy states that yield spread premiums are not "illegal *per se*."<sup>25</sup> HUD set forth a two-part test by which one could determine when mortgage broker compensation is prohibited under section eight of RESPA.<sup>26</sup> Under the first part of the test, a court must ask, "whether goods or facilities were actually furnished or services were actually performed for the compensation paid."<sup>27</sup> In the second part of the test, a court must ask whether the mortgage broker's fee was "reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed."<sup>28</sup> It is the Eleventh Circuit's failure to apply both parts of this test in the case of *Culpepper III* that grabbed the attention of the mortgage brokerage industry and prompted HUD to issue a new policy statement clarifying the 1999 statement.<sup>29</sup>

## II. HISTORY OF *CULPEPPER* LITIGATION

### A. *Background*

With the original class action dating back to April 1996, *Culpepper* has currently been in the court system for more than

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23. See 1999 Statement of Policy, 64 Fed. Reg. 10,080 (March 1, 1999) (to be codified at 24 C.F.R. pt. 3500) (stating HUD's position on the legality of lender payments to mortgage brokers under RESPA); 2001 Statement of Policy, 66 Fed. Reg. 53,052, 53,054 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500) (clarifying HUD's position on the legality of lender payments to mortgage brokers under RESPA).

24. See *Bjustrom v. Trust One Mortgage*, No. C00-1166P, 2001 U.S. Dist. LEXIS 17890, at \*1 (W.D. Wash. Oct. 26, 2001) (granting defendant's motion for summary judgment); *Vargas v. Universal Mortgage Corp.*, No. 01C0087, 2001 U.S. Dist. LEXIS 19635, at \*1 (N.D. Ill. Nov. 29, 2001) (denying the plaintiff's motion for class certification).

25. 1999 Statement of Policy, 64 Fed. Reg. at 10,084.

26. See *id.*

27. *Id.*

28. *Id.*

29. 2001 Statement of Policy, 66 Fed. Reg. 53,052, 53,052 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500).

five years.<sup>30</sup> John and Patricia Culpepper alleged that Inland Mortgage Corporation<sup>31</sup> violated the anti-kickback provision of section eight of RESPA.<sup>32</sup> The Culpeppers stated that this violation occurred as a result of payments the lender, Inland Mortgage Corporation, made to their mortgage broker, Premiere Mortgage Corporation, in the form of a yield spread premium.<sup>33</sup> The Northern District of Alabama granted Inland's motion for summary judgment and stated that the yield spread premium was a "fair market value" paid to the broker in exchange for the creation of the loan and sale of the loan to the lender, Inland.<sup>34</sup> The Culpepper's decision to appeal both the district court's grant of summary judgment in favor of the defendants and denial of class certification placed the Eleventh Circuit Court of Appeals in a very interesting position. The Eleventh Circuit became the first circuit court in the nation to hear a case stemming from the long

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30. John and Patricia Culpepper originally filed this action in the United States District Court for the Northern District of Alabama, Southern Division. *Culpepper v. Inland Mortgage Corp.*, 953 F. Supp. 367 (N.D. Ala. 1997).

31. Note that Irwin Mortgage Corporation was previously referred to as Inland Mortgage Corporation.

32. See 12 U.S.C. § 2607(a); *supra* note 13 and accompanying text. In the complaint filed in the Eleventh Circuit on April 11, 1996, the Culpeppers alleged that "Inland had violated the Real Estate Settlement Procedures of 1974 ("RESPA") in two ways: (1) by paying an impermissible "referral fee" or "kickback" to the Culpeppers' mortgage broker, Premiere Mortgage Company, and (2) by failing to disclose certain charges on the HUD-1 statement." *Culpepper*, 953 F. Supp. at 368.

33. See *Culpepper*, 144 F.3d at 718. The transaction at issue in this case is as follows:

On December 7, 1995, Premiere received a rate sheet from Inland and informed the Culpeppers that a 30-year loan was available at a 7.5% interest rate. The Culpeppers accepted the rate, and Premiere registered the loan with Inland. Unbeknownst to the Culpeppers, the rate sheet showed that 7.5% was higher than Inland's par rate on 30-year loans and carried a yield spread premium of 1.675% of the loan amount, or \$1,263.61. Premiere quoted the 7.5% rate notwithstanding the fact that Inland would make the same loan at 7.25%. At that lower interest rate, the yield spread premium paid to Premiere would be only 0.125% of the loan amount, or \$97.20.

*Culpepper v. Inland Mortgage Corp.*, 132 F.3d 692, 694 (11th Cir. 1998).

34. *Culpepper v. Inland Mortgage Corp.*, 953 F. Supp. 367, 372 (N.D. Ala. 1997).

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line of class action suits targeting the legality of yield spread premiums under section eight of RESPA.<sup>35</sup>

*B. Culpepper I*

A year later, the Culpeppers appeared before the Eleventh Circuit to appeal the Northern District Court of Alabama's grant of summary judgment to Inland for violations of section eight of RESPA and denial of class certification.<sup>36</sup> The Eleventh Circuit reversed and remanded the district court's grant of summary judgment for Inland and vacated and remanded the district court's denial of class certification.<sup>37</sup> In doing so, the Eleventh Circuit stated that the yield spread premium paid from Inland Mortgage Corporation to Premiere was a referral fee and in violation of section eight of RESPA.<sup>38</sup> The court stressed that the payment of the yield spread premium in this case was neither a payment for goods,<sup>39</sup> as Inland already owned the loan, nor a payment for services.<sup>40</sup>

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35. In *Culpepper I*, the Eleventh Circuit noted that “[n]o circuit court has addressed whether a yield spread premium violates RESPA.” *Culpepper*, 132 F.3d at 695. Several district courts construed RESPA in similar cases and reached conflicting results. *See id.*

36. *Id.* at 697-98.

37. *Id.*

38. *Id.* at 696-97.

39. *Id.* In order to explain why the yield spread premium was not a payment for goods, the Eleventh Circuit refuted the district court's deduction that “the yield spread premium was payment for a good—*i.e.*, the Culpeppers' loan—that Premiere sold to Inland.” *Id.* The Eleventh Circuit pointed out that “this deduction ignores the fact that in table-funded transactions the lender, not the broker, owns the loan from the outset.” *Id.* Thus, “Premiere could not sell the Culpeppers' loan to Inland because Inland already owned it.” *Id.*

40. In the opinion of the Eleventh circuit,

it is undisputed that the payment of the yield spread premium was not tied to the quantity or quality of the services that Premiere provided . . . [T]he sole determinant of whether a yield spread premium would be paid was the interest rate on the loan . . . Premiere expends the same amount of effort and provides the same quality and quantity of services whether it originates an above par loan, a par loan, or a below par loan. Because Premiere receives a yield spread premium only when it originates an above par loan, the premium cannot be characterized as payment for originating the loan.

*Culpepper*, 132 F.3d at 697.

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*C. Culpepper II*

A petition for rehearing by Inland Mortgage Corporation placed the *Culpepper* litigation before the Eleventh Circuit for the second time.<sup>41</sup> Although the court denied Inland's petition for rehearing, the Eleventh Circuit took the opportunity to further clarify its opinion concerning the legality of yield spread premiums as set forth in *Culpepper I*.<sup>42</sup> In *Culpepper II*, the court noted that yield spread premiums might be legal provided certain criteria are met.<sup>43</sup> The court's emphasis on the potential illegality of yield spread premiums, although not binding on either party as the class was yet to be certified, sparked the interest of mortgage brokers and class action lawyers alike.<sup>44</sup> While the Eleventh Circuit did not state that yield spread premiums were legal, they also did not state that they were illegal.<sup>45</sup>

*D. Culpepper III*

Even though the decisions reached in *Culpepper I* and *II* were not favorable to the mortgage brokerage industry, they were manageable.<sup>46</sup> It is the most recent addition to the *Culpepper* litigation, *Culpepper III*, which poses the most significant and viable threat to the mortgage brokerage industry.<sup>47</sup> Affirming the district court's grant of class certification to the plaintiffs, the Eleventh Circuit allowed the parties to move forward and litigate an issue they have been trying to litigate for five years: the legality

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41. *Culpepper v. Inland Mortgage Corp.*, 144 F.3d 717 (11th Cir. 1998).

42. *Id.*

43. *Id.* at 718. While the court did not offer a list of these "circumstances," they did stress that their decision was "highly dependent upon the facts in the current record. . . ." *Id.*

44. *See Culpepper*, 144 F.3d at 718. In *Culpepper II*, the court noted that fees not linked to goods or services actually performed by the mortgage broker are illegal under section eight of RESPA. *Id.* However, the court also noted that any fees that can be linked to such an exchange may pass scrutiny under section eight of RESPA. *Id.* The decision of legality is "highly dependent upon the facts" of each case. *Id.*

45. *Id.*

46. Robert M. Jaworski, *Culpepper goes the distance*, 5 CONSUMER FIN. SERV. L. REP., No. 11 (Nov. 26, 2001). In *Culpepper I* and *II*, the courts were the only source of authority which the *Culpeppers* and Irwin had to deal with. However, in *Culpepper III*, Congress and HUD "weighed-in." *Id.*

47. *See id.*; *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001).

of yield spread premiums.<sup>48</sup> The grant of class certification<sup>49</sup> coupled with the Eleventh Circuit's acceptance of the district court's deviation from the preferred application of HUD's two-part test is a source of confusion for the mortgage industry as well as homebuyers.<sup>50</sup>

Finding it unnecessary to analyze each loan individually under the second part of the test, the Eleventh Circuit's decision in *Culpepper III* made it easier for classes of homebuyers to achieve certification and establish that "questions of law or fact common to all the members predominates over any questions affecting only individual members."<sup>51</sup> A marked departure from the two-part test set forth in the 1999 Statement of Policy,<sup>52</sup> the Eleventh Circuit agreed with the district court and concluded that the test was ambiguous and stated that the second part of the test was unnecessary in certain circumstances.<sup>53</sup> Rather than an individual analysis of the exchange of payment for services benefiting the buyer as proscribed under the test, the focus on "the terms and conditions under which a lender pays the broker a yield spread

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48. *Culpepper*, 253 F.3d at 1332.

49. The plaintiffs were certified as a class under Rule 23(b)(3) of the Federal Rules of Civil Procedure. *Culpepper*, 253 F.3d at 1324. The defendants, challenging this certification under Rule 23(f) of the Federal Rules of Civil Procedure, alleged that "questions of law or fact common to the members of the class" do not "predominate over any questions affecting only individual members." FED. R. CIV. P. 23(b)(3) (2001).

50. *See Culpepper*, 253 F.3d at 1324.

51. FED. R. CIV. P. 23(b)(3).

52. The detailed parts of the test issued by HUD in the RESPA Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers on March 1, 1999 are as follows:

The first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

1999 Statement of Policy, 64 Fed. Reg. 10,080, 10,084 (Mar. 1, 1999) (to be codified at 24 C.F.R. pt. 3500).

53. *See Culpepper*, 144 F.3d at 718; *supra* note 44 and accompanying text.

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premium” increased homebuyers’ chances of class certification.<sup>54</sup> Thus, the Eleventh Circuit made class certification easier by rejecting an individual analysis and, instead, focusing on the terms and conditions common to all loans.<sup>55</sup>

### III. EFFECT OF *CULPEPPER III* ON MORTGAGE BROKERS AND HOMEBUYERS

The Eleventh Circuit’s grant of class certification in *Culpepper III* has placed the mortgage brokerage industry in a defensive position and forced mortgage brokers to publicly defend the social utility of their profession.<sup>56</sup> Quick to point out that *Culpepper III* only certified the class and did not decide the legality of yield spread premiums as a matter of law, the National Association of Mortgage Brokers (NAMB) and the Mortgage Brokers Association of America (MBA) are evaluating broker compensation standards,<sup>57</sup> lobbying Congress for assistance<sup>58</sup> and

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54. *Culpepper*, 253 F.3d. at 1332. Class certification was very difficult under the HUD test since the second part of the test required an analysis of each loan individually. See 1999 Statement of Policy, 64 Fed. Reg. at 10,086.

55. *Culpepper*, 253 F.3d at 1332.

56. See *Predatory Mortgage Lending: The Problem, Impact and Responses: Hearing Before the Senate Banking, Housing and Urban Affairs Comm.*, 107th Cong. (July 27, 2001) (statement of Mr. Neill Fendly, Past President of the National Association of Mortgage Brokers) [hereinafter Fendly Testimony], at [http://www.senate.gov/%7Ebanking/01\\_07hrg/072701/fendly.htm](http://www.senate.gov/%7Ebanking/01_07hrg/072701/fendly.htm) (last visited Feb. 23, 2002). Throughout his testimony, Mr. Fendly addressed the “important and unique role of mortgage brokers in the mortgage marketplace. . . .” *Id.* Mortgage brokers, according to Mr. Fendly, “have brought consumers more choices and diversity in loan programs and products than they can obtain from a branch office of even the largest national retail lender.” *Id.* Additionally, Mr. Fendly asserted that mortgage brokers “offer consumers superior expertise and assistance in getting through the tedious and complicated loan process. . . .” *Id.*

57. Laurence E. Platt, *Initial Takes on YSP Move*, ORIGINATION NEWS, July 20, 2001, 2001 WL 14830587. In response to the Eleventh Circuit’s scrutiny of the service fees that mortgage brokers charge homebuyers, mortgage broker analysts have urged lenders and brokers to “review their master form loan origination agreements to make certain that the language clearly is consistent with their intentions . . . namely, that mortgage broker compensation, regardless of the label, is paid in consideration of the performance of services and the provision of facilities by the mortgage broker.” *Id.*

58. Fendly Testimony, *supra* note 56; *Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums: Hearing before the Senate Banking, Housing and Urban Affairs Comm.*, 107th Cong. (Jan. 8, 2002) (statement of Mr. John Courson, Chairman-elect of the Mortgage Bankers Association of America)

pressing HUD for an additional interpretative rulemaking.<sup>59</sup> Advocates for the industry argue that brokers and lenders such as those involved in the *Culpepper* case have tarnished the image of the mortgage brokerage industry and are far from representative of their profession.<sup>60</sup> Originating more than sixty percent of all residential mortgages in America, mortgage brokers argue that they are an essential resource for those individuals who could not otherwise afford to purchase a home.<sup>61</sup> By incorporating all

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[hereinafter Courson Testimony], at [http://www.senate.gov/%7Ebanking/02\\_01hr/010802/courson.htm](http://www.senate.gov/%7Ebanking/02_01hr/010802/courson.htm) (last visited Feb. 23, 2002); *Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums: Hearing before the Senate Banking, Housing and Urban Affairs Committee*, 107th Cong. (Jan. 8, 2002) [hereinafter Falk Testimony] (statement of Mr. Joseph L. Falk, President of the National Association of Mortgage Brokers) at [http://www.senate.gov/%7Ebanking/02\\_01hr/010802/falk.htm](http://www.senate.gov/%7Ebanking/02_01hr/010802/falk.htm) (last visited Feb. 23, 2002).

59. Lew Sichelman & Brian Collins, *More Disclosure Ahead on YSPs?*, NAT'L MORTGAGE NEWS, Oct. 1, 2001, 2001 WL 9322544 (noting that Howard Glaser, the senior vice president of the MBA, has pressured the Secretary of HUD, Mel Martinez, to issue a statement regarding the legality of yield spread premiums under RESPA); Williams, *supra* note 8, at H1 (noting that the NAMB, as well as the Consumer Mortgage Coalition (CMC), has urged HUD to clarify its position on the legality of yield spread premiums).

60. *View From the Top*, BROKER, August 3, 2001, 2001 WL 13511223. In an interview featured in *Broker*, the past and present presidents of NAMB voiced their concern over the fact that mortgage brokers are not the only "industry participants [that] are doing things that may be highly questionable under RESPA. . . ." *Id.* The leaders of NAMB claim "those of us that play by the rules are losers. . . ." *Id.* Neill Fendly, past president of NAMB, concludes that a few "bad actors" are unjustly affecting the regulation of an entire industry. Fendly Testimony, *supra* note 56. And, as pointed out by Ginny Ferguson, secretary of NAMB, "direct lenders are doing the same thing (with their branches) but they do not have to disclose the payment." Kyriaki Venetis & Brad Finkelstein, *Class Certification Move May Revive YSP Lawsuits*, NAT'L MORTGAGE NEWS, June 25, 2001, 2001 WL 9322115. Additionally, the leaders of NAMB have asserted that the larger issue of predatory lending is a "threefold problem of: abusive practices by a small number of bad actors; lack of consumer awareness about loan terms; and the complexity of the mortgage process itself" which must be dealt with on all levels in order to be effective. Fendly Testimony, *supra* note 56.

61. Fendly Testimony, *supra* note 56. During hearings before the Senate Banking, Housing and Urban Affairs Committee, Neill Fendly stated "mortgage brokers originate more than sixty percent of all residential mortgages in America." *Id.* He went on to say that mortgage brokers "have an extremely important role in our economy." *Id.* Emphasizing the importance of the mortgage broker to the middle class homebuyer, Neill Fendly states that,

[m]ortgage brokers have brought consumers more choices and diversity in loan programs and products than they can obtain from a branch office of even the largest national retail lender. Brokers

closing costs and other fees associated with buying a home into higher monthly payments, brokers have enabled homebuyers to finance those expenses over the life of their mortgage rather than having to provide money at the time of closing.<sup>62</sup> In the opinion of Joseph Falk, the current president of NAMB, mortgage brokers, providing an invaluable service to future homeowners, have “a right to earn a yield spread premium in conjunction with payment from the borrower.”<sup>63</sup>

Homebuyers, on the other hand, fail to see the benefit mortgage brokers confer on society.<sup>64</sup> Consumer advocates argue that although mortgage brokers may assist those who otherwise would not be able to purchase a home, they do so to their own advantage.<sup>65</sup> In their opinion, the payment arrangement between the lender and the broker has “created an adulterated . . . system that gives mortgage brokers a direct incentive to obtain a higher-

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also offer consumers superior expertise and assistance in getting through the tedious and complicated loan process, often finding loans for borrowers that may have been turned down by other lenders. Meanwhile, mortgage brokers offer lenders a far less expensive alternative for nationwide product distribution without huge investments in “brick and mortar.”

*Id.*

62. See 1999 Statement of Policy, 64 Fed. Reg. 10,080, 10,081 (Mar. 1, 1999) (to be codified at 24 C.F.R. pt. 3500) (stating that compensation received by a broker from a lender can reduce the cost to the consumer by eliminating much of the out-of-pocket expense associated with entering into a mortgage agreement); *Lenders Ask HUD to Clarify Legality of Yield Spread Premiums*, NAT'L MORTGAGE NEWS, July 9, 2001, 2001 WL 9322173. In the 2001 Statement of Policy, HUD thoughtfully states that “closing costs and origination fees associated with a mortgage loan are a significant component of these up front cash requirements.” 2001 Statement of Policy, 66 Fed. Reg. 53,052, 53, 54 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500).

63. Venetis & Finkelstein, *supra* note 60.

64. See Williams, *supra* note 8, at H1; Robert Julavits, *Broker Fee Ruling Roils Mortgage Bank Lawyers*, AM. BANKER, June, 22, 2001, at 1. Consumer advocates disagree with the mortgage industry's assertion that mortgage brokers save consumers money by locating a fair interest rate and decreasing the upfront cash to cover closing costs. Williams, *supra* note 8, at H6. Sarah Ludwig, executive director of the Neighborhood Economic Development Advocacy Project of New York, voiced her opinion regarding the legality of yield spread premiums and stated the “[o]ne of the big abuses we see . . . is that in addition to getting a higher interest rate, the borrower is paying broker's fees that are financed into the loan. It's a double whammy. . . . Ultimately the borrower is getting gouged and basically being sold a loan that is deceptive.” *Id.*

65. See *supra* note 64 and accompanying text.

than-necessary loan rate for their client because this means a higher fee.”<sup>66</sup> Thus, it is their belief that mortgage brokers are working in their own best interest as opposed to their client’s best interest.<sup>67</sup>

#### IV. HUD’S RESPONSE TO *CULPEPPER III*: THE 2001 STATEMENT OF POLICY

In response to the pressure placed on HUD by both the mortgage brokerage industry and consumer advocates following the decision reached by the Eleventh Circuit in *Culpepper III*, HUD issued a policy statement in October of 2001 in order to clarify its 1999 Statement of Policy setting forth the two-part test for determining the legality of yield spread premiums.<sup>68</sup> This statement of policy also announced the start of a rulemaking process through which HUD plans to reform RESPA and, in doing so, improve disclosure of mortgage-related fees to borrowers at the time of application.<sup>69</sup> Although the rulemaking process is not expected to be complete until the spring of 2002, HUD’s current statement of policy, reiterating its stance on the legality of yield spread premiums, emphasizes the importance of fee disclosure<sup>70</sup> and clarifies any ambiguity surrounding the two-part test for determining the legality of a yield spread premium as originally set forth in the 1999 Statement of Policy.<sup>71</sup> In HUD’s current

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66. Julavits, *supra* note 64, at 17.

67. *Id.*; see *supra* note 64 and accompanying text.

68. 2001 Statement of Policy, 66 Fed. Reg. 53,052, 53,052 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500); Real Estate Settlement Procedures Act of 1974, 12 U.S.C. § 2617 (2000) (granting HUD the power “to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes” of RESPA).

69. Robert Julavits & Erick Bergquist, *HUD Helps Lenders Defend Yield Spread Premiums*, AM. BANKER, Oct. 17, 2001, at 9.

70. 2001 Statement of Policy, 66 Fed. Reg. at 53,056. In the 2001 Statement of Policy, HUD emphasizes that “disclosure is extremely important, and that many of the concerns expressed by borrowers over yield spread premiums can be addressed by disclosing yield spread premiums, borrower compensation to the broker, and the terms of the mortgage loan so that the borrower may evaluate and choose among alternative loan options.” *Id.*; see *infra* note 100 and accompanying text.

71. 2001 Statement of Policy, 66 Fed. Reg. at 53,052; see Julavits & Bergquist, *supra* note 69, at 9. The 2001 Statement of Policy was largely a result of the Eleventh Circuit’s statement claiming the two-part test as laid out in the 1999 Statement of Policy to be “ambiguous.” *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324, 1327

statement of policy, Mel Martinez, Secretary of HUD, chose to focus on the benefit mortgage brokers confer on society in the form of increased homeownership rather than the fact that “in some cases less scrupulous brokers and lenders take advantage of the complexity of the settlement transaction and use yield spread premiums as a way to enhance the profitability of mortgage transactions. . . .”<sup>72</sup>

One of the main reasons behind HUD’s decision to issue the 2001 Statement of Policy was “to eliminate any ambiguity concerning the Department’s position with respect to . . . yield spread premiums . . . as a result of questions raised by . . . *Culpepper v. Irwin Mortgage Corp.* . . .”<sup>73</sup> Reiterating its belief that “yield spread premiums are not per se illegal,” HUD stressed that “the legality of yield spread premiums can only be evaluated in the context of the test HUD established and the specific factual circumstances applicable to each transaction in which a yield spread premium is used.”<sup>74</sup> HUD’s disapproval of the Eleventh Circuit’s decision in *Culpepper III* is based on the court’s failure to employ this method of analysis.<sup>75</sup> The 2001 Statement of Policy

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(11th Cir. 2001). The Eleventh Circuit stated that “[t]he Statement is ambiguous, however, as to the core of the class-certification dispute here, permitting the parties to read it in importantly different ways. . . .” *Id.*

72. 2001 Statement of Policy, 66 Fed. Reg. at 53,054.

73. *Id.* at 53,052. This statement of policy also addresses “overcharges by settlement service providers” as discussed in the case of *Echevarria v. Chicago Title and Trust Co.*, 256 F.3d 623 (7th Cir. 2001). *Id.* This part of the 2001 Statement of Policy and the case to which the issue relates will not be discussed in this Note. *See id.*

74. *Id.* at 53,054. It is important to note that HUD has restricted coverage of the clarification of the legality of yield spread premiums under RESPA to “payments to mortgage brokers in table funded and intermediary mortgage broker transactions.” *Id.* at 53,053.

75. Stressing the agency’s disagreement with the grant of class certification in *Culpepper III*, HUD notes that

the court only applied the first part of the HUD test, and then further narrowed its examination of whether the lender’s yield spread payments were “for services” by focusing exclusively on the presumed intent of the lender in making the payments. The crux of the court’s decision is that Section 8 liability for the payment of unlawful referral fees could be established under the first part of the HUD test alone, based on the facts that the lender’s payments to mortgage brokers were calculated solely on the difference between the par interest rate and the higher rate at which the

makes it clear that “[i]t is HUD’s position that where compensable services are performed, the 1999 Statement of Policy requires application of both parts of the HUD test before a determination can be made regarding the legality of a lender payment to a mortgage broker.”<sup>76</sup> Thus, this clarification seeks to weaken the effect that *Culpepper III* will have on the mortgage brokerage industry since that court only applied the first section of the test.<sup>77</sup>

According to HUD’s 2001 Statement of Policy, a court must look at each transaction individually under the first part of the test.<sup>78</sup> This statement of policy is an attempt to undermine the effect of the decision the Eleventh Circuit reached in *Culpepper III*.<sup>79</sup> In *Culpepper III* the court certified the class of homebuyers based on the conclusion that the legality of yield spread premiums can be analyzed based on the terms and conditions common to all loans rather than an analysis of each loan individually.<sup>80</sup> HUD states that “a rate sheet is merely a mechanism for displaying the yield spread premium” and it does not, by itself, determine the legality or illegality of a yield spread premium.<sup>81</sup> Thus, the 2001

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mortgage brokers delivered loans, and that the lender had no knowledge of what services, if any, the brokers had performed.

*Id.* at 53,054.

76. *Id.* at 53,055.

77. *See generally* 2001 Statement of Policy, 66 Fed. Reg. 53,052, 53,052 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500).

78. *Id.* at 53,055.

79. *See generally* 2001 Statement of Policy, 66 Fed. Reg. 53,052 (Oct. 18, 2001) (to be codified at 24 C.F.R. pt. 3500).

80. *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324, 1332 (11th Cir. 2001). The Eleventh Circuit concluded that

the terms and conditions under which a lender pays the broker a yield spread premium can determine whether the yield spread premium is compensation for referring loans rather than a bona fide fee for services. There is no suggestion from the evidence or the argument here that Irwin negotiates yield spread premiums loan-by-loan, rather than paying them according to terms and conditions common to all the loans.

*Id.* As described by HUD, class certification in *Culpepper III* is a result of the court “appl[ying] the first part of the HUD test, and then further narrow[ing] its examination of whether the lender’s yield spread payments were ‘for services’ by focusing exclusively on the presumed intent of the lender in making the payments.” 2001 Statement of Policy, 66 Fed. Reg. at 53,054.

81. *Id.* at 53,055. According to HUD, “[w]hether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD’s test applies to the transaction involved.” *Id.*

Statement of Policy attempts to point out that the Eleventh Circuit incorrectly employed the first part of the HUD test.<sup>82</sup> Rather than analyzing the individual characteristics of compensation associated with each individual loan, the court only analyzed the terms of the agreement surrounding the suspected referral fee.<sup>83</sup>

As for the second part of the HUD test, the 2001 Statement of Policy makes it clear that the second part of the test is necessary in order to provide a complete analysis of the legality of the mortgage broker compensation in question.<sup>84</sup> This statement stands in stark contrast to the analysis employed by the Eleventh Circuit in *Culpepper III* in which the court concluded that the second part of the test was unnecessary.<sup>85</sup> This relaxed interpretation of the HUD test enabled the Eleventh Circuit to allow the Culpepper class to “prevail solely by showing that . . . yield spread premiums are referral fees, and not service fees. . . .”<sup>86</sup> Such a relaxed interpretation of the HUD test is prohibited in the 2001 Statement of Policy.<sup>87</sup> HUD’s clarification emphasizes the important role a court plays in determining the legality of yield spread premiums by inquiring whether the mortgage broker’s total compensation is reasonable in light of the services provided to the homebuyer.<sup>88</sup>

#### V. REACTION TO THE 2001 STATEMENT OF POLICY

Although HUD called for more homebuyer protection through greater disclosure, it is apparent that the 2001 Statement of Policy favors the mortgage brokerage industry and seeks to insulate them from the onslaught of litigation that has plagued

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82. *Id.* As quoted in late October in *Origination News*, Laurence Platt, mortgage banking attorney, stated that the Eleventh Circuit “tried to put words in HUD’s mouth” with the decision of *Culpepper III*. Brian Collins, *YSP OK called Bittersweet*, ORIGINATION NEWS, Oct. 26, 2001, 2001 WL 14830782. HUD’s 2001 Statement of Policy is a direct response to the court’s decision in *Culpepper III* and is HUD’s way of saying “thank you . . . I can talk for myself.” *Id.*

83. *Culpepper*, 253 F.3d at 1330.

84. 2001 Statement of Policy 66 Fed. Reg. at 53,055.

85. *Culpepper*, 253 F.3d at 1331.

86. *Id.*

87. See 2001 Statement of Policy, 66 Fed. Reg. at 53,055 (reiterating the 1999 Statement of Policy’s requirement that both parts of the HUD test be applied when analyzing the legality of yield spread premiums under RESPA).

88. *Id.*

them in the months since the Eleventh Circuit decided *Culpepper III*.<sup>89</sup> The 2001 Statement of Policy, focusing on the importance of analyzing each yield spread premium individually under both parts of the HUD test, tries to silence the effect of *Culpepper III* and put an end to the certification of all future class action suits challenging the legality of yield spread premiums under section eight of RESPA.<sup>90</sup> Advocates on both sides of the yield spread premium issue, realizing that courts tend to give deference to a statement of policy issued by an agency that is granted the power to interpret, agree that this statement may weaken the effect of *Culpepper III*.<sup>91</sup>

As one would imagine, the mortgage industry is very pleased with the 2001 Statement of Policy.<sup>92</sup> Faced with nearly two hundred similar class action suits filed after the *Culpepper III* decision, the 2001 Statement of Policy could potentially save some of the largest mortgage lending firms from bankruptcy.<sup>93</sup> This statement of policy has led to other victories for the mortgage brokerage industry. Two district court cases involving the legality of yield spread premiums, *Bjustrom v. Trust One Mortgage Corporation*<sup>94</sup> and *Vargas v. Universal Mortgage Corporation*,<sup>95</sup>

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89. See Julavits & Bergquist, *supra* note 69, at 9 (criticizing HUD's decision to focus on disclosure requirements in the new statement of policy).

90. See 2001 Statement of Policy, 66 Fed. Reg. at 53,055 (reiterating that "it is necessary to look at each transaction individually" under the first part of the HUD test). The 2001 Statement of Policy's mandate that all loans be analyzed individually defeats the requirement for class certification under Rule 23(b)(3) of the Federal Rules of Civil Procedure which states that "questions of law or fact common to the members of the class predominate over any questions affecting only individual members." FED. R. CIV. P. 23(b)(3) (2001).

91. See Julavits & Bergquist, *supra* note 69, at 9.

92. See Julavits & Bergquist, *supra* note 69, at 9. See generally Courson Testimony, *supra* note 58; Falk Testimony, *supra* note 58; Collins, *supra* note 82, at 1.

93. R. Christian Bruce, *HUD Kicks Off Home Finance Reforms; Policy Clarification Could Limit Class Suits*, 77 BANKING REP. (BNA) 651 (Oct. 22, 2001).

94. *Bjustrom v. Trust One Mortgage*, No. C00-1166P, 2001 U.S. Dist. LEXIS 17890, at \*1 (W.D. Wash. Oct. 26, 2001). In *Bjustrom*, the district court held that since there was no general one percent origination fee cap on a mortgage broker's compensation, yield spread premiums and service release premiums could be received by brokers in addition to the one percent origination fee charged to the homebuyer. *Id.* at \*2. The district court, adhering to HUD's 2001 Statement of Policy, held that a yield spread premium was a legal form of compensation under RESPA and did not qualify for consideration under the one percent fee cap. See *Broker can collect 1 percent origination fee, plus yield spread and service premiums*, 5 CONSUMER FIN. SERV. L. REP., No. 11 (Nov. 26, 2001). It is important to note that

have rejected the Eleventh Circuit's decision in *Culpepper III* and, instead, relied on the 2001 Statement of Policy to deny class certification.<sup>96</sup>

While the 2001 Statement of Policy facially appears to be an all out win for the mortgage industry, experts are speculating as to the possible ill effects the Statement of Policy may have on the industry.<sup>97</sup> First, the advocates for the mortgage industry are concerned that the 2001 Statement of Policy and the upcoming rulemaking may single out mortgage broker compensation rather than the compensation received by all originators within the mortgage industry.<sup>98</sup> Second, advocates note that the 2001 Statement of Policy was a huge victory for the lenders but "does not offer [the] closure" for mortgage brokers that it does for lenders.<sup>99</sup> Mortgage brokers will be subject to a new set of rules regarding broker disclosure upon HUD's completion of the rulemaking process with respect to this issue.<sup>100</sup>

In the opinion of consumer advocates, the 2001 Statement of Policy is an additional hurdle for the homebuyer, which leaves him more vulnerable than ever to attacks by the mortgage

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the district court stated that they "cannot conclude that the 2001 policy statement is an impermissible interpretation of RESPA. Consequently, the Court defers to HUD in considering that yield spread premiums and service release premiums be examined through an individualized determination of whether total compensation is reasonably related to the services provided." *Bjustrom*, No. C00-1166P, 2001 U.S. Dist. LEXIS 17890, at \*34-35 (W.D. Wash. Oct. 26, 2001).

95. *Vargas v. Universal Mortgage Corp.*, No. 01C0087, 2001 U.S. Dist. LEXIS 19635, at \*1 (N.D. Ill. Nov. 29, 2001). The district court denied class certification and analyzed the legality of the yield spread premium in question in accordance with the two-part test as set forth in HUD's 1999 Statement of Policy and clarified in the 2001 Statement of Policy. *Id.*

96. *See Court applies HUD 2001 policy statement, denies class action certification*, 5 CONSUMER FIN. SERV. L. REP., No. 12 (Dec. 26, 2001).

97. *See Collins*, *supra* note 82.

98. *Id.*

99. *Id.*

100. *Id.* While the rule is being considered, HUD has urged brokers to adhere to a list of "best practices" in order to provide an interim solution while the new rule is being considered. 2001 Statement of Policy, 66 Fed. Reg. 53,052, 53,052 (Oct. 18, 2001). A best practice suggested by HUD would focus on the goal of early disclosure to the borrower by reporting the yield spread premium as a "credit to the borrower in the '200' series, among the 'Amounts Paid by or in Behalf of Borrowers.'" *Id.* at 53,056. The benefit to this method would be to allow "the homebuyer or homeowner . . . [to] see that the yield spread premium is reducing closing costs, and also see the extent of the reduction." *Id.*

brokerage industry.<sup>101</sup> HUD's strong disapproval of the *Culpepper III* decision coupled with the declaration that yield spread premiums must be analyzed individually on a loan-by-loan basis is an attempt to eliminate the ability of a class of homebuyers to challenge the legality of certain yield spread premiums under section eight of RESPA.<sup>102</sup> Rather than aid the plight of the helpless borrower through early disclosure, consumer advocates argue that this statement of policy was merely issued in order to "head off class action claims"<sup>103</sup> which could bankrupt many mortgage lenders.<sup>104</sup> HUD's decision to curtail a borrower's right to challenge the legality of a yield spread premium under RESPA will be costly to borrowers.<sup>105</sup>

With a rulemaking expected from HUD during the spring of 2002, Senate Banking Committee Chairman Paul Sarbanes conducted hearings the week of January eighth on the abuses of yield spread premiums in the hope of "pressuring" HUD into promulgating a "fair" rule.<sup>106</sup> The hearings conducted by Sarbanes featured several key players on both sides of the yield spread premium debate. Joseph Falk, president of NAMB, and John Courson, chairman-elect of MBA, spoke in support of HUD's 2001 Statement of Policy<sup>107</sup> and David R. Donaldson, attorney for the plaintiff class in the *Culpepper* litigation, and Howell E. Jackson, a professor at Harvard Law School who has investigated the economic impact of yield spread premiums, spoke in opposition to the 2001 Statement of Policy.<sup>108</sup> Both Falk and

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101. See Collins, *supra* note 82, at 1; Julavits & Bergquist, *supra* note 69, at 9.

102. See Bruce, *supra* note 93, at 651.

103. Adam Wasch, *Fair Lending: Sarbanes Turns Heat Up On Recent HUD Yield Spread Premiums Policy*, BNA BANKING DAILY, Jan. 4, 2002.

104. See Bruce, *supra* note 93, at 651.

105. See *id.*

106. Adam Wasch, *supra* note 103. A critic of the 2001 Statement of Policy, Sarbanes stated that the policy "would contribute to ongoing abuses of low and moderate income home-buyers and will facilitate the predatory practice of steering homeowners to higher interest rate loans without their knowledge, and without any redress." *Id.*

107. Courson Testimony, *supra* note 58; Falk Testimony, *supra* note 58.

108. *Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums: Hearing before the Senate Banking, Housing and Urban Affairs Comm.*, 107th Cong. (Jan. 8, 2002) [hereinafter Jackson Testimony] (statement of Prof. Howell E. Jackson, Professor of Law at Harvard Law School) at [http://www.senate.gov/%7Ebanking/02\\_01hr/010802/jackson.htm](http://www.senate.gov/%7Ebanking/02_01hr/010802/jackson.htm) (last visited Feb. 23, 2002); *Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread*

Courson acknowledged that while there are instances in which brokers use a yield spread premium as a tool to inflate interest rates and increase compensation, this is not representative of the function yield spread premiums serve in the mortgage industry.<sup>109</sup> In their opinion, yield spread premiums are beneficial to the consumer and provide mortgage brokers with “the flexibility to offer consumers numerous options and choices as to the combination of up-front payments and interest rates that best suits the borrower’s individual needs.”<sup>110</sup>

On the other hand, Donaldson and Jackson, both opposed to the 2001 Statement of Policy, attempted to highlight Sarbanes’ belief that HUD’s latest statement of policy is “hurting, not helping” homebuyers.<sup>111</sup> Professor Jackson’s study of approximately 3,000 mortgages originated by one group of lending institutions in the late 1990s directly contradicts HUD’s statements concerning the usefulness of yield spread premiums.<sup>112</sup> Based on his investigation, Jackson notes that yield spread premiums are benefiting mortgage brokers rather than homebuyers.<sup>113</sup> According to his study, yield spread premiums are rarely optional and rarely needed.<sup>114</sup> The yield spread premium is merely a tool that benefits the wallet of the broker while costing the borrower, particularly the African American and Hispanic borrower, thousands of dollars.<sup>115</sup>

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*Premiums: Hearing before the Senate Banking, Housing and Urban Affairs Comm., 107th Cong. (Jan. 8, 2002) (statement of David R. Donaldson, attorney for plaintiff class in Culpepper v. Irwin Mortgage Corporation) [hereinafter Donaldson Testimony], at [http://www.senate.gov/%7Ebanking/02\\_01hr/010802/dnldson.htm](http://www.senate.gov/%7Ebanking/02_01hr/010802/dnldson.htm) (last visited Feb. 23, 2002).*

109. Courson Testimony, *supra* note 58; Falk Testimony, *supra* note 58.

110. Courson Testimony, *supra* note 58.

111. See Jackson Testimony, *supra* note 108; Donaldson Testimony, *supra* note 108; Fleishman, *supra* note 5, at E1. Although Sarbanes concedes that yield spread premiums can be legitimate in cases in which a borrower elects to pay broker fees through a higher interest rate, he emphasizes that, in many of the cases, the fee is nothing more than a payment for a referral in violation of section eight of RESPA which the borrower neither knows he is paying nor understands. *Id.*

112. Jackson Testimony, *supra* note 108.

113. *Id.*

114. *Id.*

115. *Id.* Jackson notes that mortgage brokers earn an average of \$1,046 more on loans with yield spread premiums. *Id.*

## VI. LOOKING TO THE FUTURE

Despite the mortgage brokerage industry's disapproval of the holding of *Culpepper III*, it currently represents the law in the Eleventh Circuit where many yield spread premium cases have been filed.<sup>116</sup> The Eleventh Circuit's grant of class certification<sup>117</sup> and the Supreme Court's rejection of Irwin's petition to review the *Culpepper III* decision mark two strikes against the mortgage brokerage industry.<sup>118</sup> While mortgage brokers and lenders have downplayed the Supreme Court's rejection by noting that it is not unusual for the Supreme Court to reject a case unless there are conflicting opinions in the circuit courts, the rejection does not bode well for mortgage brokers and lenders across the country.<sup>119</sup>

While the 2001 Statement of Policy is a strong statement of HUD's position on the legality of yield spread premiums and the various fee disclosures required throughout the mortgage application process, it must receive acceptance in the courts in order to shield mortgage brokers and lenders from the onslaught of class action suits as a result of *Culpepper III*. The true test of the power of HUD's 2001 Statement of Policy will occur when the District Court for the Northern District of Alabama hears the *Culpepper* case again.<sup>120</sup> Recent decisions in district courts in both Washington and Illinois have accepted and applied the analysis proffered by HUD in the 2001 Statement of Policy but a district court is only a small step for mortgage brokers and lenders.<sup>121</sup> The balance, especially in the Eleventh Circuit, weighs in favor of borrowers.<sup>122</sup>

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116. Jaworski, *supra* note 46, at 11.

117. See *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001).

118. *Irwin Mortgage Corp. v. Culpepper*, 70 U.S.L.W. 3464 (2002). On January 22, 2002, the Supreme Court rejected Irwin's petition to review the *Culpepper* class action lawsuit without explanation. *Id.*

119. See Brian Collins, *Supreme Court Refuses YSP Appeal*, NAT'L MORTGAGE NEWS, Jan. 28, 2002, 2002 WL 8158682.

120. See Brian Collins, *supra* note 119.

121. See *Bjstrom v. Trust One Mortgage*, No. C00-1166P, 2001 U.S. Dist. LEXIS 17890, at \*1 (W.D. Wash. Oct. 26, 2001) (granting defendant's motion for summary judgment); *Vargas v. Universal Mortgage Corp.*, No. 01C0087, 2001 U.S. Dist. LEXIS 19635, at \*1 (N.D. Ill. Nov. 29, 2001) (denying the plaintiff's motion for class certification).

122. See Brian Collins, *supra* note 119.

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Until the rulemaking process to reform RESPA is complete, a definitive answer concerning the legality of yield spread premiums and the proper manner by which to disclose mortgage-related expenses to borrowers is unlikely.<sup>123</sup> Only when there is a revision in place and then a subsequent determination that the statutory language is ambiguous requiring deference to an interpretation by an agency, which in this case is HUD, will the current dispute between mortgage lenders and brokers and borrowers be put to rest.<sup>124</sup> Thus, while the courts are currently the key players in the resolution of the dispute between the mortgage brokerage industry and borrowers, all eyes will be on HUD and Congress in the coming months.

LISA MORGAN

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123. See Brian Collins, *supra* note 119; Fleishman, *supra* note 5, at E1.

124. See *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

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