

The Unfair and Deceptive Use of Affiliated Business Arrangements

NAMB's efforts to prevent the use of tactics by some industry participants seeking to illegally capture market share through affiliated business arrangements ("AfBAs") have been noticed. In a recent article by nationally syndicated columnist Kenneth R. Harney, Federal Housing Commissioner, Brian D. Montgomery, commented on the recent "reports of consumers being forced – or feeling compelled – to sign on with a builder's mortgage company even when competing loan offers from unaffiliated brokers or banks were far superior."¹

BACKGROUND

When appropriately structured and disclosed, AfBAs, which are permissible under Section 8 of the Real Estate Settlement Procedures Act of 1974 ("RESPA"), can be beneficial to the industry and consumers by providing enhanced settlement services during mortgage transactions. However, NAMB has recently witnessed an increase in the number of AfBAs that are used in a manner that directly harms the consumer and potentially violates Section 5 of the Federal Trade Commission Act ("FTC Act" or "UDAP") – the primary federal law that prohibits unfair or deceptive acts or practices and unfair methods of competition in or affecting commerce. To combat the use of such harmful practices, over the past year NAMB has worked with the Federal Bureau of Investigation ("FBI"), State Attorneys General, and Congressional Representatives to shed light on the illegal use of AfBAs that restrict consumer choice and illegally capture market share.

AN EXAMPLE

One example of the illegal use of AfBAs arises from circumstances similar to the example that Montgomery mentioned – consumers are pressured into using a builder's affiliated lender.² In this example, builders offer consumers incentives, such as closing rebates or upgrades for their new home, and recommend a certain mortgage provider – *i.e.* the builder's in-house/affiliated mortgage provider. In moving through the home buying process, the consumer shops around and discovers that an unaffiliated mortgage provider can provide them with a more desirable loan product than the affiliated mortgage provider. But, when the consumer informs the builder they have chosen an unaffiliated mortgage company, the builder refuses to go to closing, cancels the contract, keeps the customer's deposit, and denies the consumer the previously offered incentives. Moreover, even where a consumer takes the incentives, it is unclear whether the costs are transferred back into the cost of the house or even the loan itself.³

Preventing the consumer from choosing a lower-cost unaffiliated mortgage harms competition and potentially violates federal anti-trust law. In this example, the builder is conditioning the purchase of the newly constructed home on the consumer's purchase of a mortgage through the builder's affiliated mortgage provider. NAMB believes that in this example, the builder's sale of the new home could be a "tie-in-sale," defined on the Federal Trade Commission's ("Commission") website, as a "sale of one product on condition that a customer purchase a second product, which the customer may not want or can buy elsewhere at a lower price. Requirements like these could be illegal if they harm

¹ Kenneth R. Harney. "Know When to Say No To Builders' Incentives." (June 24, 2006).

<http://www.washingtonpost.com/wp-dyn/content/article/2006/06/23/AR2006062300661.html>

² Kenneth R. Harney. "Know When to Say No To Builders' Incentives." (June 24, 2006).

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³ Lenders earn a service release premium ("SRP") and gain on sale but unlike mortgage brokers who are required to disclose the yield spread premium ("YSP") they do not have to disclose this backend compensation to the consumer.

competition.”⁴ Furthermore, not only is the purchase of the home conditioned on the use of the affiliated mortgage product, but the price of the home and the incentives offered are also conditioned upon the purchase of the second product – the affiliated mortgage.

NEXT STEPS

It is important to recognize that there are legitimate AfBAs and that not all builders restrict consumer choice. However, as an industry we must take steps to protect the competitive market and consumers. We must ensure that those using unethical and illegal means to restrict consumer choice through the use of AfBAs are held accountable. NAMB believes we must amend the current laws to prevent the use of AfBAs in a manner that advances unfair and deceptive trade practices.

NAMB has been proactive in this matter and over a year ago began to inform members, consumers and government officials alike to protect consumers and deter such unethical uses of AfBAs in the mortgage industry. NAMB believes efforts should be taken to protect the rights of homebuyers in dealing with homebuilders and sellers that have AfBAs with real estate service providers. Specifically, NAMB proposes to amend RESPA to include language that: (1) prevents the seller from refusing to sell; (2) increasing the cost of the property; (3) conditioning incentives on the use of an AfBA service provider; and (4) requiring different terms and/or conditions based on the use of an AfBAs service provider. While the use of AfBAs will still be permitted under RESPA, the unethical practice of restricting consumer choice to capture market share will be legally forbidden. Making this amendment to RESPA will protect consumer rights and ensure a competitive market.

MORE INFORMATION

For more information or to report a potential violation, contact your congressional representative, the Federal Trade Commission (www.ftc.gov), or the Department of Housing and Urban Development (www.hud.gov) in writing.

This article is for informational purposes only and does not constitute legal advice. Readers should not rely on it as such. No one should attempt to interpret or apply any law without the aid of an attorney.

⁴ <http://www.ftc.gov/bc/compguide/illegal.htm>