What Level of Fiduciary Duty Should Mortgage Brokers Owe Their Borrowers?

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WHAT LEVEL OF FIDUCIARY DUTY SHOULD MORTGAGE BROKERS OWE THEIR BORROWERS?

I. INTRODUCTION

The majority of borrowers purchasing or refinancing a home today obtain their mortgage loans through a mortgage broker.1 Within the last decade,2 mortgage brokers have surpassed the traditional mortgage lenders3 as the main providers of residential mortgage services.4 Although reasons cited for

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1. For the purpose of this Note, the term “mortgage broker” refers to any entity that solicits, processes and/or places a mortgage loan with a third-party mortgage lender on behalf of a borrower. Because a mortgage broker does not provide the actual funds for the loan, she acts only as an intermediary between a borrower seeking funds for the purchase or refinance of a home and the mortgage lender who ultimately provides these funds.

2. See George A. Platz, Avoiding and Defending Residential Mortgage Litigation Involving Loan Broker Compensation, Release Fees, and Defective Home Improvements, in FINANCIAL SERVICES LITIGATION: NEW PRODUCTS, HOT ISSUES, HIGH EXPOSURE-COMMERCIAL INVESTMENT ISSUES, CONSUMER CREDIT ISSUES 737 (Practicing Law Institute ed., 1996) (“Whereas only a small minority of residential mortgage loans involved a mortgage broker less than ten years ago, broker loans today comprise the majority”); John Manners, How You Can Save With a Mortgage Broker, MONEY, Feb. 1994, at 183 (“The number of brokers has nearly tripled to 18,500 in the past six years. They now arrange nearly half the 700,000 mortgage loans issued each month”).

3. For the purpose of this Note, the term “mortgage lender” refers to any entity that provides mortgage loans using their own funds. Mortgage lenders are comprised of three principal types of lending institutions: banks, insurance companies and mortgage bankers. A “bank” is the generic term used for any depository institution that, in addition to other banking services, places or refinances mortgage loans using depository funds. After funding the mortgage loan, a bank may either retain the mortgage loan in its own loan portfolio, or may resell the loan on the secondary mortgage market. Because banks possess this dual ability, they are usually willing to make both conforming loans (i.e., loans that meet the necessary requirements to be eligible for sale on the secondary market) and non-conforming loans (i.e., loans that do not meet the requirements of the secondary market and must be retained in the lender’s portfolio). The term “bank,” therefore, refers both to commercial banks as well as thrift institutions, such as savings banks, savings and loans, and credit unions.

Insurance companies fund mortgage loans from the insurance premiums paid to them by their policy holders. Because insurance companies retain these mortgages in their loan portfolio, they do not need to satisfy the requirements of the secondary market. As a result, most insurance companies focus their lending in the area of non-conforming loans. A mortgage banker is a non-depository entity whose sole function is to place or refinance mortgage loans using its own funds. After closing the mortgage loan, a mortgage banker resells the mortgage loan on the secondary mortgage market, recouping the funds it lent, and re-lending these funds to future borrowers. Because mortgage bankers must meet the requirements of the secondary market, they typically limit their lending to conforming loan programs. Mortgage bankers are not depository institutions themselves, so most mortgage bankers are affiliated with or owned by an institution that is able to provide the mortgage broker with the money necessary to fund their mortgages.

4. Most authorities agree that mortgage brokers currently originate at least half of all residential home mortgages. See, e.g., Kenneth R. Harney, Bias in Pricing of Mortgage Fees Cuts Across Lines of Race, Sex, Age, WASHINGTON POST, Sept. 14, 1996, at E01, available in 1996 WL 12393515 ("[I]ndependent mortgage brokers . . . [are] the source of 40 percent to 50 percent of all new home

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the recent increase in the mortgage broker’s market share vary, this expansion will undoubtedly result in increased litigation by borrowers against mortgage brokers. Such litigation could carry potentially grave consequences for mortgage brokers because many courts have imposed a general fiduciary duty on a mortgage broker’s dealings with its borrowers, but have not required such a duty of mortgage lenders. The result of this discrepancy is that mortgage brokers face potentially greater liability than mortgage lenders for conducting essentially the same mortgage transaction.

Part II discusses the components of agency and fiduciary duty, and explores situations in which courts have held mortgage brokers liable for a breach of a general fiduciary duty. Part III analyzes the inequity of imposing a general fiduciary duty on mortgage brokers in light of most courts’ unwillingness to impose a similar duty not only on mortgage lenders, but also on other brokers possessing characteristics and responsibilities similar to


5. Any number of factors have contributed to the increased market share of mortgage brokers, including: the ability of mortgage brokers to offer a greater variety of loan programs than single mortgage lenders; the ability of mortgage brokers to secure approval of certain types of mortgage loans that conventional mortgage lenders cannot; the demise of savings and loan institutions in the 1980s; and the increased reliance of banks on independent mortgage brokers in order to eliminate the bank’s cost of maintaining their own branch lending offices. See Earl C. Gottschalk, Jr., Picking the Wrong Mortgage Broker Can Become a Homeowner’s Nightmare, WALL ST. J., Mar. 26, 1992, at C1, available in 1992 WL-WJS 659864.

6. Mary Burt and Christian Jones note that the potential for litigation by borrowers against mortgage brokers exists because of the great variation in state legislation governing mortgage brokers:

The retail mortgage lending industry is subject to great variations in state regulation. There is little agreement both inside and outside of the industry as to its legal duties. It is not even clear how participants—particularly mortgage brokers—should be classified . . . It is not hard to predict that this legal uncertainty under state law will likely focus first on mortgage brokers, as it did in the RESPA rulemaking proceedings. Because brokers interact directly with consumers, they can be expected to be one of the first objects of scrutiny. Further, we believe that scrutiny will largely involve the duty owed to borrowers by mortgage brokers. This theme is already being played out in the media, the legislatures, and the courts. The legal question being asked is: Does a mortgage broker owe a fiduciary duty to an applicant for a mortgage loan?


7. See infra notes 9-15 and accompanying text for a discussion of the differences between a general and a specific fiduciary duty.

8. See Theodore H. Hellmuth, Lender Liability and Fiduciary Obligation: Dentures for a “Toothless Lion,” 3 PROB. & PROP. 20, 22 (1989) (“The lender who acts as a fiduciary to the borrower is liable for almost anything; the lender who does not is liable for almost nothing. This is not simply hyperbole. The average borrower must fend for himself or herself when negotiating the average loan. To the contrary, when a lender who is a fiduciary gains an advantage over the borrower, there is a presumption of unfairness”).
mortgage brokers. In addition, Part III analyzes current regulation of mortgage brokers at the federal and state level. Finally, Part IV proposes that courts should refrain from imposing a general fiduciary duty on mortgage brokers. Instead, courts should rely on existing regulations and market forces to insure that mortgage brokers deal fairly with their borrowers. This Note argues that state legislatures that have imposed a general fiduciary duty on mortgage brokers should, at the very least, permit borrowers and mortgage brokers to contract around the duplicative requirements of a general fiduciary duty.

II. FIDUCIARY DUTY AND MORTGAGE BROKERS

A. Overview of Fiduciary Duty

Analysis of fiduciary duty "comprises two fundamental issues: first, whether the relationship is fiduciary or not; and second, if it is, whether the resulting fiduciary duties were breached."9 In addressing the first issue, courts must determine whether a fiduciary relationship exists between the parties involved in a specific transaction. Courts typically find "there are two types of fiduciary relationships: (1) those specifically created by contract or a formal legal relationship, such as principal and agent . . . and (2) those implied in law due to the factual situation surrounding the transactions and relationships of the parties to each other and to the questioned transactions."10 This first type of fiduciary relationship, based upon the formal legal status of the parties involved,11 is termed "agency." Agency is defined as the "fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."12 This manifestation may be written (i.e., contract) or may be inferred from the relationship of the parties. Within the agency relationship, the agent becomes a fiduciary of the principal and must act for the principal's benefit as to

11. Relationships that fall under this category of fiduciary relations are fairly easy to detect, mainly because the legal status of the parties to a transaction, or the legal documents that provided the basis for the transaction, are usually incontrovertible. The most common legal relationships that give rise to general fiduciary duties are: (1) principal-agent; (2) attorney-client; (3) trustee-beneficiary; (4) partner-partner; (5) escrowee-beneficiary; and (6) guardian-ward. Denison State Bank v. Madeira, 640 P.2d 1235, 1241 (Kan. 1982).
matters within the scope of the agency. For the purpose of this Note, it is the agency relationship that gives rise to a "general fiduciary duty." The second category of fiduciary relationships involves a "specific" fiduciary relationship that arises as a result of circumstances specific to the parties' transaction. Therefore, even though general fiduciary duties may not arise at the outset of a transaction, the particular circumstances of the transaction may give rise to specific fiduciary duties.

After determining that a fiduciary relationship has arisen, a court must then determine whether the actions of the fiduciary breached the duties imposed by the fiduciary relationship. Although courts do not apply a uniform standard to determine which specific duties are encompassed within "fiduciary duty," the following duties are generally included: duty of loyalty, duty of good faith, duty of due care and duty of disclosure.

13. See id. § 13 ("An agent is a fiduciary with respect to matters within the scope of his agency").
14. This Note uses the terms "general" and "specific" to distinguish the two different manners in which a fiduciary duty may arise, not the degree to which this fiduciary duty controls the relationship between the parties. Therefore, a "general fiduciary duty" is one that generally arises at the outset of a transaction based upon the status of the parties to the transaction, without requiring any showing that the fiduciary performed any specific acts which would create a fiduciary duty otherwise.
15. The difficulty in determining whether or not a fiduciary relationship arises within this second category is evident from the laundry list of factors that the Kansas Supreme Court cites as possible indicia of a "specific" fiduciary relationship:

[The acting of one person for another; the having and the exercising of influence over one person by another; the reposing of confidence by one person in another; the dominance of one person by another; the inequality of the parties; and the dependence of one person upon another. In addition, courts have considered weakness of age, mental strength, business intelligence, knowledge of the facts involved or other conditions giving to one an advantage over the other.]


Ironically, only six years earlier, the Kansas Supreme Court appeared to have conceded that it could not enumerate every possible factor a court could rely on to determine the existence of a specific fiduciary relationship. See Curtis v. Freden, 585 P.2d 993, 998 (Kan. 1978) ("Whether or not a confidential or fiduciary relationship exists depends on the facts and circumstances of each individual case. This court has refused, for that reason, to give an exact definition to fiduciary relations").

16. A discussion about the creation of specific fiduciary duties in the lending relationship is beyond the scope of this Note, therefore the following discussion will focus solely on general fiduciary duties created by a court's determination that a mortgage broker becomes the agent of a borrower based solely upon her status as a "broker." For a thorough analysis of the creation of specific fiduciary duties within the lender-borrower relationship, see Cecil J. Hunt, II, The Price of Trust: An Examination of Fiduciary Duty and the Lender-Borrower Relationship, 29 Wake Forest L. Rev. 719 (1994).
18. See Kahler, Inc. v. Weiss, 539 N.W.2d 86, 92 (S.D. 1995) ("A real estate agent owes the principal a fiduciary duty to use reasonable care, skill and diligence").
19. See Faron v. Waddell & Reed, Inc., 930 S.W.2d 508, 511 (Mo. Ct. App. 1996) ("Implicit in [a stockbroker's fiduciary obligations to his customer] is a duty to disclose to the customer material
Therefore, an agent breaches her fiduciary duty to her principal when she violates a duty within the scope of the fiduciary relationship.\textsuperscript{20}

\section*{B. The Fiduciary Duties of Mortgage Brokers}

Many authorities hold that agency law generally applies to the relationship between a broker\textsuperscript{21} and her customer.\textsuperscript{22} Within the agency relationship, the broker acts as an agent of her principal/customer and owes certain fiduciary duties to her principal.\textsuperscript{23}

Some courts hold that mortgage brokers do not owe their borrowers a general fiduciary duty, reasoning that the loan transaction is conducted at arm's length, and is similar to the loan transaction between a mortgage lender and her borrower.\textsuperscript{24} In contrast, other courts have held that a general facts”.

\textsuperscript{20} Authorities disagree on the breadth of the scope of an agent's fiduciary relationship. Some legal analysts advocate a broad scope of fiduciary obligation, as enunciated by Professor DeMott: “The fiduciary's duties go beyond mere fairness and honesty; they oblige him to act to further the beneficiary's best interests. The fiduciary must avoid acts that put his interests in conflict with the beneficiary's.” Deborah A. DeMott, \textit{Beyond Metaphor: Analysis of Fiduciary Obligation}, 1988 DUKE L.\textit{J.} 879, 882 (1988).

\textsuperscript{21} Other analysts conclude that the scope of fiduciary obligation should be defined in a narrower fashion. Under this "hypothetical bargaining" approach, a court decides the scope of fiduciary obligation based upon what the parties would have agreed to, had they bargained over the particular matter in question. See Jordan v. Duff & Phelps, Inc., 815 F.2d 429 (7th Cir. 1987).

\textsuperscript{22} Courts generally define a broker as "an agent who bargains or carries on negotiations in behalf of his principal as an intermediary between the latter and third persons in transacting business relative to the acquisition of contractual rights, or to the sale or purchase of any form of property, real or personal, the custody of which is not entrusted to him for the purpose of discharging his agency." City of Chicago v. Barnet, 88 N.E.2d 477, 480 (Ill. 1949).

\textsuperscript{23} See 12 C.J.S. \textit{Brokers} § 25 (1953) (“The primary and essential feature underlying the relation of customer and broker is that of agency”); \textit{City of Chicago}, 88 N.E.2d at 481 (“The essential and basic feature underlying the relation of a broker to his employer is that of agency, and the principles of law applicable to the principal and agent govern their respective rights and obligations throughout”) (quoting 8 AM. \textit{JUR. Brokers} § 14 (1937)); Brown & Zortman Mach. Co. v. City of Pittsburgh, 100 A.2d 98, 101 (Pa. 1953) (“Agency is one of the chief characteristics of a broker”). \textit{But see} Carr v. Cigna Sec., Inc., 95 F.3d 544, 547 (7th Cir. 1996) (“The general rule, however, is that a broker is not the fiduciary of his customer unless the customer entrusts him with discretion to select the customer's investments”).

\textsuperscript{24} See 12 C.J.S. \textit{Brokers} § 56 (1955) (“[A] broker when acting as an agent for a principal occupies a fiduciary relation, in all his dealings affecting the subject matter of his agency, [and] must act with the utmost good faith and loyalty in his interest of his principal”).

\textsuperscript{24} In Cooper v. Burby, No. 387563, 1992 WL 97044, at *4 (Conn. Super. Ct. Apr. 29, 1992), the court noted that the mortgage broker and borrower “stand at arm's length” and that a mortgage broker “has a right to further its own interest in a mortgage transaction and is under no duty to represent the customer's interest.” In \textit{Bank of Red Bay v. King}, 482 So. 2d 274, 285 (Ala. 1985), the court did not distinguish any underlying fundamental difference in the mortgage broker-borrower relationship, holding that “[w]hen both parties are intelligent and fully capable of taking care of themselves and dealing at arm's length, with no confidential relations, no duty to disclose exists when information is not requested, and mere silence is then not a fraud.”
fiduciary relationship does arise between a mortgage broker and a borrower. Typically, courts base this relationship on agency, rather than contract principles. Where courts have imposed this general fiduciary duty, mortgage brokers have typically breached this duty to their borrower in one of three scenarios: failure to disclose loan terms; failure to disclose loan fees; and failure to provide the most favorable loan terms or lowest loan fees.

1. Breach of Fiduciary Duty by Failure to Disclose Loan Terms

In Wyatt v. Union Mortgage Company, a mortgage broker orally misrepresented certain mortgage terms to the borrower and failed to call the borrower's attention to the "true" terms buried in the loan documents. The Supreme Court of California affirmed the borrower's breach of fiduciary duty claim, holding that "a mortgage broker is customarily retained by a borrower to act as the borrower's agent in negotiating an acceptable loan." The court reasoned that agency principles combine with California real estate

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25. See Gorbach v. Trupin, 254 A.2d 583, 586 (Conn. Cir. Ct. 1968) ("The rights and duties of a broker employed to secure a loan depend on the same principles as those which govern the broker who undertakes to find a purchaser of the property").

26. Mortgage brokers, unlike other potential fiduciaries, do not typically incur fiduciary duties through express contractual agreements with their customers. This can be attributed to the fact that most mortgage brokers, unlike real estate brokers, do not expressly contract to act as the borrower's agent. Some courts, however, have held that the loan application between the borrower and the mortgage broker itself constitutes a contractual creation of a fiduciary relationship. In Langer v. Haber Mortgages, Ltd., N.Y. L.J., Aug. 2, 1995, at 26, col. 4, the borrower applied with a mortgage broker, Haber Mortgage, Ltd. ("Haber"), to refinance an existing mortgage loan, and executed a written agreement naming Haber as his agent. The borrower subsequently signed an interest rate agreement with a third-party mortgage lender located by Haber, ARCS Mortgage, Inc. ("ARCS"). Pursuant to this agreement, ARCS would "lock" the borrower into a specific interest rate for the duration of the loan processing period. Although ARCS denied the borrower's application, Haber misrepresented to the borrower that ARCS had approved the loan. The court held that the loan application agreement naming Haber as the borrower's agent established a fiduciary relationship, reasoning that "by their very nature, contracts between mortgage brokers and their clients generally create a fiduciary duty ..." Id. Cases in which a fiduciary relationship is created contractually appear to be the exception, not the rule. A written agreement between a borrower and mortgage broker whereby both parties agree that the mortgage broker is not the agent of the borrower appear to prevent a fiduciary relationship from arising contractually. However, it is unclear whether such a disclaimer would be sufficient to prevent a fiduciary relationship from arising under agency principles.

27. 598 P.2d 45 (Cal. 1979) (en banc).

28. Union Mortgage informed the borrowers that they had a 10-day grace period after the payment was due before it would be considered late, whereas the true grace period was five days. In addition, Union Mortgage disclosed that the annual percentage rate ("APR") was approximately between seven and eight percent, when in reality, the true APR was 10%. Finally, Union Mortgage indicated that a small balloon payment would be due in the 37th month, but the true balloon provision permitted the unreduced loan principal to be deferred, resulting in a balloon payment $1340 more than the original loan principal. See id. at 48-49.

29. Id. at 50.
law to “impose upon mortgage brokers an obligation to make a full and accurate disclosure of the terms of a loan to borrowers and to act always in the utmost good faith toward their principals.\textsuperscript{30} Other recent California decisions suggest that a mortgage broker’s general fiduciary obligation to disclose loan terms continues to be enforced.\textsuperscript{31}

2. Breach of Fiduciary Duty by Failure to Disclose Loan Fees

In \textit{Rushing v. Stephans},\textsuperscript{32} a mortgage broker required a borrower to sign mortgage-related documents, leaving several sections blank.\textsuperscript{33} Unbeknownst to the borrower, the mortgage broker increased the agreed-upon amount of the loan by $1600 to cover undisclosed loan costs and broker’s commissions.\textsuperscript{34} The Supreme Court of Washington held that the mortgage broker, as an agent of the borrower,\textsuperscript{35} breached his fiduciary duty to “reveal the nature and extent of his fees to the client for whom he acts.”\textsuperscript{36}

3. Breach of Fiduciary Duty by Failure to Provide Best Possible Loan Terms

In \textit{Realty Projects, Inc. v. Smith},\textsuperscript{37} a mortgage broker persuaded prospective borrowers to increase their loan amount so that it would exceed the statutory limits for regulated loans under state law.\textsuperscript{38} Because the borrower’s loan amount exceeded the statutory limits, the mortgage broker


\textsuperscript{31} See \textit{Munday v. Real Estate Advisors, Inc.}, No. C-95-20143-JW, 1995 WL 549015, at *2 (N.D. Cal. Sept. 12, 1995) (citing \textit{Wyatt} for favorable support that a mortgage broker breached its fiduciary duty to a borrower by failing to disclose that the non-recording of certain documents is not the custom in the real estate industry and could give rise to fraud); \textit{Umet Trust v. Santa Monica Med. Inv. Co.}, 140 Cal. App. 3d 864, 866 (Cal. Ct. App. 1983) (holding that the mortgage broker breached his fiduciary duty to a borrower by misrepresenting or failing to disclose the negative legal consequences of sale leaseback financing).

\textsuperscript{32} 393 P.2d 281 (Wash. 1964).

\textsuperscript{33} The borrower signed the following forms in blank: a loan application, a note, a mortgage, and a hold-harmless agreement. \textit{See id.} at 282.

\textsuperscript{34} \textit{See id.}

\textsuperscript{35} The court did not explain its reasons for applying agency principles to this transaction. Instead, the court merely stated that the mortgage broker’s actions were “a breach of the duty of loyalty which an agent has to his principal.” \textit{Id.} at 283.

\textsuperscript{36} \textit{Id.} at 284. The court proceeded to hold that “[w]here there has been a breach of the fiduciary relationship in addition to the partial concealment of fees,” the mortgage broker must forfeit his compensation for the disobedient conduct. \textit{Id.}


\textsuperscript{38} \textit{See id.} at 73.
could charge a higher broker commission. The California Court of Appeals held that the mortgage broker breached his fiduciary duty to the prospective borrowers, because “[m]ortgage loan brokers ... hold themselves out to prospective borrowers as loan experts who will endeavor to obtain for prospective borrowers ... a loan adequate for their needs and at the lowest practicable cost.”

This theory has found broad application in connection with recent litigation alleging that mortgage brokers breach their general fiduciary duty to borrowers when they accept “yield-spread premiums” from mortgage lenders. Yield-spread premiums are defined as “any compensation received by a mortgage broker ... for originating a loan at [an interest] rate and/or points” above that which the lender would otherwise agree to make the loan. Two recent Virginia cases, Byrd v. Crosstate Mortgage and Inv., Inc. and Archer v. Sterling, analyze whether mortgage brokers breach a general fiduciary duty to borrowers by accepting undisclosed yield-spread premium payments from third-party lenders. Although the mortgage

39. See id. At the time the loans in this case were made, California’s Necessitous Borrower’s Act applied to first mortgages under $10,000 and junior liens under $5000. See 1961 Cal. Stat. ch. 886, s. 24, p. 2339. The Necessitous Borrower’s Act regulated the maximum commission a lender could charge a borrower. The law, however, did not limit the amount of commission a lender could charge on loan amounts greater than these statutory limits. See id.

40. Realty Projects, 108 Cal. Rptr. at 75-76 (emphasis added). The court held that the mortgage broker possessed no economic justification for inducing the borrower to take a loan amount in excess of the statutory limits. The court concluded that the amount of each loan was determined solely by the fact that commissions could be charged “substantially in excess of those permitted on regulated loans.” Id. at 74.

41. This Note uses the term “yield-spread premium” to describe payments a mortgage broker receives from a mortgage lender, but it is not uncommon for the term “overage” to be used interchangeably. See Neal Gendler, “Yield Spread Premium” Suits Prompt Questions About Broker Business, MINNEAPOLIS-ST. PAUL STAR TRIB., Feb. 15, 1997, at 04H, available in 1997 WL 7554523. The practice of using these two terms interchangeably is technically incorrect, because “overage” refers to any discount points charged that are in excess of the amount of discount points a mortgage provider must charge.

42. Discount points are prepaid interest on the mortgage loan paid at the time of the loan closing. Each point is equal to one percent of the loan amount.

43. Robert M. Jaworski, Overages: To Pay or Not to Pay, That Is the Question, 113 BANKING L.J. 909, 910 (1996). The investor essentially pays the mortgage broker a fee representing a portion of the additional interest she will collect as a result of the mortgage broker charging the borrower a higher-than-market interest rate or greater upfront fees (i.e., discount points).

44. 34 Va. Cir. 17; Case No. LW-3263-4 (1994).

45. 34 Va. Cir. 17; Case No. LW-3264-4 (1994).

46. Because the facts and issues presented in both of these cases were virtually identical, the court ruled on both cases in one opinion. In Byrd v. Crosstate, 34 Va. Cir. 17; Case No. LW-3263-4 (1994), a mortgage broker collected a total of $1251.57 in connection with the plaintiff’s mortgage loan. This amount consisted of $220 in discount points and service charges paid by the borrower to the broker, a $280 broker fee paid by the borrower to the broker and $351.57 in yield-spread premium paid by the third-party lender to the broker. Only the broker fee was disclosed to the borrower prior to
brokers argued that they had no fiduciary duty to their respective borrowers, the court summarily declared that the "defendants' assertions that they are not fiduciaries are utterly without merit." The court reasoned that the mortgage brokers breached their fiduciary duty to disclose "all facts within the broker's knowledge which may be material to the transaction" when the brokers did not disclose all fees—including those paid by third parties—that were paid to the mortgage brokers at closing.

III. ANALYSIS

A. General Fiduciary Duty of Mortgage Lenders

As a general rule, courts do not impose a general fiduciary duty on mortgage lenders. Most courts hold that mortgage loan transactions between mortgage lenders and their borrowers are arms-length transactions between creditors and debtors. Because a mortgage lender (unlike a mortgage broker) is the actual provider of the mortgage funds, most courts

closing. See id. In Archer v. Sterling, 34 Va. Cir. 17; Case No. LW-3264-4 (1994), a mortgage broker collected $1146.41 in connection with the plaintiff's mortgage loan. This amount consisted of $494 in discount points and service charges paid by the plaintiff to the broker, a $198 broker fee paid by the plaintiff to the broker, and $354.41 in yield-spread premium paid by a third-party lender to the broker. Once again, the broker only disclosed the broker fee to the plaintiff prior to closing. See id. 47. 34 Va. Cir. 17, 21 (1994).

48. Id. at 20.

49. See Mid-America Nat'l Bank v. First Sav. & Loan of South Holland, 515 N.E.2d 176, 181 (Ill. App. Ct. 1987) ("The conventional mortgagor-mortgage relationship . . ., standing alone, is insufficient to sustain an allegation of a fiduciary or special relationship"); Vacinek v. First Nat'l Bank of Pine City, 416 N.W.2d 795, 799 (Minn. Ct. App. 1987) ("A bank is generally not its customer's fiduciary unless the bank knows or ought to know its customer is placing confidence in the bank"); UT Communications Credit Corp. v. Resort Dev., Inc., 861 S.W.2d 699, 710 (Mo. Ct. App. 1993) ("As a matter of law, absent some other evidence of a fiduciary relationship, there is no such relationship between a bank and lender and its customer as borrower"); Production Credit Ass'n v. Croft, 423 N.W.2d 544, 546 (Wis. Ct. App. 1988) ("The mere existence of a lender-borrower-customer relationship does not create a fiduciary relationship").

50. See Stone v. Davis, 419 N.E.2d 1094, 1098 (Ohio 1981) ("[A] bank and its customer may be said to stand at arm's length in negotiating the terms and conditions of a mortgage loan").

51. See Bank of Red Bay v. King, 482 So. 2d 274, 285 (Ala. 1985) ("The relationship between a bank and its customers has been traditionally viewed by courts as a creditor-debtor relationship which does not impose a fiduciary duty of disclosure on the bank"); Dolton v. Capitol Fed. Sav. & Loan Ass'n, 642 P.2d 21, 23 (Colo. Ct. App. 1981) ("In the absence of special circumstances, the legal relationship between a lending institution and its customer is that of debtor and creditor"); Deist v. Wachholz, 678 P.2d 188, 193 (Mont. 1984) ("The relationship between a bank and its customer is generally described as that of debtor and creditor and as such does not rise to fiduciary responsibilities") (citation omitted); Umbaugh Pole Bldg. Co., Inc. v. Scott, 590 N.E.2d 320, 321 (Ohio 1979) ("The relationship of debtor and creditor without more is not a fiduciary relationship. A fiduciary relationship may be created out of an informal relationship, but this is done only when both parties understand that a special trust or confidence has been reposed").
reason that the borrower’s interests are protected by the process of arms-length bargaining between adverse parties.\textsuperscript{52} Although many courts hold that subsequent circumstances may give rise to a specific fiduciary relationship between a mortgage lender and a borrower,\textsuperscript{53} this Note focuses on whether a fiduciary duty arises solely by virtue of the legal status of the particular mortgage provider.\textsuperscript{54}

\textbf{B. General Fiduciary Duty and Other Brokers}

All brokers do not attain the same fiduciary relationship with a customer; rather, the level of duty a broker owes a client depends on the extent of the parties’ relationship.\textsuperscript{55} Therefore, in order to compare the degree of general fiduciary duty required of brokers, this Note analyzes other broker/client relationships that closely resemble the relationship between mortgage brokers and borrowers. These examples clearly indicate that other brokers, acting in a capacity and under circumstances similar to a mortgage broker, typically owe a very limited general fiduciary duty to their clients, if any. Although real estate brokers do owe a general fiduciary duty to their principals, the duties and responsibilities of mortgage brokers and real estate brokers are readily distinguishable.

\textit{1. Consumer Loan Brokers}

A consumer loan broker is a non-lender, such as a car dealer, that serves as an intermediary between a purchaser of consumer goods (e.g., car purchaser) and a potential lender. In \textit{Blon v. Bank One, Akron, N.A.},\textsuperscript{56} a car

\textsuperscript{52} See Weinberger v. Kendrick, 698 F.2d 61, 79 (2d Cir. 1982) ("[It would be anomalous to require a lender to act as a fiduciary for interests on the opposite side of the negotiating table").

\textsuperscript{53} See Union State Bank v. Woell, 434 N.W.2d 712, 721 (N.D. 1989) ("Some courts have recognized that a fiduciary relationship may arise under circumstances which reflect a borrower's reposing of faith, confidence and trust in a bank with a resulting domination, control or influence exercised by the bank over the borrower's affairs"). Professor Cecil J. Hunt has categorized the special circumstances that courts look at in determining whether a lender-borrower relationship extends beyond the normal arms-length relationship between a mortgage lending institution and a borrower. Three categories of factors cited for "special circumstances" are: (1) the borrower reposes special trust and confidence in the lender; (2) the borrower receives and relies on advice rendered by the lender; and (3) the lender gains superiority, influence, dominion or control over the borrower. See Hunt, \textit{supra} note 16, at 740-41.

\textsuperscript{54} For the purpose of this Note, the term “mortgage provider” refers to both mortgage brokers and mortgage lenders, collectively.

\textsuperscript{55} See Fey v. Walston & Co., Inc., 493 F.2d 1036, 1049 (7th Cir. 1974) (holding that the “mere existence of a broker-customer relationship is not proof of its fiduciary character”).

\textsuperscript{56} 519 N.E.2d 363 (Ohio 1988).
dealership failed to disclose a "finder's fee" paid to them by Bank One "for preparing and placing the Blons' loan with Bank One." The court held that neither Bank One nor the car dealership was under a fiduciary duty to disclose this fee because the car loan "was nothing more than an ordinary arm's-length transaction." The court reasoned that:

a creditor and consumer stand at arm's-length in negotiating the terms and conditions of a consumer loan and, absent an understanding by both parties that a special trust and confidence has been reposed in the creditor, the creditor has no duty to disclose to the consumer the existence and details of a finder's fee or similar arrangement with a credit arranger.

Similar to a consumer loan broker, a mortgage broker serves only as an intermediary between the borrower and the ultimate provider of funds. Therefore, as long as the mortgage broker makes all the proper disclosures to the borrower, the broker should not be held to a higher standard.

57. Bank One paid West Chevrolet, the car dealer, a fee of three percent of the loan amount pursuant to a sliding fee schedule agreement between Bank One and West Chevrolet. See id. at 365.

58. Id.

59. Id. at 368. Another recent case which arrives at a similar decision is Perino v. Mercury Fin. Co. of Ill., 912 F. Supp. 313 (N.D. Ill. 1995). In this case the plaintiff purchased a used car from Mancari's Chrysler Plymouth, Inc. ("Mancari Chrysler"). See id. at 314. Mancari Chrysler agreed to arrange financing for the plaintiff through MFC Illinois, a "sales finance agency" whose primary business included purchasing individual installment sales contracts from automobile dealers and retail vendors. Id. Mancari Chrysler executed a retail installment contract with the plaintiff at an APR of 41.04%. MFC Illinois subsequently purchased the plaintiff's installment contract from Mancari Chrysler at an APR lower than 41.04%, crediting part of the difference between the two rates back to Mancari Chrysler. See id. The plaintiff claimed that MFC's undisclosed payment of this money to Mancari Chrysler "induced the dealer to breach the duty it owed [the plaintiff] as his agent and that MFC Illinois' conduct is explicitly illegal." Id. at 318. The court held that "the alleged failure to disclose this discount does not violate either federal or state law" because MFC Illinois "made all required disclosures under the federal Truth-In-Lending Act." Id.

60. Blon, 519 N.E.2d at 368.

61. But see Robert A. Cook, Yield-Spread Premiums Come Under Attack, 48 CONSUMER FIN. L.Q. REP. 94, 96 (Winter 1994) (asserting that mortgage brokers are distinguishable from consumer loan brokers because it is "reasonable for borrowers to expect that [mortgage] brokers with whom they have entered into a contractual relationship owe some duty to them to obtain the best loan possible"). Cook's attempt to differentiate these two types of brokers is incorrect. While a borrower may pay a mortgage broker a broker fee, this fee is not paid to secure the best terms for the borrower. Rather, this fee covers the broker's costs in processing and placing the mortgage loan. Unlike mortgage brokers, consumer loan brokers typically incur only nominal costs in connection with processing the loan financing because the costs of processing the consumer loan applications are borne by the provider of the funds.
2. Stock Brokers

Although the stockbroker/customer relationship is governed primarily by agency and securities laws, stockbrokers also may be liable to their customers based on a breach of fiduciary duty. Because stockbrokers provide their customers with a wide variety of services, ranging from simply executing a customer’s purchase or sales orders to exercising complete management control over a customer’s portfolio, courts typically consider the circumstances surrounding the alleged wrongdoing. In determining whether a stockbroker owes his customer a fiduciary duty, courts give considerable weight to whether the stockbroker managed a discretionary account or a non-discretionary account on behalf of her customer. Courts that make this distinction typically hold that a stockbroker who manages a discretionary account for a customer incurs a general fiduciary duty to the customer, whereas a stockbroker managing a non-discretionary account does not.

Similar to stockbrokers managing non-discretionary accounts, a mortgage

62. For a brief discussion of the application of agency law to the stockbroker/customer relationship, see Carol R. Goforth, Stockbrokers’ Duties To Their Customers, 33 St. Louis U. L.J. 407, 409-12 (1989).
63. For a brief discussion of the application of securities laws to the stockbroker/customer relationship, see id. at 412-17.
64. A discretionary account is one in which the stockbroker, rather than the customer, decides which purchases and sales to make.
65. A non-discretionary account is one in which the customer, rather than the stockbroker, decides which purchases and sales to make. The stockbroker simply executes purchase or sales contracts on behalf of the customer.
66. See Goforth, supra note 62, at 422 (“A number of courts have held that the decision to impose fiduciary obligations upon a broker turns on whether the account handled by the broker was discretionary or non-discretionary”).
67. See Ohio Co. v. Nemecek, 886 F. Supp. 1342, 1346 (E.D. Mich. 1995) (“A fiduciary relationship arises between a broker and his customer when the broker is handling a discretionary account”); Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. 951, 953 (E.D. Mich. 1978) (“Unlike the broker who handles a non-discretionary account, the broker handling a discretionary account becomes the fiduciary of his customer in a broad sense”); Rupert v. Clayton Brokerage Co. of St. Louis, Inc., 737 P.2d 1106, 1109 (Colo. 1987) (en banc) (“Where a customer relinquishes practical control over his brokerage account to a stockbroker, the broker owes wide-ranging fiduciary duties to the customer to manage the account in accordance with the customer’s needs and objectives”).
68. See Greenwood v. Dittmer, 776 F.2d 785, 788 (8th Cir. 1985) (“[N]o fiduciary duty arises between a broker and his client in relation to a non-discretionary commodity trading account”); Shearson Hayden Stone, Inc. v. Leach, 583 F.2d 367, 371-72 (7th Cir. 1978) (“Although in some circumstances a broker would stand in a fiduciary relationship to its customer, those circumstances are not present ... [with] a ‘nonsupervised’ ... account”); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Boeck, 377 N.W.2d 605, 609 (Wis. 1985) (“[A] broker does not owe a fiduciary duty to an investor/customer who makes all of the investment decisions, unless there is an express agreement placing a greater obligation on the broker or other special circumstances”).
broker does not possess the discretionary authority to bind a borrower to loan terms and fees without the borrower’s approval. Federal law requires that all mortgage providers must provide a Good Faith Estimate\(^69\) to the borrower within three business days of the loan application.\(^70\) Based upon this Good Faith Estimate, the borrower possesses the ability to compare loan terms and fees with those offered by other lenders well in advance of the loan closing.

3. **Real Estate Brokers**

In a typical real estate transaction, the real estate broker creates an agency relationship with the seller\(^71\) by means of a written agreement, known as a listing agreement.\(^72\) Under this agreement, the real estate broker ("listing broker") enters into a listing agreement with the seller, and contracts to act as the seller’s exclusive agent for the sale of seller’s home. Within the listing agreement, the listing broker typically agrees to accept offers from other real estate brokers who represent potential purchasers. These other real estate brokers ("selling agents") become subagents of the seller by virtue of the listing agreement. Once this agency relationship is established, the real estate broker owes certain fiduciary duties to her principal: good faith, loyalty,\(^73\) due diligence and disclosure.\(^74\)

Significant differences between the powers and duties held by real estate

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69. If the mortgage broker is an exclusive agent of the mortgage lender, then either the mortgage lender or the mortgage broker must provide a Good Faith Estimate. If the mortgage broker is not an exclusive agent of the mortgage lender, the mortgage broker must provide the Good Faith Estimate to the borrower. See 24 C.F.R. § 3500.7(a) (1997) ("Regulation X").

The Good Faith Estimate provides the borrower with the mortgage provider’s estimate of the cost of each of the following fees: loan origination fee; loan discount points; appraisal; credit report; lender inspection fee; mortgage broker fee; prepaid interest; mortgage insurance premium; hazard insurance premium; settlement fee; title insurance; document preparation; notary fee; attorney fee; recording fee; survey; pest inspection; commitment fee; and tax stamps. See 24 C.F.R. § 3500 app. A (1977).


71. A real estate broker may also create an agency relationship with a home purchaser through an express written agreement, known as a buyer’s brokerage agreement. Situations may also arise in which a real estate agent owes certain fiduciary duties to a home seller or purchaser that arise outside of any agency relationship. See Brett L. Hopper, Comment, The Selling Real Estate Broker and the Purchaser: Assessing the Relationship, 1992 BYU L. REV. 1135 (1992).

72. Although the written listing agreement usually serves as the basis of the agency relationship between a real estate broker and a home seller, courts have inferred this agency relationship from parties' oral statements or conduct. See Miller v. Bogger, 405 P.2d 573, 576 (Ariz. Ct. App. 1965) (holding that a "limited agency relationship [was] initiated at the time the [sellers] gave to the real estate agent an oral listing"); Anderson v. Thacher, 172 P.2d 533, 541 (Cal. Dist. Ct. App. 1946) ("An agency may be created not only by written instrument or word of mouth, but also may be implied from the conduct of the parties").


brokers and mortgage brokers allow the latter to be easily distinguished from the former. First, unlike real estate brokers, mortgage brokers rarely contract in writing to act as a borrower's agent. In order to impose an agency relationship on mortgage brokers, courts must usually infer the agency requirements from the intentions of the parties, a process far more susceptible to error than that of real estate brokers, whose agency agreement is in writing. Second, the real estate agent is in a much greater position to influence or bind her principal than a mortgage broker. In order for a real estate broker to procure prospective buyers (either by herself or with the assistance of a selling broker), a real estate broker must perform certain acts that influence or bind her principal, including making representations regarding the property to all potential buyers and negotiating the sales contract terms on behalf of the seller. Both of these actions give a real estate broker the opportunity to speak for or influence the principal. In contrast, the mortgage broker's ability to influence the borrower's actions are limited to presenting the terms upon which the mortgage lender will provide the mortgage funds. The borrower alone is able to bind herself to any terms and conditions of the subsequent agreement with the mortgage lender. Additionally, the listing agreement usually requires a seller to agree to use one real estate broker exclusively. This fact places a higher degree of responsibility upon the listing broker selected because the seller cannot unilaterally cancel this contract or rely on any other persons to provide these same services. Conversely, a borrower is free to make a loan application with more than one mortgage broker, which insures that the borrower can switch to the services of a different mortgage broker if her current broker is not performing his duties satisfactorily.

Regardless of the inherent differences between real estate brokers and mortgage brokers, four states disregard these differences and maintain laws that statutorily impose the identical agency responsibilities on mortgage brokers that exist for real estate brokers.\(^75\) In these states, mortgage brokers are deemed to have entered into an agency relationship with their borrowers and, as a result, acquire general fiduciary duties to their borrowers.

### C. Regulation of Mortgage Brokers

In the past, it appears that courts imposed a fiduciary duty of disclosure on mortgage brokers in large part to protect unwitting borrowers\(^76\) from the

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75. For a list of these states, see infra note 81.

76. Often, where a mortgage broker is deemed to have breached a general fiduciary duty of disclosure, courts have justified their decisions in part based upon the financial naiveté of the
lax or non-existent regulation of mortgage brokers at the state and federal level. Continued judicial regulation of mortgage brokers via a general fiduciary duty is unnecessary, based upon existing and proposed laws at the state and federal level that require the disclosure of loan terms and all loan fees and provide for adequate enforcement mechanisms.

1. State Regulation of Mortgage Brokers

States currently possess several methods for regulating mortgage brokers. First, states may impose licensing requirements on mortgage brokers. Currently, thirty-nine states require some level of licensing for mortgage brokers. Twenty-nine states require the payment of a fee and proof of a minimum net worth and/or pledge of a surety bond in order to receive a license. Six states require proof of the person's competence as a mortgage borrower. See, e.g., Wyatt v. Union Mortgage Co., 24 Cal. 3d 773, 783 (Cal. 1979) (stating that borrowers "were persons of modest means and limited experience in financial affairs"); Rushing v. Stephanus, 64 Wash. 2d 607, 608 (Wash. 1964) (stating that the borrower "is a side-sweat contractor, and has only a fifth grade education. His wife's formal education ended in the 10th grade. Both were found to have a limited ability to read and understand technical language.").

77. Although Professor Frankel argues that "the decline of legal and social controls over those who offer services" increases the importance of fiduciary obligations, this is certainly not the current trend within the mortgage industry. Tamar Frankel, Fiduciary Law, 71 CALIF. L. REV. 795, 802 (1983). In addition to extensive federal regulations of mortgage providers, there are currently 39 states that regulate mortgage brokers through the licensing process. See infra notes 79-81 and accompanying text for a complete breakdown of these regulations.

78. The 11 states that do not regulate mortgage brokers through the licensing process are: Alaska, Colorado, Maine, Montana, Nevada, North Dakota, Oklahoma, Texas, Vermont, West Virginia and Wyoming.


80. The following six states impose educational or experience requirements in addition to other monetary requirements: Arizona: Ariz. Rev. Stat. Ann. § 6-903 et seq. (West Supp. 1996) (requiring, in addition to payment of a fee and pledge of a bond, (1) three years experience in mortgage lending, (2) completion of a designated course of study, and (3) passing a standardized mortgage broker’s test within one year of licensing); Florida: Fla. Stat. Ann. § 494.003 et seq. (West 1997) (requiring 24 hours of classroom education and passing a written test for license); Idaho: Idaho Code § 26-3108 (1990) (requiring, in addition to payment of $200 fee, proof of three years experience in lending for license); New Jersey: N.J. Stat. Ann. § 17:11B-1 et seq. (West 1984) (requiring, in addition to payment of fee not to exceed $1,000 and bond not less than $25,000, successful completion of examination aplied by commissioner or demonstration that applicant has five years experience as a mortgage broker or mortgage banker); New York: N.Y. Banking Law § 592-a (McKinney Supp. 1997) (requiring, in addition to payment of $500 fee, proof of experience or educational background in lending for license); Oregon: Or. Rev. Stat. § 59-845 et seq. (1995) (requiring, in addition to payment of fee and pledge of $10,000 surety bond, proof of three years experience in lending).

81. The following four states require mortgage brokers to be licensed as real estate brokers: California: Cal. [Bus. & Prof.] Code § 10131(d) (West 1987) (stating that a real estate broker includes a person who “solicits borrowers or lenders for or negotiates loans . . . secured directly or collaterally by liens on real property”); Minnesota: Minn. Stat. Ann. § 82.17, subd. 4, (b) (West Supp. 1997) (stating that a real estate broker includes any person who “for another and for commission, fee or other valuable consideration or with the intention or expectation of receiving the same, directly or indirectly negotiates or offers or attempts to negotiate a loan, secured or to be secured by a mortgage or other encumbrance on real estate”); Rhode Island: R.I. Gen. Laws § 5-20.1-4 (1956) (stating that a real estate broker includes all persons who “negotiate or attempt to negotiate a loan secured or to be secured by mortgage or other encumbrance upon a transfer of any real estate”);
In addition to licensing requirements, states can regulate the activities of mortgage brokers through various types of consumer protection laws that permit borrowers to sue mortgage providers for certain violations. These laws typically require lenders (including mortgage brokers) to disclose all relevant loan terms and fees, including any yield-spread premiums. 82

2. Federal Regulation of Mortgage Brokers

In addition to these state laws, two relatively recent 83 statutes provide comprehensive regulation of mortgage providers at the federal level: the Real Estate Settlement Procedures Act ("RESPA") 84 and the Truth In Lending Act ("TILA"). 85 These statutes regulate mortgage providers in their disclosure of all direct and indirect fees assessed to the borrower.

Direct fees are those fees paid by the borrower in connection with the processing or closing of the mortgage loan. Under RESPA, all mortgage providers must disclose to borrowers an estimate of each charge "that the borrower will normally pay or incur at or before settlement based upon common practice in the locality of the mortgage property," 86 including any mortgage broker fees paid to mortgage brokers. 87 In addition, mortgage providers must calculate the mortgage loan's Annual Percentage Rate ("APR") based on the total finance charges the borrower will pay in connection with the loan. 88 TILA appears to require mortgage brokers to include any broker fees they assess borrowers in the calculation of the finance charge. 89 Therefore, the APR that the mortgage broker discloses to

South Dakota: S.D. CODIFIED LAWS ANN. § 36-21A-6(11) (Michie 1994) (stating that a real estate broker includes any person who "acts as a mortgage broker").


83. Both of these statutes were enacted in 1974.

84. 12 U.S.C. §§ 2601 et seq. (1994) RESPA regulates all "federally regulated mortgage loans" including both purchase money mortgages and refinance mortgages.


86. Regulation X, 24 C.F.R. § 3500.7(c)(2) (1997).

87. The 1992 Revised Regulation X specifically added "mortgage broker fees" to the list of fees requiring disclosure.


89. Section 1605 of TILA ("Determination of finance charge") requires that "the amount of the finance charge . . . shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended." 15 U.S.C. § 1605(a) (1994). Examples of charges that are included in the finance charge include "[b]orrower-paid mortgage broker fees, including fees paid directly to the broker or the lender (for delivery to the broker) whether such fees are paid in cash or financed." 15 U.S.C. § 1605(a)(6) (1994).
the borrower is an accurate calculation of all direct fees the borrower will pay in connection with their loan, allowing the borrower to compare the loan’s total “sticker price” with loans offered by other mortgage providers. RESPA and TILA, with their explicit disclosure requirements, are a much more effective method for ensuring the correct disclosure of loan terms and fees than the imposition of a general fiduciary duty.

Indirect fees are all fees paid to mortgage brokers by parties other than the borrower in connection with the processing or closing of the borrower’s mortgage loan. In 1992, HUD adopted the position that mortgage brokers\(^9\) are required to disclose all indirect fees received in connection with a borrower’s mortgage loan.\(^9\) After mortgage brokers complained that this requirement “placed mortgage brokers on an unequal footing with other mortgage loan providers and that information on indirect fees was confusing to borrowers,” HUD engaged in rulemaking activities on this topic.\(^9\) The result of these rulemaking activities is a proposed rule, whereby mortgage brokers would be ensured that “direct fees received from the borrower, as well as the indirect fees paid to the broker from a lender for the transaction, will be covered by a ‘qualified safe harbor’ and presumed legal and permissible under section 8 of RESPA.”\(^9\) This presumption of legality may be rebutted if the mortgage broker does not meet the criteria of the safe harbor which includes disclosing to borrowers whether the mortgage broker will receive any indirect fees from mortgage lenders.\(^9\) The final rule that emerges from these rulemaking activities will continue to require disclosure of all fees, both direct and indirect, earned by mortgage brokers in connection with the mortgage transaction.

In addition to these existing and proposed laws, there currently is a very

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90. The amended Regulation X defined mortgage broker for the first time: “mortgage broker means a person (not an employee of a lender) who brings a borrower and lender together to obtain a federally related mortgage loan.” 24 C.F.R. § 3500.2(b) (1997).

91. “[A]ny other fee or payment received by the mortgage broker from either the lender or the borrower arising from the initial funding transaction, including a servicing release premium or yield spread premium, is to be noted on the Good Faith Estimate.” 24 C.F.R. § 3500, app. B, Fact Situation 13 (1997). These disclosure requirements, however, do not apply to mortgage brokers who fund mortgage loans either with their own funds or with a warehouse line of credit. The reason for this exception is that RESPA does not require disclosure of fees paid in secondary market transactions. See 24 C.F.R. § 3500.5(b)(7) (1997).


93. Id. at 53,912.

94. See id. Although the criteria for the safe harbor will be finalized in the final rule, a number of tests have been recommended that would allow mortgage brokers to establish “with certainty whether total compensation to a broker is or is not legal.” Id.
compelling monetary disincentive for third-party mortgage lenders to pay indirect fees, such as yield-spread premiums, to mortgage brokers. An increasing number of mortgage lenders are finding themselves the object of class-action lawsuits based upon their payment of overages to mortgage brokers.\textsuperscript{95} Although the legal grounds for these lawsuits vary,\textsuperscript{96} the likely outcome of this litigation is that mortgage lenders will be much less likely to pay overages unless they can be assured that they will not incur liability to mortgage brokers for this payment.\textsuperscript{97} In addition, mortgage brokers may be less likely to accept overages for these very same reasons.\textsuperscript{98}

IV. PROPOSAL

The previous section illustrates that state and federal regulation currently require mortgage brokers to disclose loan terms and loan fees, including all direct and indirect fees earned by the mortgage broker. These regulations essentially eliminate the need to impose a general fiduciary duty on mortgage brokers to ensure disclosure of these loan terms or loan fees. In spite of this

\textsuperscript{95} See Heather Timmons, Lenders Rattled by Class Action On Broker Fees, AM. BANKER, Apr. 12, 1996, at 1, available in 1996 WL 5563218 (quoting Joe Lefkoff, counsel for the National Home Equity Association, as stating that there were between fifty and one hundred overage class-action lawsuits filed against mortgage lenders across the country in 1996).

\textsuperscript{96} Two recent lawsuits demonstrate the most popular legal bases for these class-action suits: discrimination and breach of fiduciary duty. A class-action suit brought by the Department of Justice against Long Beach Mortgage Co. alleged that employees of the mortgage lender (including the mortgage brokers with whom Long Beach corresponded) "routinely charged minorities, women and elderly applicants significantly higher fees, or 'overages,' than they charged white male applicants." Kenneth R. Harney, Bias in Pricing of Mortgage Fees Cuts Across Lines of Race, Sex, Age, WASH. POST, Sept. 14, 1996 at F01, available in 1996 WL 12393515. Another class-action suit brought in 1995 against GE Capital Mortgage Services, Inc. alleged that GE Capital "bribed [mortgage] brokers to breach their statutory, contractual, and fiduciary duties to borrowers"... by paying mortgage brokers a reward for jacking up interest rates on borrowers." Jonathan S. Hornbliss, Lawsuit Says General Electric Unit Bribes Loan Brokers to Hike Rate, AM. BANKER, May 16, 1995, at 8, available in 1995 WL 6915230.

\textsuperscript{97} The following are examples of class-action suits settled by mortgage lenders who paid yield-spread premiums to mortgage brokers and demonstrate the grave risks associated with this lending practice:


Long Beach Mortgage Co. settled a class-action suit brought by the Department of Justice for approximately $4 million. See Kenneth R. Harney, Bias in Pricing of Mortgage Fees Cuts Across Lines of Race, Sex, Age, WASH. POST, Sept. 14, 1996, at F01, available in 1996 WL 12393515.

\textsuperscript{98} See Harney, supra note 97, at F03. ("The [class-action settlement against Fleet Mortgage] also opens the door to further legal challenges to mortgage brokers on the grounds that they breach their fiduciary duties to customers when they pocket overages. Under some interpretations of common law, mortgage brokers could be construed as having the primary duty to their clients of obtaining the most favorable terms and rates available").
fact, some critics still contend that a general fiduciary duty should be imposed to ensure that mortgage brokers provide the best possible loan terms and lowest fees to the borrower.

First, this requirement would impose a discriminatory standard upon mortgage brokers that is not required of all other mortgage providers. The line that distinguishes mortgage brokers from banks and mortgage bankers is far from clear, and extracting a higher degree of duty from mortgage brokers has no practical basis.

Second, a mortgage broker should not be legally required to provide the lowest possible price to its borrowers. This very issue is at the center of the current debate over the payment of yield-spread premiums by mortgage lenders to mortgage brokers. Critics who advocate requiring brokers to provide the lowest possible rates and fees to borrowers ignore the fact that a borrower seeking to purchase or refinance a home is only concerned with the "bottom-line" cost that he or she must pay for the mortgage funds, and this "bottom line" cost will reflect any yield-spread premium payments received by the mortgage broker. Because current federal regulations have standardized the manner in which a mortgage provider must disclose interest rates and loan fees, a borrower is free to compare the total cost a mortgage broker will charge with the total cost of any other mortgage provider. Also, the argument that mortgage brokers must provide the lowest cost, fees and

99. In its most recent revision to the settlement cost booklet that all borrowers receive at the loan application, HUD explicitly states that a "mortgage broker may operate as an independent business and may not be operating as your 'agent' or representative." Real Estate Settlement Procedures Act; Notice of Revision of Special Information Booklet, 62 Fed. Reg. 31982, 31990 (1997). This language suggests that mortgage brokers, similar to mortgage lenders, stand at arm's length from their borrowers in the mortgage transaction.

100. For a detailed discussion of the debate over payment of yield-spread premiums, see supra notes 41-48, 90-98.

101. Because mortgage lenders only pay mortgage brokers yield-spread premiums if they can convince borrowers to accept higher-than-market interest rates or loan fees, these higher interest rates or loan fees will result in a higher APR. It is logical that mortgage brokers who receive yield-spread premiums from mortgage lenders for charging higher interest rates or loan fees can still be competitive with mortgage lenders who charge their standard rates and fees. The reason for this is that mortgage lenders who rely on mortgage brokers to originate the mortgage do not incur the direct costs of operating a retail lending office and, as a result, can offer mortgage brokers a lower interest rate than if the mortgage lender originated the loan through its own retail lending office. Therefore, even though the mortgage brokers may be charging their borrowers higher interest rates or loan fees than the mortgage lenders require, these higher rates and fees may still be equal to (or even less than) the interest rates and loan fees that mortgage lenders who must bear the cost of maintaining a retail lending office would be able to offer. See Kenneth R. Harney, Mortgage Brokers Earning Premiums at Buyer's Expense, WASH. POST, Aug. 5, 1995, at E01, available in 1995 WL 9255537 (quoting Mary Burt as saying that the payment of yield-spread premiums "actually allows [national] lenders to deliver more competitive prices to consumers because they don't need to set up expensive retail branches of their own everywhere").
services disregards the simple fact that a mortgage broker can still act in the best interest of the borrower without providing the lowest priced services. Most mortgage providers are responsible for coordinating the services of several different entities on behalf of their borrowers for the processing and closing of the mortgage loan. Such services include: the credit report, appraisal and private mortgage insurance. In addition, mortgage providers are often directed by the borrower to procure other necessary items, including title insurance, survey and pest inspection. In many instances, the lowest-priced service provider may not necessarily be the one ultimately most beneficial to the borrower, possibly because the mortgage broker knows that the lowest-priced service provider may be unreliable and may jeopardize the entire loan transaction. Therefore, requiring mortgage brokers to provide the lowest-priced loan transaction not only imposes an extreme hardship on the mortgage broker, but it also might work against the borrower’s best interest. Instead, the borrower should decide the issue of “bottom line” cost herself, using the APR disclosed by the mortgage broker to “shop around” for the lowest overall price.

103. A mortgage provider is often directed to procure these services at the request of the borrower or the borrower’s attorney because the mortgage provider may receive a discounted price from these service providers based on the volume of business a mortgage provider may refer to these businesses. In some instances, the mortgage provider may also have a “wash agreement” with these businesses, which allows the mortgage provider to cancel the transaction with minimal or no cost to the borrower. The borrower or her attorney does not usually enjoy these same advantages, and therefore would want the mortgage provider to order these services on her behalf.

104. If mortgage brokers are required to provide the lowest-price loan package to borrowers, one option would be for mortgage brokers to furnish their borrowers with a list of all service providers acceptable to the mortgage broker, allowing borrowers to contact these service providers and arrange for these services themselves. However, this solution has potential drawbacks because it deprives borrowers of the broker’s expertise in selecting the service provider the mortgage broker feels will perform the best given the borrower’s individual circumstances.

105. Much of the recent literature on securing a home mortgage emphasizes comparing interest rates and fees with several different mortgage providers. See Amy Dunkin, In the Market for a House? You’re in Luck, BUS. Wk., June 5, 1995, at 131 (“Comparison-shop for a mortgage: Lenders and mortgage brokers are in hot competition and will sometimes shave points or whittle down the interest rate”). There are currently many opportunities for a borrower to do this recommended comparison shopping. A borrower can secure the necessary information from:

Newspapers: Most major newspapers provide weekly updates on local mortgage providers’ interest rates and loan terms. If this information is unavailable in a particular area, HSH Associates, a national company which monitors the mortgage industry, can provide a listing of all the lenders in a particular region (800-873-2837).

Real estate agents: Because real estate agents must work with mortgage providers who secure financing for their customers, real estate agents can often provide referrals to reputable mortgage providers.

Internet: Increasingly more mortgage providers provide computer access to their interest rates and terms via the Internet. See Elizabeth Razzi, House Hunting on the Internet, KIPLINGER’S PERS. FIN. MAG., July 1, 1995, at 96, available in 1995 WL 10021735.

Telephone: If a borrower has the time (and does not mind the occasional high-pressure sales
Finally, states that impose a general fiduciary duty on mortgage brokers statutorily by requiring that they be licensed as real estate brokers possess two alternatives. First, these states’ legislatures could repeal the provisions requiring mortgage brokers to be licensed as real estate brokers. When most of these special licensing requirements were enacted, the level of state and federal regulation of mortgage brokers was minimal. Even if these four states eliminated their special licensing requirement, they could still maintain the requirement that mortgage brokers continue to receive the education required of real estate brokers. Second, if states do not want to repeal the requirement that mortgage brokers must also be licensed as real estate brokers, the legislature could allow the resulting general fiduciary duty created by this requirement to be a “default rule” that the mortgage broker and borrower could contract around. In a recent article, Professor Tamar Frankel argues that most fiduciary duty rules are default rules only. Professor Frankel proposes allowing entrustors, in this case borrowers, to waive any fiduciary duty owed them if (1) they are “put on clear notice that, with respect to the particular duties that they waive, they can no longer rely on their fiduciaries” (in this case, mortgage brokers) and (2) fiduciaries “provide entrustors with information . . . to enable entrustors to make an informed independent decision regarding the waiver.”

The adoption of this rule would not place an undue burden on the borrower. Borrowers do not benefit from a general fiduciary duty in their dealings with all mortgage providers because the law does not impose such a duty on mortgage lenders. Moreover, state and federal regulation sufficiently protect borrowers from the danger of non-disclosure of loan terms and fees. Furthermore, the wealth of information currently available to borrowers who wish to compare interest rates and fees eliminates the need for mortgage brokers to provide the best possible terms and fees. Thus, current state and federal regulation of mortgage brokers, in conjunction with market forces,

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106. North Dakota has taken this approach. Effective December 1, 1995, North Dakota repealed their previous requirement that mortgage brokers be licensed as real estate brokers. Previously, North Dakota required that “no person shall act as real estate broker, real estate salesperson or mortgage broker . . . without a license issued by the real estate commission.” N.D. CENT. CODE § 43-23-05 (1991). The 1995 amendment deleted all references to “mortgage broker” within this section.


109. See id. at 1211.

110. Id. at 1212.
permit courts to withhold imposition of a general fiduciary duty upon mortgage brokers.

David Unseth