RESPA REFORM AND THE ECONOMIC EFFECTS ON SMALL BUSINESS

HEARING

BEFORE THE

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HOUSE OF REPRESENTATIVES

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HEARING ON RESPA REFORM AND THE ECONOMIC EFFECTS ON SMALL BUSINESS

TUESDAY, MARCH 11, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Committee met, pursuant to call, at 3:00 p.m. in Room 2172, Rayburn House Office Building, Hon. Donald Manzullo presiding.

Present: Representatives Velazquez, Davis, Chabot, Udall, Sanchez, Majette, Bordallo, Capito, Christensen, Musgrave, Bradley, Bartlett, Shuster, Beauprez

Chairman MANZULLO. Okay. If the panel could take a seat. We are honored today to have Secretary Martinez, the Department Housing and Urban Development; accompanied by John Weicher, Assistant Secretary for Housing; and John Kennedy, Associate General Counsel, is going to be with us also. Because of the Secretary's time, we are going to waive opening statements, move immediately to his testimony. Then we will go into questions from the members of the panel. Mr. Secretary, at a certain time—I think it is 3:40, whatever it is—you have to leave, and if at that time you are still on the panel, just excuse yourself and leave, and then the two gentlemen with you would be available for answers on this panel and also available just in case we have some technical questions that have to be answered from the second panel.

So, without further ado, Mr. Secretary, I want to thank you for coming here. Personally, I want to thank you for the swift action of your team on which you accomplished, with the Rockford Housing Authority. As soon as we found out there was a problem there, literally within hours your office had that problem resolved, and as a result of that, 70 people are getting back to work very happy with the efficiency of your office. So we look forward to your testimony.

STATEMENT OF THE HONORABLE MEL MARTINEZ, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; ACCOMPANIED BY THE HONORABLE JOHN C. WEICHER, ASSISTANT SECRETARY FOR HOUSING/FHA COMMISSIONER, AND JOHN KENNEDY, GENERAL COUNSEL

Mr. MARTINEZ. Thank you, Mr. Chairman, and it is a pleasure to be here with you and Ranking Member Velazquez and other members of the Committee. I want to thank you for the opportunity to join you this afternoon to discuss a major initiative of our administration, which is an unprecedented effort to better protect consumers and increase home ownership by making the home-financing process more transparent, simpler, and less costly.

Mr. Chairman, there may be fuller comments, which I would like to submit for the record, and I will try to abbreviate them just so that we can get to the questions I know the panel would like to ask.

The emphasis Americans place on home ownership sets us apart from many other nations in the world. In this country, home ownership provides financial security for families and stability for children. It creates community stakeholders who have a vested interest in what happens in their neighborhood. It generates economic strength that fuels the entire nation.

The Bush administration is committed to helping more families achieve the American dream of home ownership. However, the mortgage-finance process and the cost of closing remain major impediments to home ownership. Every day, Americans enter into mortgage loans, the largest financial transaction most families will undertake, without the clear and useful information they receive with most any other major purchase. The uncertainty hurts consumers and could also be a problem that would allow those who would prey on the weakest in our society to make them victims of predatory lending.

Therefore, we are streamlining and improving the mortgage-finance process. Our intent is to establish better and timelier disclosure for consumers so that they have an opportunity to shop for the best loan, to simplify the mortgage-origination process itself, and to eliminate the confusion and uncertainty, and ultimately to lower the settlement costs for home buyers. At the same time, the department is committed to issuing a final rule, fully mindful of the impact that it may have on small businesses.

Beginning last year, we undertook a major reform of RESPA's regulatory requirements. From day number one, our efforts have been focused on fixing a process that absolutely no one will deny is broken. To do this, we reached out to consumer groups as well as small businesses and other representatives within the affected industry to solicit their concerns about the RESPA regulation and their suggestions for reform. Their recommendations helped to shape the direction of our work. During the months we spent drafting our reform proposals, we continued to meet with consumer advocates, industry groups, small businesses, and other interested parties to ensure that, to the best of our ability, their concerns were addressed in our draft proposal.

We were methodical and deliberate in our planning, and we took our time to get it right. Nine months after first publicly announcing our intention to reform RESPA's regulatory requirements, and well over a year after our internal work had begun, HUD published a reform proposal for public comment. Within the rule itself, we solicited additional input from the consumer advocates, industry groups, small businesses, and other interested parties we had been communicating with throughout the process.

The rule asked 30 specific questions to help us gauge the impact of our proposal on these various stakeholders. We felt it was critical to know whether the approaches that we proposed were the right ones and what alternatives might work better.

H.U.D. received nearly 43,000 comments in response, and although many of them were form letters, we also found some very,

very thoughtful comments. It has been 18 weeks since the comment period closed, on October 28, 2002, and we have since that time been carefully studying the written comments. Many came from mortgage brokers and title agents. Also, there were many detailed letters from trade associations for these industries.

As you can imagine, reviewing and cataloguing the comments has been a lengthy process due to the sheer volume that we received. Many of those comments have come from small businesses, and I want to take this opportunity at this hearing to emphasize my commitment to ensuring the fullest consideration of the regulatory impacts on small businesses in our RESPA rulemaking.

We regard this administration's RESPA reform and small business objectives as necessary and complementary. For RESPA reform to work, small businesses must continue to serve a pivotal role in an efficient and effective settlement process.

Real estate settlement services are provided by many different businesses—mortgage lenders, mortgage brokers, realtors, real estate professionals, title insurers, title and settlement agents, pest inspectors, appraisers, credit bureaus, and others. Included in each of these industries are businesses ranging from the very large to the very small, and many our sole proprietors.

The reason that small businesses perform the function they do in real estate settlement transactions is that these transactions are by their nature local. All housing markets are local. The local realtor, appraiser, settlement agent, home inspector, pest inspector, and mortgage broker or mortgage banker is ordinarily required to complete the transaction, and we do not expect this to change. At the time the rule was issued, the department issued its initial regulatory flexibility analysis, in accordance with the Small Business Regulatory Enforcement Fairness Act, along with its economic analysis of the rule. In it, the department analyzed the impacts of the proposal on small businesses as well as alternatives to the proposal. This analysis recognized the market impacts of packaging, particularly as they relate to small businesses. The analysis also indicated that packaging would not change the fact that locally provided, third-party services will be in demand but, rather, how their services will be sold.

A number of comments addressed matters that were discussed in the initial regulatory flexibility analysis and proposed alternatives for our consideration. In the final rule, we will prepare a final regulatory flexibility analysis, including a summary of the issues raised in the public comments, a summary assessment of these issues, and a statement of any changes made in the proposed rule as a result of these comments.

Let me stress that throughout this entire process we have been guided by the knowledge that the goal of RESPA is to ensure that settlement costs for consumers are reduced. Because they ensure greater transparency, our proposed reforms will make it more difficult for unscrupulous lenders to abuse consumers.

Efforts HUD has undertaken in the past two years to target abusive lending practices include at least 15 new rules focused on, among other priorities, weeding out unscrupulous appraisers, ending the practice of quick resale or "flipping," and helping us to identify problem loans and lenders early on. We intend to do even

more to address predatory lending while preserving a source of credit to those with less-than-perfect credit histories.

H.U.D. is committed to creating a home-buying and mortgage-finance process that protects consumers by being grounded in transparency and simplicity. By reforming the rules governing the purchase and financing of a home, we will create new opportunities for first-time home buyers, keep the American dream of home ownership alive for more families, and inspire greater public confidence in the mortgage-lending industry.

Mr. Chairman, there are many issues about this rule which we look forward to discussing with the Committee in fuller detail. We know that there are suggestions that perhaps would include dealing with issues such as fee payments, which we believe are important to ensure a continuing confidence of the public in the process, that need to be dealt with, and we look forward to working with you and continuing to hear suggestions. What has been an open-door policy continues to be, and we look forward to hearing from any remaining industry groups and any comment they may make so that we can incorporate their views into our final rulemaking.

We thank you for holding this hearing so that we can attempt to address the issues that may be on the minds of the members of the Committee.

[Mr. Martinez's statement may be found in the appendix.]

Chairman MANZULLO. Thank you, Mr. Secretary. We appreciate your being here. My concern, as I read your testimony last night, and, again, you talked about abusive lending rules, is the fact that we all agree that there may be needs from time to time to tighten up the reporting requirements, tighten up enforcement, et cetera, and yet the conclusion is that the only way to do that is to enter into this risky area, untried, untested, of a massive contract bundling whereby the lender comes in with a guaranteed interest rate as part of the package, which means that only the people that can guarantee the interest rate, which are the mortgage lenders, will be the players.

They will be the equivalent of the HMO. They will determine exactly who becomes a player with them. Section 8 will be waived. Hidden fees again will be allowed, so that for people to become a player, they actually have to give money back to the giant mortgage lender, which means that there is no guarantee that there will be any savings passed on to the consumer, and you can end up simply with the bank making more money, and the smaller service providers making a lot less because they have to pay their fee to the mortgage lender to be part of it.

So what I do not understand is how can you make the quantum jump from the laudable purpose of ending abusive lending problems to going to his whole new area that will allow the contract bundling as being the cure for the problem?

Mr. MARTINEZ. Well, if I might try to answer your question, Mr. Chairman, I think that there are a number of reasons why a reform of the RESPA rule was timely. One of them, and perhaps not the most salient, is the issue of predatory lending, but I think that there are other issues that really arise, the cost to the consumer, for one, and the clarity and understanding of what the consumer is to expect at the closing table, I think, is also another.

I believe that the rule should also include a prohibition against the kinds of abusive fees that you were referring to, but I think, beyond that, Mr. Chairman, the rule does not require that services be bundled and packaged. It deregulates the field so that it can take place.

Chairman MANZULLO. But that is what is going to happen.

Mr. MARTINEZ. We already are encouraged by the fact that mortgage brokers already seem to be approaching the field and trying to put packages together themselves.

I also believe, Mr. Chairman, it is important to point out that currently there are some big players that already are packaging, and they do so within the confines of their businesses. So, in other words, if we do not change the current existing rules, those that are today packaging and succeeding at it will continue to do it but will only be able to do it within the confines of their corporate structure. It will then leave out the local, small player because they will not be able to participate.

Chairman MANZULLO. Do you really think that these 10 giant lenders are going to be dealing with the little guys by the time they are done with this entire shakeup of the mortgage industry?

Mr. MARTINEZ. Yes, sir. I believe they will. First of all, I do not think it will only be the 10, but I think that it will be to their advantage, financially and otherwise, to be dealing with the local providers of these services.

Chairman MANZULLO. But what we are seeing now is we are talking to some community banks, and they are not getting mortgages because some real estate firms have entered into contractual relationships with other banks.

Mr. MARTINEZ. But, see, that is the problem now.

Chairman MANZULLO. And I think we are going in the wrong direction on this.

Mr. MARTINEZ. No. That is the problem now because these packages cannot share fees or otherwise enter into relationships with people outside their company.

Chairman MANZULLO. But why would a package be the answer to the lack of enforceability?

Mr. MARTINEZ. No, no, no. It is not a lack of enforceability. Today, a package provider can do so so long as they do not share fees with people outside their company. So they then would be encouraged to continue to do what they are doing but will not be able to then contract with a local provider who may provide the title insurance or whatever, so they create title insurance companies that are captive. Then they create all of the wherewithal to provide the services but only within the confines of their firm.

What we are doing here in deregulating the environment is allow packaging if it will happen. I do not think there is any certainty that packaging will have to occur. I think there is an equal opportunity for there to be those who will continue to provide services in the traditional way.

Chairman MANZULLO. But why is it that this is being driven by the 10 largest lenders in the country and being fought tooth and nail by all of the small business people that are players in real estate? This is one of the reasons we are having the hearing today. This is the Small Business Committee, as you know, and this is our

great concern, is that whenever Mr. Big gets involved, Mr. Big is going to look out, the same way the HMOs do it. They will go to a doctor, and say, "You are our doctor. This is what you are going to get paid." But does the price ever go down? No.

Mr. MARTINEZ. I believe, sir, first of all—I ought to assure you that I am equally concerned about what happens to the small businesses in the transaction, but I believe that what we are doing is allowing the continuation of these people to continue to do business in a closer semblance to what they are doing today than we would if we did not allow for the option of packaging for those who might elect to do it.

The bottom line is that I believe that the closing and settlement services today, and the reason for RESPA existing in the first place is to provide an avenue for consumers to be well informed in the closing process and, wherever possible, to lower the cost to the consumer so that more and more people can avail themselves of that opportunity to own a home.

So I believe that to suggest that only a few small, large businesses will survive in this environment, Mr. Chairman, would suggest that the marketplace just simply will not operate.

Chairman MANZULLO. Then what happens if I am right, and you are wrong? Then we have an oligopoly.

Mr. MARTINEZ. But then, see, what prompted regulation in the first place is when you have oligopolies or other things that are noncompetitive, government simply feels it must step in. What we are suggesting here is to deregulate, to allow the marketplace to set the tone of what they will and will not do, and I believe the rules of the marketplace are far more effective than government regulation imposing the inability for there to be competition. So it is as a result of that competition that fees will be lowered and that the consumer will receive and perceive a benefit.

You know, tolerances in the good-faith estimate, unquestionably, are the kinds of things that when people go to the closing table today, oftentimes receive a surprise when they get there of how much, in fact, the check they need to write will be for. So we will make less tolerances in the good-faith estimate.

Chairman MANZULLO. My time has expired. That problem could be taken care of by simple regulation. Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Mr. Secretary, please help me out. You know, I am a member of the Financial Services Committee, and I guess that we both attended the same hearing where you testified on the budget on the RESPA rule. At that hearing, the gentleman from Missouri, Mr. Clay, asked you if this proposed rule will help combat predatory lending. You say no. Today, you are saying, yes, it will do it.

Mr. MARTINEZ. No. What I am saying to you very clearly is, and I hope I am being consistent in this, is that the purpose for us deriving this rule is not as an attack on the possibility of predatory lending. We do a whole host of things to attack predatory lending, but I believe that if you have mortgage broker abuse, as was evident in the yield-spread-premium problems that we have been facing and continue to face, that it is easy for someone not to understand the current process and also fall prey to that issue.

So to the extent that the consumer has better clarity, it does not eliminate the need for continued enforcement and maybe even further legislation on the issue of predatory lending, but it darned sure helps the consumer, when they sit at the settlement table, to better understand the process, to better understand what they are signing and what they are paying for because when you have a package set of services, there is one fee, they know at the front end what they are going to pay for their interest rate, and they know at the front end what they are going to pay for their closing costs, and it is not going to change. So they go to the table knowing what they are going to get. Today, that can vary greatly.

So the purpose for doing this is to modernize, is to improve the process by which consumers buy a home, and also to lower the cost for consumers, first and foremost.

Ms. VELAZQUEZ. And we could achieve that, but at the same time we have to comply with statutes that we pass here in Congress, and one of those is the Regulatory Flexibility Act. Our task here is to protect small businesses, but, of course, it cannot be at the expense of consumers either, and you will not find a more pro-consumer member of Congress than this one that you have in front of you, but I am glad to hear that you at least mentioned small business in your testimony, but you do not provide specifics. In your ongoing analysis of the effects on small business, which specific part of the rule are you taking take into consideration?

Mr. MARTINEZ. Ms. Velazquez, let me say, first of all, and I want to ask Mr. Weicher perhaps to chime in on this answer, I know your concern not only for consumers. If you think what is good for consumers is a good thing, then you are going to like this RESPA reform because it is good for consumers. The AARP solidly supports it. Other consumer groups very much support it. The bottom line is that this is good for consumers.

You are also interested in home ownership by minorities. I know you are. This is a way that when you can lower the cost at settlement by $700, that is like allowing how many more people now to buy a home that otherwise would not be able to get it. So the specifics of it, I am happy to try to answer, and that is why we have the technical people here with me so that we can do that, and I will be glad for Mr. Weicher to try to answer your specific question.

Mr. WEICHER. Yes, Ms. Velazquez. With respect to where in the economic analysis we discuss each part of the rule, you will find that chapter three of the analysis discusses the good-faith estimate and the issues related to that concerning regulatory burden and impact. And chapter four addresses packaging.

Ms. VELAZQUEZ. Do you do that by industry? Are you putting all of them together, land title insurance, realtors, and mortgage brokers?

Mr. WEICHER. No. We have separate calculations for mortgage brokers and some specificity because of the yield-spread-premium issue because that is the biggest of the settlement services, and we also have discussion of other settlement-service providers as well. There is a discussion of each of the major service providers in each chapter.

Ms. VELAZQUEZ. But you have to provide economic analysis for every industry.

Mr. WEICHER. We have provided economic analysis for the settlement-services industries. We think we have met the requirements of the Small Business Regulatory Enforcement Fairness Act with respect to that, and we will continue to do so.

Ms. VELAZQUEZ. Hold it right there. The Office of Advocacy has indicated that they believe HUD needs to submit a revised economic analysis, an initial regulatory flexibility analysis that takes take into consideration the comments you have received from small businesses and does an industry-by-industry analysis of the economic impact of this rule. Will you commit to submitting such a revised analysis?

Mr. WEICHER. We will have a final regulatory flexibility analysis as part of the final rule, and we will incorporate the comments that we have received——.

Ms. VELAZQUEZ. Isn't that too late, sir?

Mr. WEICHER. It is our understanding that that is the I requirement of the Small Business Regulatory Enforcement Fairness Act, and that is what we are expecting to do.

Ms. VELAZQUEZ. I am aware that you met, Mr. Secretary, several times with industry representatives prior to proposing this rule, and what really concerns me is that despite these meetings, we sit here today, and virtually every sector of the industry opposes your rule. So clearly you did not take into consideration their concerns. Perhaps this situation will be aided by going out into the field and listening to the firsthand accounts of the business owners who believe that they will be driven out of the market by this rule.

Mr. MARTINEZ. Ranking Member Velazquez, let me say that we have carefully listened to members of the industry, varied members of the industry. We are in the process of continuing to listen, and as we have listened, we have modified what will ultimately be the final rule. We have made considerable adjustments to the disclosure for mortgage brokers, for instance. There are very helpful suggestions that we have received on that. There have been suggestions on how the good-faith estimate might better serve the interests of consumers. We have looked at that as well. There have been those who have suggested that perhaps a two-package system might be a better way to look at it. We are also considering that very carefully.

I do not believe that in good faith anyone who may oppose the rule, and, by the way, I think there is a number of people who are very supportive of the rule, some that are supportive of parts of it and do not like other parts of it, but one thing I think we do have fairly unanimous support is from a group you consider important as well, which is consumers, and I think that is a very good thing. And also I think the FTC, when they looked at our plan, has commented that in response to our proposal that they believe that it will promote competition and that it will lower the cost of settlement services for consumers.

These are all good things, but I do not believe in good faith. Anyone could suggest that we have not been attentive and had an open door to anyone who cared to comment on the rule, and we have been very, very studious about listening. I have insisted on that. We are continuing to do that, and we will try to incorporate many of the helpful suggestions we have received as we go to final rule.

Chairman MANZULLO. Thank you, Mr. Secretary. Mr. Shuster. I would like everybody to have a shot. If you could just give us your best question, and then we can move as rapidly to the other members as possible.

Mr. SHUSTER. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for being here today. My question, I guess, echoes what the chairman and the Ranking Member were talking about. My concerns are the costs to small business in this country. If we are not concerned with small business, we are almost robbing Peter to pay Paul. Driving small business people out of the market is not something I want to see because they are the very people working for them that are utilizing this and buying the homes.

So are you confident in your estimates because there is some concern out there in the various industries that you have underestimated the costs to small business?

Mr. MARTINEZ. Mr. Shuster, I believe that we have tried to equitably look at the problem. I think we have also allowed for the fact that most of us—I know I believe in the marketplace. I believe that when government regulates, government ought to regulate to prevent a harm or to do something that ought to maintain the opportunity for competitiveness. What this does, this is deregulating. We have a regulation now that is freezing in place any evolution of the marketplace. We believe that this is not only good for consumers, but, frankly, as in other business setting, as in any other arrangement, those that will adjust and will adapt to the changed environment will do well. Those that will remain rooted in the ways of the past perhaps will not do as well.

So there is no way we can guarantee that everybody is going to do well in this scheme, but I think those that are on top of it, who adjust to it, who come up with creative solutions that are ultimately good for the consumer because the consumer is ultimately going to determine where they go. There may be some who want to offer traditional packages or traditional services without packaging, and if the consumer finds that more appealing, they will do that. In addition to that, the option of including in the package individual, itemized services can also be there, and if the consumer finds that more attractive, they will gravitate to those.

So I do not think we need to fear the marketplace because I think ultimately that is what makes America work. That is how small businesses prosper.

Mr. SHUSTER. And I agree with you, and I do not fear the market. I just want to make sure that when we move forward with this rulemaking that we are not underestimating the cost to small business because it seems that every time government acts for the good of business, it seems to pile on regulations and paper that is unnecessary.

Mr. MARTINEZ. This is in the vein of deregulation. This is in the vein of less paper work, and so, in that context, I believe we are very much on the side of small business as it relates to those issues.

Mr. SHUSTER. Thank you.

Mr. MARTINEZ. Thank you, sir.

Chairman MANZULLO. Dr. Christian-Christensen, your best question.

Mrs. CHRISTENSEN. My best question? Okay. I am concerned with whether HUD has the statutory authority to move forward with these revisions, specifically, I guess, with regard to the packaging and the rewriting of Section 8, which then seems to weaken RESPA with respect to referral fees or kickbacks and also the GFP. Are you certain that you have the authority to move ahead with these revisions? I am not so sure.

Mr. MARTINEZ. We have very, very certain opinions from our general counsel's office that we do have the legal authority to proceed in this light. Mr. Kennedy is here from our general counsel's office, and I will let him briefly continue the response.

Mr. KENNEDY. Are you referring to the reg flex statutory authority or the more general authority to provide for exemptions for the packaging?

Mrs. CHRISTENSEN. The more general authority to provide for revisions—specifically, I think in rewriting Section 8, I do not know that you have the authority to do that or on the issue of the good-faith estimate requiring up-front pricing.

Mr. KENNEDY. Okay. On the good-faith estimate, when we looked at the language surrounding the good-faith estimate, what we realized is that in the regulations up to this point there was no context, there was no definition of what that meant, so what we were doing in this rule was giving a definition to good faith. Certainly, we think we have the legal authority, but, in addition to that, by talking to the industry groups, all of the industry groups, it became clear to us that people in business know what their costs are. So, for example, if you are the person that is providing the good-faith estimate, and you know what your costs are in your business, then a good-faith estimate from you, which is what you would get from probably any business, is your cost.

Now, in the good-faith estimate, there are costs that are not in your control, that are not your settlement services, but in putting out your good-faith estimate, you, as a prudent business person, are going to go to the marketplace and find out what those services are. In the proposed rule, we recommended 10 percent. That was the proposal for the third-party settlement services that you would include in the good-faith estimate.

Chairman MANZULLO. Mr. Beauprez.

Mr. BEAUPREZ. Thank you, Mr. Chairman. Let me start off by just echoing your comments. I think you said it very well. Mr. Secretary, thank you very much for being here today.

As you may remember, I am one of those small guys. I was a community banker until a couple of months ago when I got this job, and our bank actually did originate mortgages as a broker, and I also served not only as a community banker for 12 years; I served as president and chairman of our state community bank trade association and served on the National Association of Independent Community Bankers of America. That is an organization that represents 5,000 community banks around the country, Mr. Chairman, and I would be remiss if I did not point out very briefly that at the end of their testimony recently to, I think, the Financial Services Committee, after summarizing this rule, they said, "Accordingly, we strongly urge the Committee to encourage HUD to reconsider the proposed rule," and it goes on.

Mr. Secretary, I applaud the effort very much. I very sincerely applaud the effort, but having not only been on both sides of that table, I recently did three refinances, so I have been on the other side of the closing desk as well, I would hasten to point out—I would actually challenge—I know a little bit about that business—I have closed loans myself—I would challenge almost anyone to sit down at the closing of a mortgage loan and feel that they fully understand the multitude of forms that they have been given, either in the application process or at the closing process.

So I would ask you, echoing the chairman's comments and others, I do not really believe that this is in the best interest of the marketplace, and I respect your intent, but, in reading this, I really question whether or not it levels the playing field. Five thousand community banks that are very much involved in dealing with their communities are clearly opposed to it in spite of the 10 banks or so that seem to favor it. I think one can lead to their own conclusion as to why that might be.

Chairman MANZULLO. Okay. Conclude your question.

Mr. BEAUPREZ. Where are we cutting regulation? Where are we truly simplifying process? I wrote down 15 new rules to do so, but I do not see correspondence of cutting back and making it simpler other than for those banks that can vertically integrate and control the entire process.

Mr. MARTINEZ. First of all, we will allow for the first time a clear disclosure of mortgage broker fees, which will be disclosed to the consumer. They will know they are paying the mortgage broker and how much.

Mr. BEAUPREZ. To the broker but not the mortgage banker. That is where the disparity exists.

Mr. MARTINEZ. Well, to the broker who is involved in that part of the process. The banker does not charge a direct fee.

Mr. BEAUPREZ. The mortgage banker can make as much as they want, and the customer never knows the difference.

Mr. MARTINEZ. Sir, the problem is that at the settlement table we can only deal with those fees that are paid at that time, and the broker fee——.

Mr. BEAUPREZ. That is the inequity that chases the little guy out of the marketplace.

Chairman MANZULLO. Let us take one more question from Ms. Majette.

Mr. WEICHER. Mr. Chairman, may I just respond?

Chairman MANZULLO. I tell you what. Why don't you respond to that after the Secretary leaves?

Mr. WEICHER. All right.

Chairman MANZULLO. Would that be okay?

Mr. WEICHER. Sure.

Chairman MANZULLO. Can we take one more question, Bill?

Mr. MARTINEZ. Yes, sir.

Chairman MANZULLO. Let us do it in two minutes, Ms. Majette, and then he has to be out of here.

Ms. MAJETTE. Good afternoon. Thank you, Mr. Chairman, and thank you for being here, Mr. Secretary. I, like my colleague across the aisle, have some experience in this area. When I was a practicing attorney, part of what I did was closing real estate. I did

closings of sales of real estate, and my small business was a contractor for the Resolution Trust Corporation, and during that period of time, we literally closed, I would say, thousands of loans for homeowners and the purchasers, and I can tell you from my own experience, not including the other experiences that I know of the many realtors that I am aware of, that the settlement statement is not the easiest thing to read. But it is not that difficult to inform the person before they come to closing as to what exactly the costs are going to be if there is some variance from what was stated in the good-faith estimate as it currently works.

Sometimes you will have situations in which there is going to need to be a variance, a significant variance, depending on title-research issues, lots of different things that can impact the amount that is listed on the good-faith estimate and what somebody may have to bring to the closing table. But I cannot remember any time when we were not table to deliver that information and have the realtor inform someone that they would need to bring a certain amount before they showed up at the closing table.

The changes that are being proposed I do not think will really address that issue, and that issue being that the consumer needs to know what the expenses are in a clear way, and I would ask the question, how really effective do you think this is going to be in terms of the everyday experiences of purchasers, and is it really that much of a problem that people are not getting the information before they show up to closing because that has not been my experience and has not been the experience of so many of the other realtors that I know?

Mr. MARTINEZ. I believe that what you describe is usually not the exception but the rule, that there is additional fees or additional charges or additional monies that the person must bring. The problem which you describe is while they may have found out about it, they may have found out about it three days before closing, they will know how much they need to bring on the day of closing. It will not be just a complete and total surprise, hopefully, particularly with credible folks at the table, as you, I am sure, were when you were doing the business.

The problem is that at the time they have options, at the time they can shop for services, they do not know what the total fees are going to be, and that is a fundamental flaw in the system now that we are attempting to correct, is to give the consumer that early opportunity to be fully aware of what they are getting into and what they are going to be paying so that they can then have an opportunity to be prepared to shop for services elsewhere.

What we are doing now is opening the opportunity for a consumer to be so well informed early enough in the process to shop for the best and cheapest services available. That, I believe, is good for consumers. It may also alter how businesses have to do business, but I believe, at the end of the day, if the goal of RESPA is to improve the playing field and the cost towards the consumer, that the change to RESPA does exactly that.

Chairman MANZULLO. Wait just a second. We have gotten a high sign from your people, Mr. Secretary, that you have to leave. You fit us in the middle of a horrible schedule, and I want to thank you for spending 40 minutes with us, and——.

Mr. MARTINEZ. You really have the great technical people here who know a lot of the answers.

Chairman MANZULLO. You have done a good job yourself, too, Mr. Secretary.

Ms. VELAZQUEZ. Mr. Chairman, can I just make a comment here, please? As you can see, there are more questions than answers here, and a lot of us continue to have some concerns and questions. Would you commit yourself to come back to this Committee once you finalize the rule?

Mr. MARTINEZ. The gentlemen that I am leaving behind are the people who are technically involved in this day to day and have answers to all of the technical issues that are involved in the rule. At the call of the chair, I would be very happy to consider any invitation the Committee might issue, but I do not want to leave you with the impression that we are not willing to answer questions. We have been, Ms. Velazquez, very, very engaged with everyone in this industry, and I think you would be hard pressed to find someone who could tell you that the HUD door was closed to them, that they could not come in and tell us what they thought, what their concerns were, and that they did not have a receptive ear. At some point, we may agree to disagree with some people, but we have been receptive, and we have been listening.

Chairman MANZULLO. Mr. Secretary, again, thank you for coming, and you are excused.

Mr. MARTINEZ. Thank you.

Chairman MANZULLO. Thank you so much.

Let us continue with the questions. Mr. Bartlett, I want to go back to the five-minute clock, and then I will make sure that those that got—have an opportunity to talk to Mr. Weicher and Mr. Kennedy. Mr. Bartlett?

Mr. BARTLETT. Thank you. You all——.

Chairman MANZULLO. Before you do that, if I can interrupt you. You had wanted to make a comment, Mr. Weicher, and I cut you off. Did you want to finish that thought?

Mr. WEICHER. If I may, thank you.

Chairman MANZULLO. Then we will recognize you, Mr. Bartlett.

Mr. WEICHER. Thank you, Mr. Chairman. This is with respect to Mr. Beauprez's question and the discussion we were having with respect to the big guys and the little guys in mortgage origination. About 60 percent of the loans in America are now being originated by mortgage brokers. Ten years ago, it was a much smaller percentage. The mortgage brokers, the small guys, have been taking market share away from the lenders, from the bigger guys, and that is fine. That is the way the market has worked out. The brokers have been more flexible. They have been able to operate with lower capital requirements, and they have provided a service that home buyers and other participants in the settlement-services market have been willing to accept. We do not believe that anything we are doing is going to interfere with that process by which small firms have been an increasingly important part of the market.

May I also say, with respect to the 15 rules, we are doing a number of rules, 15 rules, concerning predatory lending in FHA loans? As FHA commissioner, I have responsibility for that area, and we at HUD only have responsibility for predatory lending issues, de-

ceptive and misleading practices in the real estate market insofar as it concerns FHA mortgages. The predatory lending issues in general are the responsibility of the financial regulators: the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and so forth.

Mr. BEAUPREZ. Sir, may I?

Chairman MANZULLO. Let us go to Mr. Bartlett.

Mr. BARTLETT. Thank you. You have a proposed rule that you have circulated. You have gone through a comment period. You have gotten a lot of comments. Your appearance here today reflects the reality that a number of those comments have been concerns by the small business community. You now take these comments, and you make changes, or you do not make changes in your proposed rule, and then you will publish a final rule.

There has to be a certain pride of authorship here, and my question is, whose counsel do you seek to make sure that you have really fairly evaluated the concerns of small business so that at the end of the day your rule will reflect a reasonable consideration of those concerns?

Mr. WEICHER. Mr. Bartlett, we have been meeting, Mr. Kennedy and I have been meeting, along with our colleagues, with industry groups and consumer groups and everyone who said they wanted to meet with us, going back to before we issued a clarification on our policy statement on yield-spread premiums back in October of 2001. We have been meeting with groups that are concerned about this issue, the issues relating to RESPA, for very close to two years, and we continue to do that. We have meetings on the schedule, one or another meeting, almost daily with organizations that want to meet with us on this issue.

We seek the counsel of anyone who is concerned about this issue, and we take the counsel that we receive very seriously. We are working to incorporate the suggestions of the groups that we have met with, given our purpose of making RESPA consumer friendly so consumers know what they are paying for a loan, for the settlement services, and are able to shop effectively for the best deal for their standpoint.

I do not think any of us have pride of authorship in anything. I think, by the end of the day, no one will have a clue who wrote any particular sentence in the final rule, whatever it says.

Mr. BARTLETT. That is the department. It would not be human nature if you did not have some pride of authorship.

My question really was not who you seek counsel with as you look at whether or not you are going to change the rule, but whose counsel do you seek at the end of the day that the final rule you come up with has, in fact, addressed the legitimate concerns of the small business community? There needs to be an honest broker somewhere here. There has to be someone whose counsel you value that you seek before you come out with this rule so that you will be sure that you have, in fact, addressed the legitimate needs of the small business community. Whose counsel do you seek to do this? It cannot be your own counsel. You cannot have a conversation with yourselves and say that you sought counsel.

Mr. WEICHER. Any final rule, as we write it, will be reviewed by the Office of Management and Budget's Office of Information and Regulatory Affairs, who have up to 90 days to review the comment, to ask for clarification. They constitute a review process, an informed review process, on behalf of the president and on behalf of the Executive Office of the President, and there is a give and take as to what the final rule will be, based on the conversations we have with them and the issues we raise with them.

Mr. BARTLETT. Is the Office of Advocacy at the table during this final deliberation?

Mr. WEICHER. The Office of Advocacy is part of the government, and the Office of Advocacy can be consulted by OMB and has been consulted by us.

Mr. BARTLETT. Are they? Are they sought by you?

Mr. WEICHER. Our staffs have been meeting with staffs of the Office of Advocacy.

Mr. BARTLETT. At the end of the day, will the Office of Advocacy be at the table when you are seeking counsel as to whether the rule you have finally come out with meets the needs and concerns of the small business community?

Mr. WEICHER. We will be meeting with them straight through the process.

Mr. BARTLETT. Including at the end of the day, at the final table.

Mr. WEICHER. OMB sets the final table. That, I cannot speak to, sir.

Mr. BARTLETT. Thank you. Thank you, Mr. Chairman.

Mr. KENNEDY. If I could just add to that for a second, Congressman Bartlett, this whole RESPA debate, I want to assure you that it is not something that came up suddenly, we looked at it, and put out a rule. This particular discussion has been going on at HUD. Dr. Weicher, in a previous life, was at HUD when he was starting this analysis of RESPA. There was a HUD treasury report. There was a HUD Federal Reserve Bank report. There was a private-industry group; they met for, I think, 18 months to discuss options for improving RESPA, and at that table were all of the same groups, including the groups that you represent. They have been at the table for this very long discussion of ways that everyone is looking forward to improve the settlement process and make it cheaper, wherever possible.

I can assure you, this is not something that came up suddenly and is being pushed by any particular group. It is being pushed by the Secretary, and he is seeking the advice and counsel of all of the groups that you are concerned about.

Chairman MANZULLO. Thank you. Congresswoman Bordallo.

Ms. BORDALLO. Thank you, Mr. Chairman, and Mr. Secretary is gone now, but the gentlemen before us. You stated that this rule would streamline and reduce the burdens on small business, yet your economic analysis says that this will increase burden hours by 2.5 million on small businesses. Can you explain that? That does not sound like streamlining to me.

Mr. WEICHER. There are several matters that give you that final figure. There will be a certain amount of transition, getting used to the new rule. There will be what we consider a one-time cost for the individuals who are in the industry to understand what is

being done. We calculate that, and that is part of what we expect to see. We expect it to be, certainly, a one-time change. There will be that in any instance.

Beyond that, we are reducing regulatory burden in the revised good-faith estimate compared to the current good-faith estimate on everyone in the loan-origination process other than the lender, who provides the good-faith estimate. For the lender, there will be additional regulatory burden because there will be the need to put together that good-faith estimate and to do the paper work associated with it. Other settlement services providers, small businesses, by and large, will not have the regulatory burden that they now have under the current good-faith estimate.

With respect to packaging, there is no regulatory burden. That is a voluntary decision by individual firms as to whether to put a package together and whether to participate in the package. We are imposing no burden on anyone. But if you add up the burdens that will fall on the lender in the transition, then there is some burden. There is an unavoidable burden in any regulatory change of any sort or any legislation that Congress passes that will fall on those who effectively have to get used to doing things differently.

Ms. BORDALLO. So what you are saying, then, that the estimate is a one-time only.

Mr. WEICHER. A good part of it is a one-time only estimate. There will be a continuing burden in preparing a good-faith estimate for the lender who assumes the responsibility for putting it together.

Ms. BORDALLO. Do you have any estimates on those figures?

Mr. WEICHER. Those are the figures I quoted to you.

Ms. BORDALLO. For the future.

Mr. WEICHER. Yes. The figure you quoted includes both the one-time cost and the ongoing cost.

Ms. BORDALLO. What about the continuing?

Mr. WEICHER. And the continuing. It includes both the one-time cost and the continuing cost.

Ms. BORDALLO. Thank you. Thank you, Mr. Chairman.

Chairman MANZULLO. Mr. Bradley?

Mr. BRADLEY. Thank you very much, Mr. Chairman, and thank you to the gentlemen who are here. This certainly appears to be a very significant proposal that you have put forward, and it would appear that there are groups all over the place on this proposal with a lot of opposition and perhaps some in support of it.

My question goes to your data collection, your research, your analysis. Given the fact that there has been so many questions raised by this proposal, is it appropriate for you to go back and conduct additional research and data analysis before going final with this rule and taking into account some of the positions of the various small business interests, and will you make that before this rule becomes final?

Mr. WEICHER. Mr. Bradley, we have received the comments of many entities and the suggestions from many entities—small businesses, consumer groups, and others—as to issues that we should be looking at. We are doing that in the process of preparing the final rule, as we are required to do, and we will look at the issues that they raise with us, do whatever additional analysis we need

to do in order to establish the facts of the impact on small business and consumers and the economic impact as well as the regulatory flexibility analysis, and that will be part of the final rule, which is the statutory requirement and procedure.

Mr. BRADLEY. And potentially you will alter, then, some of the provisions of the rule that seem to be attracting the most scrutiny. Is that what I am hearing you say?

Mr. WEICHER. Mr. Bradley, as I understand it, we are not really in a position to discuss specific changes that we contemplate in public. As Mr. Kennedy would point out, there are concerns about the Administrative Procedures Act. I can tell you this. I have been involved in a number of regulatory matters at HUD, a number of regulations at HUD. I have never seen a final regulation which was identical to the proposed regulation, unless we literally got zero comments.

Mr. BRADLEY. Thank you.

Chairman MANZULLO. Mr. Davis.

Mr. DAVIS. Gentlemen, I have been speaking with people in the industry who suggest that this rule will actually force some small businesses in the industry out of business. If that is the case, then this reduces the competition. If competition is reduced, how does that benefit the person seeking a loan?

Mr. WEICHER. We do not think that the rule is forcing anyone out of business at all. We think the rule is providing information to consumers to enable them to make informed choices as to what loan and what service providers are the best from their standpoint. That has been a driving motivation in preparing the rule.

We also think that clarity, simplicity, the opportunity to shop for a loan expands the overall market, makes home ownership possible for more families who now cannot get through the process of originating a loan, cannot really understand exactly what they are doing and drop out. We think that this rule will contribute to the goal of increasing home ownership in America and to the president's specific goal of increasing minority home ownership in America by five and a half million more households by the end of the decade.

Mr. DAVIS. Given that nonlenders cannot guarantee interest rates, it would appear to put them at the mercy of lenders. Would you agree with that, first of all?

Mr. WEICHER. No, Mr. Davis, I would not. I think you need all of the services to have a loan. To have a transaction, you have to have a loan, you have to have a broker, you have to have title insurance, you have to have an appraisal, and you have to have pest inspection. All of them are necessary to put a loan together. You do not have a package, and the package has to be a guarantee of a loan, you do not have a package without all of the services that are required for the package. If you do not have all of the services in the package, then, as I understand it, you are violating a contract which you are making when you sign the guaranteed mortgage package.

I think all of the services that are necessary will be included in a package, or you do not have a guaranteed mortgage package, and all of those services continue to be needed for the benefit of either the lender or the consumer or both going forward.

Mr. DAVIS. Thank you very much, Mr. Chairman. I have no further questions.

Chairman MANZULLO. Ms. Musgrave.

Ms. MUSGRAVE. Thank you, Mr. Chairman. I would certainly like to reiterate what many of my colleagues have said, specifically that this will harm small bank competition and effectively limit choice in the number of quality of loans that will ultimately harm consumers.

Many concerns have been voiced to you today, but there is one that has not been voiced. I am wondering about enforcement. I represent the State of Colorado, the Fourth District in Colorado, and it is my understanding that we have one HUD officer for the State of Colorado, and as if that were not bad enough, that individual has responsibility for four other states. Can you tell me how this proposed rule will help us in the area of enforcement?

Mr. WEICHER. Enforcement is a separate matter, Ms. Musgrave. As Assistant Secretary for Housing, I have the responsibility for the enforcement staff. There is an Office of Regulatory Affairs, which reports to me and which investigates RESPA complaints. We then work with the Office of General Counsel and perhaps with the inspector general and perhaps with the Justice Department on investigating complaints.

We are now in the process of substantially expanding our enforcement staff. We are literally tripling the number of people who are devoted to RESPA enforcement within the department. I cannot tell you how many more——.

Ms. MUSGRAVE. So will this be a new day with enforcement, then, as you pile more regulations on top of the others?

Mr. WEICHER. With respect, Ms. Musgrave, we do not believe we are piling new regulations on. The guaranteed mortgage package is not a requirement of anyone. It is an option, and the good-faith estimate is a requirement that consumers be given information early enough so that they can make an informed decision. Violations of RESPA will be enforced as effectively as we can. The biggest violation we hear of now, the biggest complaint we hear of now, is, quoting a typical complaint, "I came to close, and at closing I suddenly had to have $700 more, and I do not know why, and I do not know what it was for, and my choice was either to pay the $700 or risk losing the house."

Ms. MUSGRAVE. I think that when you harm small business, and I know you have heard many concerns from my colleagues on both sides of the aisle today about their concerns about that, you ultimately will harm the consumer. I am hoping that you will delay these rule changes and get more input.

Mr. Chairman, in order that I not rehash what has been said, I have two letters that I would like to submit today from Colorado Mortgage Lenders Association and then from Former United States Senator Bill Armstrong from the Cherry Creek Mortgage Company, and I would say to you that these proposed changes will probably benefit folks like these, but they are saying that we have to level the playing field, not do something that will even make the problem worse than it is now. Thank you, Mr. Chairman.

Chairman MANZULLO. The letters will be admitted without objection. Mr. Chabot?

Mr. CHABOT. Thank you, Mr. Chairman, and we thank the folks on the panel for being here this afternoon. I apologize for being a little bit late, but I had to handle two bills on the floor.

Before I address the proposed RESPA reform, I want to make sure that HUD is aware of a critical problem that many of my constituents back in Cincinnati are having with the local housing authority. Specifically, the Cincinnati Metropolitan Housing Agency, CMHA, has been unresponsive, amid vigorous community opposition, to the proposed demolition of English Woods, which is a public-housing community in my district.

The demolition is opposed by the residents who live there. It is opposed by the surrounding neighborhoods. It is opposed by the City of Cincinnati and the Cincinnati City Council. It is opposed by their congressman, me, and despite the fact that CMHA does not have a workable plan for funding for redevelopment of this particular site, they have really taken a very confrontational approach, hoping, I believe, that once the demolition is completed, the city or us, the federal government, will be forced to provide money for some type of redevelopment effort.

I am sure you would agree that these heavy-handed tactics are inappropriate, that housing authorities have a responsibility to work in partnership with the local community, which CMHA has not done in this particular instance. CMHA has filed a demolition application to you all, to HUD, and I urge you not to issue a permit until CMHA addresses these concerns. If you would convey that to the Secretary, I would certainly appreciate it.

Mr. WEICHER. Mr. Chabot, if I may respond to that, that decision lies within the Office of Public and Indian Housing as opposed to the Office of Housing or the Office of General Counsel. I will bring that back to my colleague, Assistant Secretary Michael Lieu.

It happens that I was part of a group of senior HUD officials who met with a delegation from National People's Action last week, including a resident of English Woods, who described to us her concerns and the concerns of the residents, which are very similar to the concerns that you stated. Again, it is not the part of HUD for which I am responsible, for which Mr. Kennedy is responsible. It has been called to our attention, and I will carry your concerns back to my colleagues as well.

Mr. CHABOT. I appreciate that very much, and I thank you.

I would also like to state my strong support for your efforts to provide more clarity and greater disclosure to the home-buying process. Encouraging greater transparency will give consumers the ability to make more informed choices. While I recognize that HUD's goal in formulating this rule was to simplify the mortgage-financing process, ultimately leading to increased home ownership and, hopefully, saving consumers money, I am concerned, as many of my colleagues are, and many have expressed it already, as my staff informs me this afternoon, that some of the elements of this proposal may actually cause even greater confusion among consumers and lead them to make poor decisions.

I also have reservations about the rule's potentially negative impact on competition and on small businesses. This has, again, been mentioned already this afternoon on more than one occasion.

I would like to ask you a question, and I know, as I say, it has already been touched on, but regarding the enhanced good-faith estimate and the disadvantage mortgage brokers would face when it comes to zero-point loans, under the proposed rule, a mortgage broker and a mortgage lender might charge a consumer the same rate and closing costs for a mortgage loan, but if both receive indirect compensation, only the mortgage broker must show this as direct compensation. This means that for the very same loan a lender can advertise and show his customer a zero-point loan. The mortgage broker cannot. While this is a clear competitive disadvantage for small mortgage brokers, it also puts consumers at a disadvantage, making it very difficult for home buyers to accurately compare their options.

Will HUD address this discrepancy before finalizing the rule?

Mr. WEICHER. The issue you are raising is an old one in RESPA. It is the problem of what we refer to as the "secondary market exemption." A lender cannot know at closing what the lender will be paid in the secondary market for the loan, and that is the equivalent of the yield-spread premium that the broker charges the consumer, because, as the Secretary was saying, we cannot address what payment a secondary market, either the GSEs or anyone else in the secondary market, will make for a given loan. The lender does not know what that will be when the lender is at the closing table. The lender may not, in fact, sell the loan into the secondary market. There may be no subsequent payment, and one simply does not know that.

What we are doing in our rule, what we are trying to very hard to do in our rule, is make sure that you, the consumer, know which loan is cheaper for you when you go to the closing table, which one is going to be the best deal from your standpoint, and we have heard a number of concerns raised about the enhanced good-faith estimate that we issued as part of our rule with "proposed" all over it so no one took it as final, and we have been thoroughly testing options, alternatives to that, some of them suggested by the folks who have commented on the rule, to make as sure as we can that you know which is the best loan for you so that if a broker is offering you a cheaper loan than the lender is offering you, you know that.

Chairman MANZULLO. Mr. Weicher, that was not the question.

Mr. WEICHER. I am sorry. I thought it was.

Chairman MANZULLO. The question was not for the consumer; the question was that the mortgage broker would be at a disadvantage because the kickbacks are being shown to him but not to the mortgage lender. That is the issue right there, and you have not answered the question.

Mr. WEICHER. I understood the first part of the question to be about the secondary market exemption.

Chairman MANZULLO. It was not from the consumer. Am I right, Mr. Chabot?

Mr. CHABOT. We are interested in both, but I think, yes, what the chairman has indicated was the basis of the question, really.

Chairman MANZULLO. The form shows a kickback, a waiver of Section 8, passing through to the mortgage broker but not to the

mortgage banker. The question is, would that be a disadvantage to the mortgage broker?

Mr. WEICHER. Mr. Chairman, it is not a kickback under Section 8. The Secretary, in the clarification of the policy statement concerning yield-spread premiums, and that is what we are talking about here, the yield-spread premium is a legitimate way to provide for part of the cost of origination and closing for the consumer, so the consumer who does not have all of the cash for the up-front closing but can take a little bit higher mortgage rate is able to get a loan with less up-front cash and a somewhat higher mortgage rate with the yield-spread premium. It is the converse of points, with which we have all been familiar for a long period of time.

It is not a violation of Section 8, and it is not a kickback. It is a payment for the services that are provided by the mortgage broker as part of the loan origination, and the department stated that in 1999 and stated it again in 2001.

Chairman MANZULLO. Mr. Beauprez, you had a follow-up.

Mr. BEAUPREZ. One last one, Mr. Chairman, and thank you very much.

Mr. Weicher, I will confess to being a little bit confused. I have no doubt at all of the intent of the agency and what you are trying to accomplish. I was pleased to hear your reference, I think, earlier that 60 percent now of mortgages are originated by brokers, most of those probably small brokers, many of them community banks, credit unions that are out there providing service. If that is a good thing, and I submit that it is a good thing—I agree that it is a good thing—I am going to assume that they got that by being able to compete, and being able to compete both on price as well as based on service. That is a good thing, too, I think.

If this is designed to provide further competition and further clarity in the market, transparency in the market, certainly lower costs for consumers, then why is it that, as I cited earlier, the independent community bankers, who are the small guys out there providing them, getting part of that 60 percent, why aren't they in favor of it? Why aren't, as my colleague from Colorado cited earlier, why aren't folks like the Colorado mortgage lenders, 310 companies across Colorado, excited by this? They state, quite clearly: "This approach will result in higher costs, additional disclosures, would confuse rather than clarify information for consumers, and unintended consequences which will ultimately limit competition and consumer choice."

My question is, are the people on the street that are actually doing this for a living, that have clawed and scratched and worked hard to get some of that market share, are they confused that this is really a good thing for them, and they just do not get it?

Mr. WEICHER. I think, Mr. Beauprez, there certainly has been confusion as to what is in the proposed rule. We believe that the proposed rule will make it possible for consumers to know up front what it is they are going to have to pay at closing and to know that in time to shop effectively for an alternative and to see if the price they are being quoted by the first originator they talk to is better than the price quoted by the second or the third and so on, in the same way that we shop for any other major purchase where we

want to be sure that we are getting the best price for what it is that we want.

We do not believe we are imposing regulatory burdens other than, as I said earlier, other than the good-faith estimate requires the lender to be responsible for putting that form together, and there will be regulatory burden there. We think, otherwise, there will not be regulatory burdens on small businesses.

Ms. VELAZQUEZ. So what is it?

Mr. BEAUPREZ. I think what I am hearing is that the folks on the street that are doing it are wrong and that the agency is right, and I know that that is your intent, sir, and I respect that.

Mr. WEICHER. If I may just say so, we have read the comments of anyone who submitted comments to us, and we are trying to take them seriously into account. It is not our intention to raise the cost of settlement for anyone, and we believe that, in fact, we are effectively lowering the cost of settlement for consumers and making it possible for more people to become home owners, and we are providing a level playing field which will let small firms continue to play at least the role they are playing now.

Chairman MANZULLO. Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. It seems to me, sir, that you do not get it. You answered to the gentleman that this does not represent a burden for small businesses, but yet, on the last page of your statement for the Paperwork Reduction Act, you state that the programmatic changes you are mandating at HUD will increase the burden on small businesses by 2.5 million hours. However, two pages before that, you state that the collection of this information does not impact small businesses. So what is it?

Chairman MANZULLO. Mr. Weicher, could you bring the mike a little bit closer to you?

Mr. WEICHER. I am sorry, Mr. Chairman. I was looking to see if I had brought the analysis with me so I could see what Ms. Velazquez is referring to. Can you tell me what pages you are referring to, Ms. Velazquez?

Chairman MANZULLO. Here it is.

Ms. VELAZQUEZ. She is going to show it to you.

[Pause.]

Mr. WEICHER. I see what you are referring to here, Ms. Velazquez. We are proposing, in the good-faith estimate and the guaranteed mortgage package, that consumers know that, besides the loan they are being offered, they have the option of paying points and receiving a lower interest rate and what that option is likely to consist of or to have a yield-spread premium paid on their behalf and accept a higher interest rate so that they know that, besides this loan, there is an alternative with lower up-front costs and a higher rate, an alternative with higher up-front costs and a lower rate, and it is to provide that information that there is an additional burden required——.

Ms. VELAZQUEZ. With all due respect, sir, my question is not about consumers. My question is about the burden on small businesses.

Mr. WEICHER. The burden is in order to explain to consumers their loan, how this loan compares to alternatives they could choose, which would have a higher interest rate and lower up-front

costs or a lower interest rate and higher up-front costs, something which has been strongly endorsed by all of the consumer groups who have commented on the proposal. The burden here is a burden on the lender, who prepares the good-faith estimate——.

Chairman MANZULLO. If I could interrupt just a second, Mr. Weicher. This is the Small Business Committee. Time after time after time again, a question has been asked by a Member on the impact to small business. You have flipped it on its head and come back with the same canned answer on helping the consumer. I appreciate that you are here, but I want you to be very specific and answer these questions because we are concerned about small businesses.

Ms. Velazquez, would you like to ask your question again, or would you like to——.

Ms. VELAZQUEZ. No. Can we both agree that 2.5 million hours does impact small businesses?

Mr. WEICHER. That burden falls on the lender. It does not fall on small business in general. It actually falls on lenders, some of whom will be small, others of whom will be large, and this is, of course, the concern that the chairman raised earlier, that we will have more larger lenders. The burden of responding, the burden of providing the information to the consumer, will fall on the lender, and in return for that, the consumer will be able to make an informed choice.

Ms. VELAZQUEZ. Sir, you are so much concerned about consumers, and you are telling me that all kinds of consumer groups are in support of this rule. Can you please answer to me, is the Consumer Federation on record supporting this or the Consumer Union or the National Consumer Law Center?

Mr. WEICHER. Yes.

Ms. VELAZQUEZ. Are they on record supporting this?

Mr. WEICHER. The National Consumer Law Center is on record supporting us.

Ms. VELAZQUEZ. Consumer Federation?

Mr. WEICHER. I cannot remember at the moment if they——.

Ms. VELAZQUEZ. And Consumer Union?

Mr. WEICHER. The American Association of Retired Persons is a strong supporter. They submitted a long response to each of our 30 questions, and they are the largest organization representing consumers in the country, and I am informed that the Consumer Federation of America also has responded in support of what we are doing.

Ms. VELAZQUEZ. Were your staff at the banking hearing last week where the person representing the National Consumer Law Center said that they were not on record supporting this?

Mr. WEICHER. We had staff at that hearing, and the National Consumer Law Center has supported the rule and the comment. I did not read the statement. If this was Margot Sanders, I did not read a statement that she presented there, but they have supported the rule.

Ms. VELAZQUEZ. I would ask that you read or your staff the hearing, the record on the hearing that took place last week because any of the groups that you are mentioned were not in support of this rule at that hearing. Thank you, Mr. Chairman.

Chairman MANZULLO. I have some questions. Why do not you go ahead, Dr. Christensen?

Mrs. CHRISTENSEN. Thank you, Mr. Chairman. I think there is general agreement that some reform is necessary, but, for example, the uncertainties and some of the lack of clarity in the good-faith-estimate part have recently been cleared up through the courts. Won't this new rule essentially change what the courts have done to clear up this issue and thus place an additional economic burden, as well as perhaps some legal burdens, on small businesses?

Mr. WEICHER. We see this rule as continuing the policy clarification that we issued on yield-spread premiums indicating that yield-spread premiums were acceptable so long as they were for actual goods or services, so long as they bore a reasonable relationship to the cost of the goods or services, which had been the subject of intense litigation over a number of years.

Since that clarification was issued, a number of courts have given deference to the statement that we issued, the clarification that we issued, and have said that the particular class-action suits in front of them, they did not accept them and did not side for the plaintiff.

We see ourselves as clarifying further how the yield-spread premium fits into the entire cost of settlement on the loan. We do not see ourselves as doing anything inconsistent with what we did in the fall of 2001.

Mrs. CHRISTENSEN. I did not have a chance to really look through the case, but I was asking about the good-faith estimate——

Mr. WEICHER. Right.

Mrs. CHRISTENSEN [continuing]. That was recently settled.

Mr. WEICHER. There have been a number of cases.

Mrs. CHRISTENSEN. It was recently clarified within the courts, and it is my understanding that what you are doing would effectively change what the courts did and create some of that uncertainty again and then continue to place an additional economic burden on small businesses, and within that lack of clarity again put them in a situation where they would be facing suits from borrowers in an attempt to further clarify this issue.

Mr. WEICHER. No. All of the court decisions of which I am aware have given deference to the statement we issued in October of 2001, and we are certainly not reversing the statement that we issued in October of 2001. I do not know if Mr. Kennedy is aware of any other case.

Mr. KENNEDY. No. In addition, I think that the good-faith estimate that we are proposing, the general terms of that, will actually reduce the likelihood of litigation because the disclosure would be clear to the consumer at the time that they are given that good-faith estimate. There is not going to be any later surprise. So I think, if anything, it is going to reduce the likelihood of any litigation, which I think is probably something that we would all want.

Quite frankly, the lending industry and the brokers were very happy with the yield-spread-premium policy statement because they were under the gun. There were over 150 lawsuits, many class-action lawsuits, filed against lenders for this very problem. There were folks, including consumers, who wanted HUD to state that yield-spread premiums were, per se, illegal and permit those

lawsuits to go on. The Secretary, quite frankly, analyzed the yield-spread premium and realized that it was something that was good for the consumer and a useful tool in the lending business and for brokers to use. The Secretary preserved it, and this will probably prevent further litigation, in my opinion.

Mrs. CHRISTENSEN. I may have a follow-up question in writing to the Secretary.

Chairman MANZULLO. Congresswoman Majette?

Ms. MAJETTE. Thank you, Mr. Chairman. I have another concern regarding small businesses and the possibility that they would be foreclosed from competition under the RESPA reform, the rules that are being proposed. Now, again, in my experience and, I know, in my district, there are many lending institutions that will keep lists of approved appraisers and other service providers, and it is very difficult, particularly for women and minority businesses, to get onto those lists.

In the rule, as it is proposed, as I understand, there would not be a requirement that you package or bundle the services as part of the statement that would be given, but if the largest national lenders are going to be likely to negotiate volume discounts with the larger providers, where is that going to leave the small business owner, the women business owners, the minority business owners, those people who are not already on those lists and may again have problems getting onto those lists, particularly in areas where there is not a lot of competition already? I want to hear what the plans are, what you are planning to do to address this issue, to make sure that there is that kind of inclusion for the smaller business owners, for women and minority businesses in the bundling of these services.

Mr. WEICHER. Two things, I think, are relevant here, Ms. Majette. First of all, a consumer has the option of asking that a settlement-service provider of his or her own choosing be used by the lender instead of any provider in the bundle so that if you know of any settlement-service provider—a woman appraiser, a minority pest-inspection firm—you can ask that they be part of your loan package instead of the provider that is in the package that is being offered. A lender who turns that down is likely to need a pretty good reason for possibly passing up a loan.

Ms. MAJETTE. Well, what if the reason is cost? If the lender has negotiated with provider X to do an appraisal at $250 for the appraisal, and another small business owner, another appraiser, might do it for $275, that is going to mean that if the person who is seeking the loan is going to have to ask for somebody else to do that, it is going to cost them more money, but the only reason that they are actually getting this cheaper deal is because of the ability of the lender to have negotiated with someone who could afford to negotiate.

My concern is that we will end up with loss leaders and that small business owners will not be able to compete, nor will they be able to have the inroads that already established businesses or larger businesses already have. And I just do not want us to be in a situation where we are going overboard and having a negative impact on these providers who are doing a good job, who can do a good job, but cannot compete at the level of the big-time owners.

Some small businesses cannot compete at the same level as a large ReMax operation. That does not mean they cannot do any better; it is just that they are not on that same level, and I am looking for what you have in place to protect those other business owners.

Mr. WEICHER. Most settlement services in most markets are provided by small businesses. Most of the providers of any settlement service are small. We know that. We reported that in our economic analysis. Those small businesses are going to remain in place because if they are able to operate in the present market, and they are, they will be able to operate in the market as it evolves with the option of packaging and with the enhanced good-faith estimate.

Ultimately, a large lender, a large anybody else, has to come back to the local firm, which is providing the service locally and knows the local market, and they have been doing that for decades, and they will continue to do that.

Ms. MAJETTE. But it's going to help those that are already established, and we need to be forward-thinking and look at those businesses that are just beginning or trying to get a foothold or want to get a foothold, and are going to be foreclosing that, or certainly impeded in their ability to do that if they can't get into this part of the market.

And the other question I have, if I may continue, Mr. Chairman, is with respect to—to follow up on the gentlewoman from New York—this whole issue about the 2.5 million hours, I do not know if you would agree with me that time is money, but I think most business people would. Someone is going to have to bear the cost of this 2.5 million hours. Somebody has the burden of that, and at a minimum wage 2.5 million hours is still a lot of money.

I do not know what—I really do not understand how that is going to be dealt with. You are saying that it is going to be a benefit to the consumer, the lender is going to take that on. Well, I cannot imagine that any lender is going to do that for free and not pass that cost on in some form or fashion to the borrower.

Can you enlighten me on that?

Mr. WEICHER. Any specific cost will certainly be borne ultimately by the consumer, and that is why we remain concerned about the cost to the consumer of what we are proposing. This is only one aspect of what we are proposing to do in the rule.

We also believe that by making clear what the cost of the settlement package is, either through the good faith estimate or through the guaranteed mortgage passage, that will enable consumers to shop effectively. That will enable consumers to find the least cost service loan for their purposes. That will enable consumers to avoid the surprise cost at settlement when they cannot do anything about it except grit their teeth and pay it because they do not want to lose their home.

And there will be substantial savings to consumers from these other features of the proposed rule, and those savings will enable more families to buy homes and to get started on middle class status in America.

Ms. MAJETTE. Thank you.

Chairman MANZULLO. This is the beginning of my sixth term, and I want to be very frank with you. I have never seen such a worse piece of scholarship going in that is going to be a Regulatory

Flexibility Act that impacts small businesses by $5.5 billion, and I want to take you through this thing and show you how poorly done this is.

I'm going to ask you this question. If HUD amended the Regulatory Flexibility Act to allow judicial review of the Regulatory Flexibility Act, if your regulations go into effect, there will be a lawsuit, and if possible, I would join in on it as a plaintiff, and I think every member of the Small Business Committee would.

If this is overturned by judge, and you are wrong because HUD is so bullheaded it would not issue a supplemental Regulatory Flexibility Act as requested by the Office of Advocacy of the Small Business Administration, how can you justify the tremendous amount of attorney's fees, the tremendous amount of lost hours in HUD simply because you are not listening to Congress in issuing an amended RFA. You are asking for a lawsuit. You will get a lawsuit.

If you are wrong, you have cost the taxpayers hundreds of millions of dollars in going through this flawed RFA and going through every type of information that you have gotten, and that is why we are upset, because of the inflexibility of a bureaucratic regime where you sit there, and members of my staff have been to over 1,000 real estate closings, and attorney down here has been through hundreds, if not thousands, a community banker down here know what on the Banking Committee, same background, over 22 years of practice in law, over 1,000 real estate closings, and we have asked you for one thing continuously, and that is an amended brief.

What are you afraid of? Is it the truth? But I am not done yet because I want to show you want you did, and why it is fatally flawed, fatally flawed. I am turning to page 75. No, Effect on Small Retailers and Brokers, page 73, under C. It is the last sentence in the—I guess that first paragraph.

"If this market for packages of third party services were competitive, and there is no reason to believe it would not be, then the small originators would not be at a disadvantage relative to the large originators."

No backup, no data, no research. In fact, the research, let me show you what your research shows. Go to page 45, and this is appalling. It is absolutely appalling that an agency of your size could not take the time, in fact, I think your entire study was only 85 pages on a $8 billion thing. Look on page 43.

This is supposed to be your analysis of the estimated magnitude of effects. Starting on page 43, the second full paragraph that deals with real estate brokers, one sentence, the real estate brokers; the definition of small real estate brokers, today's revenue or $6 million. We have information on title service fees, just one sentence on title service fees. Small real estate appraisers, there is one sentence there.

Now you go down to the next one, the sample of FHA loans applicable to us has an average price of appraisal of $289. If the firm did nothing but appraisal, they would do so many per year or 17 per workday.

That is the complete—then you have a paragraph on appraisal. Come down to title services, about another three lines on title serv-

ices. You have one sentence on law firms. Law firms range in size from one lawyer to several hundred. Many settlement companies have one office, but there are firms with multiple offices with a few exceeding 10 offices. It seems some of these firms are small, but some are—this is your analysis of the impact. This is your total analysis. You have done nothing on this. You have got no documents on it. You have guessed at it. You said, well, we hope it introduces some type of competition on it.

Let me turn to page—I will probably get excited now when I see this. Here it is on small services agents, page 75, part of the package, third paragraph down starts with, "There is competition under packaging drives down prices. It is the less efficient who will be driven out of the market, not necessarily small business."

Come on. How can you look at a small business person in the eye and say the less efficient will be out of businesses, but not necessarily small businesses. Who do think gets smoked out there? The little guys or the big guys? Why do you think we are upset up here, and you make the statement that demonstrates, "The small advisement appraisal despite the fact that it is the originator rather than the individual borrower. The relatively large, relatively small who does the selection," it sounds like Darwinism. "As noted above, there is no reason to believe that small firms cannot survive and pass inspection surveying in the settlement agent industry, but under packaging those third party service provides, both large and small, who are currently charging high prices for their settlement services, would experience reductions in the prices of their services."

So you made a statement of fact that the people, the surveyors, the settlement people are charging high prices. Where do you come up with that? You have no statements to document this.

Mr. WEICHER. We have—in the passage which you cited on page 43, we are discussing the way in which we define small.

Chairman MANZULLO. Are discussing. Go ahead.

Mr. WEICHER. We are discussing at that point the way in which we are defining what is a small business. That is not the only part of the analysis.

Chairman MANZULLO. Where is the other analysis that gives the——.

Mr. WEICHER. Well, let me direct you to Table 1–1, and the material before and after it at pages 5 and 6, for instance, where we discuss——.

Chairman MANZULLO. Let me find that. Hang on.

Mr. WEICHER. We discuss that, what it is that—the size distribution of mortgage bankers and correspondence and loan brokers. We are looking at the size distribution of businesses at these points. We are then going on to discuss the impact on businesses of different sizes according to the industry.

Chairman MANZULLO. No, the size——.

Mr. WEICHER. There is no compliance burden on the industries which are discussed on page 43. Those are not the people who are affected by the good faith estimates. Those entities are not affected by the packaging. There is no regulatory burden on those entities here, and we are in fact addressing what it is, what their size is,

how you define a small appraiser versus a larger appraiser, and providing that to look at the——.

Chairman MANZULLO. But where in this does it state if this package passes, this is impact upon title service people? Where is it in there, and then what type of proof do you have to show that? What substantive evidence?

Mr. WEICHER. We have provided evidence.

Chairman MANZULLO. Where?

Mr. WEICHER. Throughout——.

Chairman MANZULLO. Where?

Mr. WEICHER. Throughout this 97-page——.

Chairman MANZULLO. I want to know where it is.

Mr. WEICHER. Throughout this 97-page rule.

Chairman MANZULLO. Where? I want to know where it is.

Mr. WEICHER. I will have to——.

Chairman MANZULLO. No, I want you to do it now. You have got a whole staff here, and that is what this is all about. I want to know where it is. Your staff can help. They are sitting right behind you. That is what the small business people want to know for a long period of time. Where is it? It is not here.

Mr. WEICHER. Mr. Chairman, I cannot go through a 97-page——.

Chairman MANZULLO. You have how many people here from your staff?

Mr. WEICHER. I do not——.

Chairman MANZULLO. It is only 97 pages with $6 billion.

Mr. WEICHER. I do not think that we can go through a 97-page rule and point—and pull out—97-page analysis and——

Chairman MANZULLO. Because it is not there.

Mr. WEICHER [continuing]. Pull out specific points.

Chairman MANZULLO. Well, then answer me off the cuff.

Mr. WEICHER. I will be happy to——

Chairman MANZULLO. No, no, no, I want the answer now.

Mr. WEICHER [continuing]. Add it to the record.

Chairman MANZULLO. No, nothing in writing. I want the answer now. This is accountability time for the small businesses. They have been waiting for this day for a long time, and I want the answer now.

You have to tell me where in this report you go through each of these small businesses and show us the impact, the economic impact and the alternatives to the rest of redesign that are ordered to be done by the—by the Regulatory Flexibility Act. It must be in here.

Mr. WEICHER. Mr. Chairman, as I said earlier, Chapter 3 of this report is devoted to the effect of——

Chairman MANZULLO. Then show me where it is.

Mr. WEICHER [continuing]. The changes. It is a good faith estimate.

Chairman MANZULLO. Show me where it is.

Mr. WEICHER. It is Chapter 3.

Chairman MANZULLO. Show it to me.

Mr. WEICHER. Chapter 3.

Chairman MANZULLO. What page it?

Mr. WEICHER. The page number—I will have to look up the page number on which chapter——

Chairman MANZULLO. Somebody help Mr. Weicher.

Mr. WEICHER [continuing]. Because we do not—Chapter 3 begins on page 19, and continues through—continues through page 58. Chapter 4, discussing guaranteed packages, ——

Chairman MANZULLO. Show me in Chapter 3.

Mr. WEICHER [continuing]. Begins on page 59.

Chairman MANZULLO. This is a very simple question. I want to know the impact on the small business, the financial impact on the small businesses, and I want you to point it to me because this is the first question I will be asking you in a lawsuit. Pretend this is a deposition. I am trying to work with HUD and avoid these lawsuits from coming, but you have got to help me to defend this document.

Mr. WEICHER. Mr. Chairman, to find the specific passage that you are looking for in a 40-page chapter——

Chairman MANZULLO. You do not know.

Mr. WEICHER [continuing]. Is not something I can do off the top of my head without going through and spending time——.

Chairman MANZULLO. Did you prepare for this hearing, Mr. Weicher?

Mr. WEICHER. Yes, and I read——.

Chairman MANZULLO. Did you not know what this is all about? I discussed it with the staff in the office.

Mr. WEICHER. Yes, and I read the economic impact analysis.

Chairman MANZULLO. How many staffers do you have behind you?

Mr. WEICHER. I would have to turn around and look.

Chairman MANZULLO. Go ahead and look.

Mr. WEICHER. We have—we probably have——.

Chairman MANZULLO. How many from here are from HUD? Stand up.

Mr. WEICHER. One from my office, Mr. Chairman.

Chairman MANZULLO. How many here from HUD? Would you stand up, please? Everybody from HUD, please stand up.

All right. One by one, I want you to identify who you are and what you do in the HUD office. Starting over here on the far left.

[Audience identifies themselves.]

Chairman MANZULLO. The Office of General Counsel, that is the law firm portion; is that correct? We have all these lawyers. I have got a very simple question, and no one knows the answer to this question.

Mr. WEICHER. Mr. Chairman, I reread the rule, the economic analysis and the rule over the weekend. I cannot reproduce off the top of my head a specific page in a 97-page rule.

Chairman MANZULLO. That is because it is not in here.

Mr. WEICHER. Because I have not committed the 97-page analysis to memory.

Chairman MANZULLO. You do not have to commit it to memory. I am looking at it right here. It just not in here.

Anybody else from HUD know the answer to this question? I am not going to move until they have answered. I am serious. I want this question answered. Here is the issue again.

As to all the small businesses impacted by the proposed RFA rule, where in the regulatory flexibility analysis does it show the financial impact on small businesses and where is the evidence that substantiates it?

Mr. WEICHER. Mr. Chairman, I would have to direct your attention to Section 10 of the analysis, which begins on page 53 and continues to page 55, summary of benefits of costs, transfers and efficiency gain. This summarizes what has appeared in the previous 33 pages of this chapter, and contains the information that was——.

Chairman MANZULLO. This is a summary and lumps the service providers today. That is not the answer to my question.

Mr. WEICHER. The pervious—this is a summary. The previous 33 pages go into the information for individual services and individual service providers——

Chairman MANZULLO. Then show us.

Mr. WEICHER [continuing]. In individual categories.

Chairman MANZULLO. Show us.

Mr. WEICHER. There is no one single——

Chairman MANZULLO. It is not in here.

Mr. WEICHER [continuing]. Number per—there are numbers for individual activities and individuals kinds of costs that may arise. And then at the end of this section we report the summary, this 3.3 billion in transfers——

Chairman MANZULLO. Just show me the section that deals with the——

Mr. WEICHER [continuing]. From firms to borrowers, ——

Chairman MANZULLO [continuing]. Appraisers.

Mr. WEICHER [continuing]. Originators contribute 4.5 billion of this and settlements, third-party settlement services providers——

Chairman MANZULLO. This is a summary.

Mr. WEICHER [continuing]. Provide 1.8——.

Chairman MANZULLO. I want to know the evidence.

Mr. WEICHER. The evidence appears earlier in the——.

Chairman MANZULLO. Where? Show me the evidence. You must defend your document.

Mr. WEICHER. We discuss the market and economic—Mr. Chairman, I have now got it out of order as you moved back and forth through it. The market and economic analysis and economic impacts start on page 30, and continues from there, let me see if I can—see if I can get page 31.

I now have it out of order, Mr. Chairman, and I will have to put it back in order to answer the question that you are asking. If you will bear with me, I will proceed to try to get the pages which I misplaced unless someone has an extra copy.

Beginning on page 30, market and economic impact, we describe the way in which this affects loan originators. We start with a discussion of origination fees, the role of the yield spread premium, and the role of points. We discuss the alternatives that we have considered. Beginning on page 34, we discuss the estimated magnitude of yield spread premiums which would affect——.

Chairman MANZULLO. You use hypotheticals here, but no substantive evidence.

Mr. WEICHER. We have—we have used the latest evidence that we have in each case to provide the information. On the bottom of page 34 we present analysis from David Olson, who testified in front of Senator Sarbanes in January of 2002, the estimate from his research that 60 percent of loans originated by brokers. We believe that half of these—HUD uses a somewhat different definition of broker than other people in the industry. It does not matter except that this is the basis upon which——.

Chairman MANZULLO. Could you point to where it shows the impact on community banks?

Mr. WEICHER. I am trying——.

Chairman MANZULLO. And also on lawyers.

Mr. WEICHER. I have started by taking the biggest of the magnitudes, which is the magnitude on yield spread premium, which we estimate at three and three-quarter billion dollars to consumers because the yield spread premiums will go to help consumers to bring down their up-front cash requirement. That is by far the biggest of the costs that is——.

Chairman MANZULLO. But there are other people besides mortgage brokers that are involved. There is a lot of empirical evidence, based upon the myriad of law suits on the yield spread premium——.

Mr. WEICHER. And then——.

Chairman MANZULLO. And then you can sit here and speculate as to whether or not the consumer will be the beneficiary of this—of this packaging.

But I mean, for example, on attorneys, attorneys at settlement, did you show me here where you talk about that?

Mr. WEICHER. We have looked at the major contributors to the——.

Chairman MANZULLO. You do not think that a lawyer is a major contributor of the settlement?

Mr. WEICHER. In cost.

Chairman MANZULLO. You do not——.

Mr. WEICHER. The origination fee and the yield spread premium——

Chairman MANZULLO. But that is the whole point. These are small business people.

Mr. WEICHER [continuing]. And title insurance as well provided generally speaking by the small businesses. These are the largest single components of cost. Of the 1.8 billion, which is the estimate of the change in the cost of third party settlement service providers——

Chairman MANZULLO. So what you have told me——.

Mr. WEICHER [continuing]. Over 1 billion of that represents title insurance.

Chairman MANZULLO. Mr. Weicher.

Mr. WEICHER. Yes, sir.

Chairman MANZULLO. Would you agree that an attorney, a sole practitioner in a partnership is a small business person?

Mr. WEICHER. I would think so unless he were an extremely—well, he would certainly be by size, and I would imagine he would be by dollar volume of billings.

Chairman MANZULLO. All right. And you mention lawyers in this report but once, and that is on page 43 where you say, "Law firms rank in size from one lawyer to several hundred." And you say, "Settlements are conducted by independent settlement companies or lawyers."

What economic analysis did you do to show the impact on the small business lawyers that are involved in real estate closings?

Mr. WEICHER. We provided the—the evidence that we had been looking at the data that we had from the Small Business Administration.

Chairman MANZULLO. Well, you do not have——.

Mr. WEICHER. And we had from the Census Bureau——.

Chairman MANZULLO. It is not there.

Mr. WEICHER. To look at the—to look at individual service providers.

Chairman MANZULLO. Mr. Weicher, it is not there. The only place you mention a law firm.

Mr. WEICHER. We are——.

Chairman MANZULLO. These are small—these are small people. They are small business people, and they deserve something more than two sentences in an 88-page report on a $5.5 billion smack to the industry.

Where in here do you state what impact this would have on small law firms?

Mr. WEICHER. We have identified in here the bigger impact on—the big impact——.

Chairman MANZULLO. No, no, this——

Mr. WEICHER. The large impact——.

Chairman MANZULLO [continuing]. Is the Small Business Committee.

Mr. WEICHER. That is right. The large, the largest impact by industry, an impact——.

Chairman MANZULLO. No, you do not have that authority and you do not have that largess under the Regulatory Flexibility Act. Your job is to discuss the impact on any small business. You cannot pick and choose which businesses you are going to do research on.

Mr. WEICHER. We have reported in here on the largest cost components borne by small business.

Chairman MANZULLO. That does not answer my question.

Mr. WEICHER. And we do not——.

Chairman MANZULLO. Why did you leave out the lawyers?

Mr. WEICHER. And we are only required to provide industry detail in the final regulatory flexibility analysis and——

Chairman MANZULLO. No, no, then it is too late.

Mr. WEICHER [continuing]. We will do that.

Chairman MANZULLO. Mr. Weicher, it is too late for scholarship to come up with a document at the time that the final rules are issued.

Do you not see what we are trying to do here? I mean, the purpose of this Committee is to resolve an impasse that has gone on with the small business people who continue to get smoked.

Now, I do not know to whom you have been talking, but I do know this. When I practiced law, when Mel Watt practiced law, when Ms. Majette practiced law, we were there at that closing. We

are little guys, small business people, bringing together at many times a very complicated real estate closing, and you do not every have that small business segment mentioned as having an economic impact in terms of quantifying the economic loss to them.

Mr. WEICHER. What was your average price per settlement or the average price of lawyers as you know it now?

Chairman MANZULLO. Back then it was anywhere from $100 to $300.

Mr. WEICHER. In settlement which run several thousand dollars at the time.

Chairman MANZULLO. No, no, see, you still do not get it. I do not care if it was 10 cents. What you do not understand, Mr. Weicher, is it is your obligation to come up with an analysis under the Regulatory Flexibility Act to determine the economic impact on small businesses. You do not have the authority to say this person is insignificant and that one is insignificant.

The pest control people, was there an analysis done on the impact on them?

Mr. WEICHER. We reported on all of the small business categories on which we have had information, and we will report in the final regulatory flexibility analysis on all other small business categories on which we can find information.

Chairman MANZULLO. We are going to go in the second panel. My question has not been answered, but I thank you for your time, and you have agreed to sit in the audience in case there is a question that has to be answered by the next panel. Thank you.

If we could get the next panel up quickly.

[Whereupon, a short recess was taken.]

Chairman MANZULLO. Mr. Kosin, you have to catch a plane. We are going to have you go first. We are going to run the five-minute clock, and I am sorry for the prolonged questioning of the first panel, but I am sure that you guys have wanted to ask those questions for a long time.

Mr. Kosin, I look forward to your testimony. Does anybody else have to catch a plane?

Okay, Mr. Kosin, please.

STATEMENT OF GREGORY M. KOSIN, SECRETARY, H.B. WILKINSON TITLE COMPANY, INC., GALENA, ILLINOIS, AND GREATER ILLINOIS TITLE COMPANY ON BEHALF OF THE AMERICAN LAND TITLE ASSOCIATION

Mr. KOSIN. Thank you very much, Mr. Chairman. My name is Gregory M. Kosin. I am the Chief Executive and Secretary of H.B. Wilkinson Title Company based in Galena, Illinois. I am also Chairman of the Government Affairs Committee of the American Land Title Association, and serve as an abstractor and title agent representative on ALTA's board of governors.

I appreciate the opportunity to appear today on behalf of the ALTA, which represents over 1,750 title insurance agents, most of which are small businesses.

First, I would like to thank Mr. Chairman for holding this hearing on the effects of the proposed HUD rule on small businesses.

Title agents and settlement service providers traditionally thrive as small businesses. This is due in part to the local nature of our

business, serving the needs of local customers in local real estate transactions.

In addition, we are also a highly service-oriented business which meets the needs of local customers at a competitive price.

A recent ALTA survey found that 51 percent of title insurance agents and abstractors in the country had less than $500,000 in gross revenue, and 72 percent had less than $1 million. Sixty-eight percent had 10 or fewer employees, and 42 percent had less than five employees. These are truly small businesses.

But these individuals and companies have demonstrated that they can effectively compete for the consumer's business. However, we expect that the real estate services marketplace would change drastically if the proposed RESPA rule were implemented as drafted.

Specifically, the guaranteed mortgage packaging proposal would limit consumer access to and choice of settlement service providers. It would result in the nationalization of the real estate services delivery system, eliminate many small businesses, and prevent the formation of small settlement service providers.

In fact, because these changes would have a pronounced effect on the industry, the ALTA board has agreed to explore litigation should HUD come out with a final rule similar to the proposed rule.

The ALTA believes that HUD lacks the necessary statutory authority to propose these sweeping changes. I will submit for inclusion in the record of this hearing an analysis of HUD's lack of statutory authorization.

The elimination of the Section 8 anti-kickback exemption will provide substantial incentives for packaging. Therefore, the market will move in that direction rather than towards the revised good faith estimate regime.

Second, because the agreement must include a loan at a guaranteed interest rate only lenders will be able to effectively package.

In the last five years the top 10 mortgage originators have doubled their market share from 25 percent to over 50 percent by favoring large national providers who will be able to negotiate and dictate prices for a settlement package. The HUD packaging proposal will lead to a concentration of service providers.

Third, under the package the lender will decide which attorney or title company will be part of the package. The consumer will have to accept that selection if he or she wants the loan. Small local attorneys and title companies, such as H.B. Wilkinson Title, will inevitably find that they cannot gain access to major national lenders to gain entry into the package.

I have already experienced being locked out of a large national lender that operates in northern Illinois by refusing to answer my phone calls or to meet face to face. The effect on these providers will be particular severe in rural areas of the country.

H.U.D. believes that mortgage lenders will forego the opportunity to pick up substantial packaging fees and will pass alleged savings on to consumers. On the contrary, we believe this may simply shift revenue from settlement service providers to major lenders. We believe that this regime is a means to a new revenue source for major

lenders, not a streamlining of the system as others lead you to believe.

Further, HUD estimates that packaging will have economic benefits because time will be saved. This time will be saved because consumers will not shop for settlement services, and lenders and settlement service providers will not have to answer questions about the services or prices.

We believe that the result is bad when savings are achieved at the expense of consumers' knowledge and understanding. By HUD's own admission, they estimate that small businesses will lose somewhere between 3.5 and 5.9 billion dollars in annual revenue if these proposals are implemented.

In this environment, the local attorneys, small abstractors, and title agencies will not be able to maintain service. HUD's economic analysis concludes that lower prices will drive out less efficient firms. However, many counties in this country, particularly in rural areas, have only one or maybe two providers. Packaging will eliminate some of those and consumers may not have access to any of these services.

The bottom line is that consumers will effectively have fewer choices in their selection of providers of legal and title-related services for their real estate transaction. Under HUD's approach, the consumer selects the lender and must accepted whatever service provides are in that lender's package.

This is a particular problem with regard to services such as those provided by attorneys and title companies which are provided not only for the benefit of the purchaser, but also for the benefit of the seller of real estate.

It is particularly ironic at this time that the administration is proposing that federal agencies reduce the adverse impact on small business resulting from the bundling or packaging of federal contracts. HUD's packaging proposal is completely out of step with OMB's unbundling approach to government contracts.

The loss of small businesses will eliminate local companies that support the community, provide jobs and pay taxes.

We thank you for holding this hearing and addressing this most important issue.

[Mr. Kosin's statement may be found in the appendix.]

Chairman MANZULLO. Mr. Kosin, what time does your plane leave?

Mr. KOSIN. At 6:53.

Chairman MANZULLO. Oh, 6:53, okay. Anytime that you want to leave, out the door.

Mr. KOSIN. Okay, I appreciate that, Mr. Chairman.

Chairman MANZULLO. Our next witness is Alan Hummel, Chief Executive Officer of the Iowa Residential Appraisal Companies from West Des Moines, Iowa. Mr. Hummel.

STATEMENT OF ALAN EUGENE HUMMEL, SRA, CHIEF EXECUTIVE OFFICER, IOWA RESIDENTIAL APPRAISAL COMPANY, WEST DES MOINES, IOWA; PRESIDENT, APPRAISAL INSTITUTE; AMERICAN SOCIETY OF APPRAISERS

Mr. HUMMEL. Thank you, Mr. Chairman, Representative Christensen. I truly thank you for the questions and comments

that you had earlier today. I think you have done a wonderful job of putting the stark reality and to the concerns of the small business person, such as my profession.

I am an active real estate appraiser and am pleased to appear before the Committee on behalf of the Appraisal Institute and the American Society of Appraisers.

The HUD's rule works against its own good intentions of providing reliable economical real estate services. This rule reflects a misunderstanding of the appraisal function, and it overlooks recent history.

The proposed RESPA rule could destroy a decade of progress by inadvertently allowing the old menace of lenders controlling appraisals out of the box. It threatens objectivity. HUD proposed packaging the services unwittingly provides cover for reviving undue lender influence.

Contrary to HUD's assumption that appraisals constitute high priced services, cost have remained constant for 10 years, even decreasing in some cases. Residential fees range from 200 to 325 dollars for typical assignments. This is certainly not exorbitant for an authoritative evaluation of the largest financial investment most Americans will ever make. Yet cost is HUD's justification for putting appraisals in the RESPA bundle.

A conflict concern is that HUD's guaranteed price bundling of services will deprive appraiser from the residential markets. It will drive them from the residential markets.

A shortage of qualified appraisers could become a disastrous bottleneck in the mortgage industry. For those appraisers remaining in mortgage work, HUD's 10 percent tolerance rule would be stifling. For some transactions, a simple valuation by a computer may be adequate, more complex is a full appraisal, exploring not only the general market characteristics but the property's specific features. A physical inspection is often essential to a valid appraisal. The one size fits all structure in the 10 percent tolerance does not reflect the diversity of appraisal demands.

Our next concern is EPSEL, that the package and arrangement proposal render appraisal firms, commonly small one-to-two-person businesses subject to client pressures from the biggest players in the mortgage finance industry. Because appraisers are objective parties, the uniform standard response to abusive pressure of big lenders who push for unsupported values to facilitate mortgage transactions.

The proposed rule would encourage large lenders to seek out appraisers likely to deliver the desired evaluation, those who would not take the moral high ground, compromise themselves would find themselves effected brow-lifted by the large packages as uncooperative or hard to work with.

If this scenario seems far-fetched, I assure you it has happened before. I believe government should not provide incentives for less consumer projection.

Ninety-seven percent of appraisal firms are small businesses. We rely upon our good reputations in our communities. The present premium of integrity is at risk when these and other small businesses are smothered together in large packages.

The new entity had envisioned the packages as especially troubling in its potential to contrive junk fees and short cuts hidden from consumers. The RESPA rule can be brought closer to its goal of industry integrity and consumer protection. We offer HUD the following suggestion.

Keep the contract appraisal feel under the good faith estimate and out of the guaranteed mortgage package so consumers know the type of evaluation and the fees charged. Make certain that lenders pay for all third party services without regard to loan status. Concealing what consumers are buying, the present HUD packaging concept is a classic pig in a poke.

After a decade of the uniform standards of enhancing our professional skills, emphasizing our EPSEL duties, and controlling or reducing our cost to consumers, American appraisers reject a return to the insider mortgage dealings. As small business people we are committed to our communities. We urge HUD to amend its rule and open the poke so consumers can see what the value they get for their money.

Thank you.

[Mr. Hummel's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is Peter Birnbaum, President of Attorney's Title Guaranty Funds out of Chicago, on behalf of the National Association of Bar-Related Title insurance. Mr. Birnbaum.

STATEMENT OF PETER J. BIRNBAUM, PRESIDENT, ATTORNEY'S TITLE GUARANTY FUND, INC., CHICAGO, ILLINOIS, ON BEHALF OF THE NATIONAL ASSOCIATION OF BAR-RELATED TITLE INSURERS

Mr. BIRNBAUM. Mr. Chairman, you are absolutely right, this Committee asked questions today that I have been dying to answer.

Chairman MANZULLO. Mr. Birnbaum, could you pull the microphone closer to you?

Mr. BIRNBAUM. Yes. Can you hear me now, Mr. Chairman?

Chairman MANZULLO. Thank you.

Mr. BIRNBAUM. You are absolutely right, you asked questions today, every member of this Committee, that I have been dying to ask for the last couple of years, and the comments that were made today I found myself saying "Me too."

I represent a constituency that you, Mr. Chairman, make note that HUD does short shrift with the regs, and that is the small law firms. I represent 20,000 law firms nationwide, and these are virtually all small firms. We are doing closing of mom and pop bungalows for the average citizen.

We are opposed to the packaging provisions in these regulations, and we believe that packaging at a minimum is going to raise consumer prices and it is going to also eliminate competition and those hardest hit will be the small business owners.

I agree that RESPA is far from perfect, but it is nevertheless, I think, the cornerstone of consumer protection in the U.S. housing industry. Despite its flaws, I think we can agree that it was the intent of Congress when you enacted it in 1974 to accomplish four things.

One is to give consumer protection to people for the largest financial transaction in their lives; two, to outlaw kickbacks you found specifically that when there are kickbacks the cost gets passed onto the consumers; three, to make the transaction transparent to the consumer, to disclose costs; and finally, to encourage shopping as a way of increasing competition.

The proposed rule and despite what I have heard today, some of which was encouraging, but the proposed rule as I read it totally, totally contradicts the goals of Congress when you established RESPA in 1974.

The way I read this rule I see at least three six things that are contradictory:

One, the rule now says that kickbacks are okay, they are good, but only if you are a bank. For everybody else it remains a federal crime.

Two, where they are being transparent, some of the cost can now be hidden from the consumer.

Three, that the consumer is not going to shop, will let the bank do it for them.

Four, that small businesses may benefit or they might not benefit or who the heck knows. And I think you did an excellent job of ferreting that out.

Five, and this is important, that the regulation by implication is going to preempt state law.

And the finally, despite the sanctioned kickbacks and less competition, and this is what really gets me, that somehow that at the end of the day the consumer is going to save money.

That proposed rule defies logic. I have been in this business for 22 years, and I can tell you that if the rule is implemented a couple of things are going to happen.

One, banks, particularly big banks, are going to come to monopolize this business. The small business provider is going to be gone. There was a great question earlier about the 250 to 275. Forget about it. It is going to be the person that can provide the biggest kickbacks. Prices, because of that, are going to skyrocket. You are going to have kickbacks, fewer competition, and in my State of Illinois, and you know this very well, Mr. Chairman, the seller pays for the title costs. The seller pays for the closing costs. Those costs are going to be shifted to the buyers. The price is going to go through the roof.

Finally, the federalization that is proposed in this rule is going to do great violence to the way that we do business in this country, and it is ironic when you enacted RESPA in 1972 it originally had a preemption provision. You came back a year later and said this needs to be revisited and in the words of the conference committee, a national framework for closing is "unworkable."

We urge Congress to take control of this Trojan horse, and I will give you a couple of reasons why.

One, HUD does not have statutory authority to do this. Look at the Section 8 exemption. It gives exemption from prosecution to a class of people. Signing up for that, you know, where do you get off, where does a regulator get off even an exception from criminal prosecution to a class of folks?

Two, there is absolutely no evidence to support that this is going to lower cost.

Three, I heard this at the Housing Committee meeting that I testified last week that is this going to make closings easier; if not, you are still going to have the 400 pages of paper. It does not address that at all.

And then finally, and most important to this Committee, small businesses will be devastated. Those same kind of lenders that you talked about, Mr. Chairman, they are going to control this process, and guys like us are going to be out of this business.

Mr. Chairman, and to the rest of the Committee, I thank you for this opportunity to participate in this process.

[Mr. Birnbaum's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is Gary Acosta, President, SDF Realty, San Diego; CEO and Chairman-elect of the National Association of Hispanic Real Estate Professionals. Mr. Acosta.

STATEMENT OF GARY E. ACOSTA, PRESIDENT, SDF REALTY, SAN DIEGO, CALIFORNIA; CEO AND CHAIRMAN-ELECT, NATIONAL ASSOCIATION OF HISPANIC REAL ESTATE PROFESSIONALS.

Mr. ACOSTA. Chairman Manzullo, Congressman Christensen, I am Gary Acosta, the President of SDF Reality in San Diego, California, and the CEO and Chairman-elect of the National Association of Hispanic Real Estate Professionals, or NAHREP.

The NAHREP is a nonprofit trade associations dedicated to increasing the Hispanic home ownership rate. NAHREP is the nation's fastest growing real estate trade organization and is a partner in President Bush's Blue Print for the American Dream, Minority Home Ownership Initiative.

We appreciate the opportunity to address the Committee today on the views and plans of action of the Department of Housing and Urban Development on the proposed amendment to the regulations implementing RESPA.

The NAHREP has over 10,000 members in 43 states. Our members come from all segments of the housing industry, including but not limited to real estate agents and mortgage professionals. NAHREP provides professional education, industry representation, publications, and technology solutions for those real estate professionals primarily dedicated to serving Hispanic consumers and home buyers.

Today, the home ownership rate in the United States stands at about 38 percent. However, for Hispanic Americans it is about 47 percent. This disparity is driven by a number of factors, including the lack of competitive mortgage financing in those markets.

In addition, NAHREP estimates that approximately 80 percent of Hispanic home buyers are first time home buyers, double the percentage of the overall market. Particularly for the first time home buyer—the purchase of a home is both a complicated and emotional experience, which create a more labor-intensive real estate process for the professionals.

According to a recent study produced by Pepperdine University and the La Jolla Institute, up to 65 percent of Hispanic home buy-

ers prefer to communicate in Spanish, a skill possessed by a small percentage of real estate professionals.

Additionally, many Hispanic consumers have thin credit files, little money for down payment, and multiple source of income. In order to serve this market effectively, mortgage and real estate professionals must have specialized skills and have a keen understanding of this market. Accordingly, NAHREP professionals increases awareness, reduces cost and simplifies the process of buying a home.

In this regard, NAHREP applauds Secretary Martinez, President Bush and President Bush for their demonstrated commitment to make home ownership attainable for more Hispanic, minorities and other underserved Americans, and particularly we strongly support Secretary Martinez's efforts to simplify and improve the process of obtaining home mortgages and to reduce the costs for future home buyers.

A recent NAHREP member survey indicated that 80 percent of our members who are real estate agents regularly use the services of a mortgage brokers to arrange financing for their clients. Latinos are more likely to use mortgage brokers and other small business professionals because they tend to live and work in the communities they serve, and have strong language skills and cultural understanding.

Today's mortgage industry is increasingly a formula-driven, high volume, low margin business, and larger players generally lack the flexibility and the diverse personnel necessary to adequately serve home buyers that don't always fit the box.

For this reason, NAHREP believes that the growth in Hispanic home ownership will depend on Hispanic-owned small businesses in those communities.

The NAHREP believes that consumers should have access to the best mortgage rate possible and be given maximum choice of mortgage product and services. We also believe that this outcome for the consumer could not be possible without real competition in the mortgage market.

However, the proposed rule in connection with the enhanced good faith estimate results in a different treatment of compensation in loans originated by lenders and those originated by mortgage brokers.

In effect, a mortgage loan originated by a mortgage broker who now would have additional disclosure requirements may look more expensive to the consumer than an identical loan originated through a direct lender.

Disclosure of compensation of a mortgage banker or an national bank is not required under this proposed rule. In some cases the consumer could select a more expensive loan product by assuming the loan with no origination fee is always the better deal.

Additionally, NAHREP believes that because interest rates change several times daily the proposed rule may cause consumers to focus too much on the compensation of the loan originator rather than the ultimate interest rate and terms. The different disclosure requirements between brokers and bankers could bias consumers against small business which may affect their long-term viability.

In addition to working to increase the Hispanic home ownership rate, NAHREP uses education and advocacy to preserve and create more business opportunities for Hispanic Americans. As more Latinos strive for home ownership, the housing industry will need more Latino real estate agents and mortgage professionals to serve them. Today Latinos have in general limited access to start-up capital. Aspiring entrepreneurs have few opportunities equal to mortgage and real estate that have the potential for success with a relatively modest barrier for entry.

Fourteen years ago my wife and I started our own business as a mortgage broker with only $5,000 from our personal savings. Today, our company has helped several hundred families achieve the goal of home ownership. Our company employs 14 people, including eight other Latinos.

Chairman MANZULLO. How are you doing on time? We are out.

Mr. ACOSTA. Okay, let me just wrap up by saying the housing sector has been one of the few bright spots in our economy, and Hispanic home buyers have fueled the strength of the housing industry. Over the next two decade nearly 80 percent of all new home buyers will be minorities and/or immigrants. NAHREP strongly advocates that consumers must have access to the best mortgage rate possible, and stands ready to support Secretary Martinez's efforts to improve the process and reduce the cost of mortgage finance.

I look forward to working with the Committee and HUD to ensure that the proposed rule encourages more minority-owned small businesses to enter the mortgage market and thereby help to increase home ownership opportunities, particularly for minority families.

Thank you, sir.

[Mr. Acosta's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

The next witness is Neill Fendly, Government Affairs Chair and Past President, National Association of Mortgage Brokers.

STATEMENT OF NEILL FENDLY, GOVERNMENT AFFAIRS CHAIR AND PAST PRESIDENT, NATIONAL ASSOCIATION OF MORTGAGE BROKERS

Mr. FENDLY. Chairman Manzullo, Ranking Member Velazquez, Members of the Committee, thank you for inviting me to testify on an issue that is of vital importance to the small business mortgage community, and specifically mortgage brokers.

Mortgage brokers are typically small businesses who operate in the communities in which they live, often in areas where traditional mortgage lenders may not have branch offices. Today, mortgage brokers originate more than 60 percent of all residential mortgages. They are also the key to minority home ownership as illustrated in the recent study which stated that mortgage brokers reach more minorities than lenders.

Our members are not just upset and frustrated about the impact that HUD's proposed rule to reform RESPA, RESPA will have on their business, or the ability to put people in homes, they are terrified, they fear the extinction of their careers, their industry and their livelihood. HUD's proposal creates an unlevel playing field in

the marketplace for mortgage brokers, will limit consumers' choice, and access to credit, and will be unworkable in the real world.

The HUD's proposed rule will significantly reduce small business revenues while substantially increasing the regulatory burden on small business.

My testimony today focuses on the proposed rule's disproportionate impact on small business, especially mortgage brokers, its impact on consumers, and HUD's failure to comply with the Regulatory Flexibility Act.

The NAMB has serious concerns about the proposed rule's recharacterization of a yield spread premium as a lender payment to the borrower for a higher interest rate, creates unintended consequence, and can further confuse the consumer. In fact, the Federal Trade Commission stated that HUD's approach to the disclosure of broker compensation could confuse consumers and lead them to misinterpret the overall profit of the transaction.

The rule creates an unlevel playing field by requiring that mortgage brokers include the yield spread premium in the calculation of net loan origination charge but not requiring the same of all originators which, as the FTC noted, may inadvertently burden consumers and competition. NAMB agrees.

The proposed rule also creates packaging which requires an originator, third party settlement services, a mortgage and closing costs for a set price. This will devastate small business since they do not have the bargaining power to enter into volume-based discounts with third party service providers as the larger entities.

The NAMB does not believe that HUD has sufficiently complied with the Regulatory Flexibility Act when promulgating the proposed rule for two reasons:

One, HUD's initial regulatory flexibility analysis did not contain a sufficient comparative analysis of alternatives to the proposed rule that would minimize the impact on small entities.

And two, the analysis does not accurately describe the projected reporting and recordkeeping requirements and other compliance requirements of the proposed rule, including an accurate estimate of the classes of small entities which would be subject to this requirement.

Although HUD's economic analysis states that over 55 percent, approximately 3.5 billion of the 6.3 billion dollars will be transferred to consumers will come from small businesses, HUD does not specifically explain how much of that comes from the mortgage broker industry.

In fact, the SBA, Office of Advocacy explained in their comment letter that HUD's analysis would be improved by a revised initial analysis under the Regulatory Flexibility Act which clearly defines the impact on small entities instead of merely citing the overall cost to small business.

The National Federation of Independent Business said the specifics of the impact on small business were missing from the initial regulatory flexibility analysis.

Since HUD did not actually specifically compute the cost of compliance per small business, HUD could not and did not sufficiently analyze regulatory alternatives as required by act that would minimize the burden on small business.

Their failure to accurately analyze the economic impact on small business can also be illustrated through their own reported inconsistencies.

For example, HUD's Paperwork Reduction Act submissions to OMB state, "The annual responses for good faith estimate is 11 million." However, HUD's analysis states that the rule would apply to the 20002, it would impact 19.7 million applications. This is significant because the submission to OMB underestimates the paperwork burden by at least 8.7 million GFEs. This in inconsistency that could cost small business millions.

Inconsistencies like this led to NAMB's commission of an independent economic study on the underlying assumptions of HUD's economic analysis, and the effect that the proposed rule would have on small business.

The study anticipates that small originator brokers and small third party service providers will lose more than 60 percent of the revenue arising from a loss of market share, and lower revenue services and reduce prices.

Further, the study states that this revenue that will be lost by small business will likely go to larger businesses, not to consumers.

As stated in HUD's own estimation, the program being changed mandated by the proposed by the proposed rule would increase the burden on industry by 2.5 million hours. That's 289 years. This is a huge burden.

We believe HUD must undergo a more expansive and realistic review of the economic impact that their proposal will have on small business.

We have recently resumed our dialogue with HUD and are hopeful that we can come to a resolution that will not adversely impact small business. We believe this is due in large part to the efforts of the Committee, Mr. Chairman, and we thank you.

We appreciate the opportunity to share our concerns with you today, and we hope the Small Business Committee will protect against the extinction of small businesses in the mortgage industry as a result of HUD's proposed rule. Thank you.

[Mr. Fendly's statement may be found in the appendix.]

Chairman MANZULLO. Thank you for your testimony.

Our next witness is Catherine—is it Whatley?

Ms. WHATLEY. Yes, sir.

Chairman MANZULLO. Who is President of National Association of Realtors, Jacksonville, Florida, representing a family firm established by her grandfather in 1907.

Ms. WHATLEY. Yes, sir.

Chairman MANZULLO. We look forward to your testimony.

STATEMENT OF CATHERINE WHATLEY, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS, JACKSONVILLE, FLORIDA

Ms. WHATLEY. Thank you, Mr. Chairman and members of the Committee. I am Cathy Whatley. I am the President of the National Association of Realtors.

I thank you for holding these hearings, and I appreciate the opportunity to be here with you to be able to share our views on HUD's RESPA reform proposal.

While our membership is large, 880,000 members, the typical real estate brokerage is small, operating just single office serving a local market. Sixty-seven percent of real estate brokerage have a sales force of five or fewer agents, including my own company. It is from this perspective that I present our views.

The Secretary's goal for reform is to simply the home buying process and to reduce cost to borrowers. These are worthy goals and ones which we support. But we do not believe this proposal achieves them.

The NAR recommends HUD take an incremental approach to reform by improving the good faith estimate so that can become a better shopping tool if redesigned and some enforcement mechanisms are provided.

We believe the guaranteed mortgage package will hurt small business for a number of reasons. It has the potential to create the following four environments.

First, packaging will be limited exclusively to lenders. The requirements of the packaging make it impossible for anyone other than a lender to package. The proposal requires the packages to also guarantee an interest rate. Only a lender can do this.

Further, by granting a Section 8 safe harbor, lenders are placed in preferred position to control essentially the entire settlement service industry. The largest lenders will determine the winners and losers in the new world of packaging.

Second, a lender is not required to disclose the services in the package, thus creating a black box. Today's services required to close the transaction are fully disclosed to the borrower. To move to a process where the borrower is assumed to only be interested in a lump sum price of the package and not the individual services is flawed. Despite claims to the contrary, consumers want to know what they are getting for their money. If they don't know what services are in a lender package, they won't be able to comparison shop.

Third, the consumer's choice of service providers will be limited. A positive real estate transaction experience is dependent on a health, competitive environment for settlement services. Today, a real estate agent has unlimited choices of services to recommend to their client. These choices in the marketplace help to ensure a smooth transaction for the home buyer, the goal of everyone of your realtor members.

To enact rules that could result in the removal of these choices could directly impact the quality of service a real estate professional can provide to their clients. This in turn will hurt the consumer who relies on the expert advice of their agent to guide them through this process.

And four, the cost of the transaction may actually increase. Section 8, the anti-kickback provision of RESPA prohibits lenders from charging the borrower more than the actual cost of the third party settlement service. Granting lenders an exemption from this provision will permit lenders to charge whatever they want for these services. As a result, the cost of the transaction could and probably will increase.

Before HUD removes the most significant consumer protection provision in RESPA, they should more fully understand the consequences to the industry as well as the consumer.

Mr. Chairman, this proposal is not without merit. The goals are admirable, but the proposal is extremely complex. The unintended consequences of this proposal could be devastating to all market participants involved in the home buying process.

We commended you, Mr. Chairman, for calling on HUD to conduct additional survey studies, and I agree, we feel it is imperative for HUD to conduct more due diligence, to undertake additional research and analysis. And because of the probable multiple proposed changes, we also recommend that HUD issue a new proposed rule that reflects the research analysis as well as the comments by all affected parties. The potential consequences to the industry and the consumers are too great not to take this approach.

I thank you on behalf of the National Association of Realtors for the opportunity to testify.

[Ms. Whatley's statement may be found in the appendix.]

Chairman MANZULLO. Thank you for your testimony.

Our next and last witness is Terry Clemans, Executive Director of the National Credit Reporting Association from Bloomingdale, Illinois.

Mr. Clemans, we look forward to your testimony.

STATEMENT OF TERRY W. CLEMANS, EXECUTIVE DIRECTOR, NATIONAL CREDIT REPORTING ASSOCIATION, BLOOMINGDALE, ILLINOIS

Mr. CLEMANS. Thank you. Good afternoon, Mr. Chairman, Ranking Member Velazquez, and distinguished members of the Committee.

I am Terry Clemans, Executive Director of the National Credit Reporting Association, and I would like to thank you for inviting me to today's hearing.

The NCRA is a nonprofit trade association that represents the consumer reporting industry and specifically mortgage credit reporting agencies. There are approximately 300 businesses in the United States who specialize in mortgage credit reporting. This is a reduction of approximately 1500 companies just 10 years ago.

The NCRA's more than 125 members provide in excess of 15 million credit reports for year to the mortgage industry and specialize in the preparation of the three bureau merged and residential mortgage credit reports as required by HUD, Fannie Mae and Freddie Mac for mortgage underwriting.

Our typical member is a classic small business with approximately eight employees and about $1 million in annual revenue. Our members are highly specialized agents in the credit reporting industry, with the responsibility to ensure the accuracy of credit reports used for the most critical purchase in the average consumer's financial life, the purchase of a home.

While we commend Secretary Martinez in HUD for addressing problematic issues regarding the current mortgage settlement solutions process, and we see how some aspects of the RESPA reform would be beneficial to consumers, we also have grave concerns regarding HUD's proposed RESPA reform in two specific areas.

First, HUD's lack of adherence to the Regulatory Flexibility Act and how this rule, if enacted, could eliminate approximately 90 percent of the small businesses in the mortgage credit reporting industry.

We urge this Committee to request HUD to further evaluate this possibility with a new economic analysis addressing our industry's specific issues and all small businesses.

Second, that the guaranteed mortgage package, or GMP, as it relates specifically to the credit reporting industry brings an enormous potential risk with this plan to more than one-third of the nation's consumers due to the unique impact only the credit report has on the loan.

The NCRA conditionally supports the pursuit of a GMP type concept as a means to bring greater efficiencies to the consumer in the acquisition of settlement services only with precautions.

However, when we support that, these precautions are specifically for settlement services needed to close a loan and not to prequalify or approve a loan. Therefore, with this support we require the additional investigation.

The credit report is required as a first step in the process of loan prequalification and then approval with far too great of an impact on the consumer not found in any other service in the mortgage process.

All of these services may not even be needed until after the credit report has been secured and evaluated. The enticement for the cheapest possible solution to the credit reporting services may at first glance seem attractive. However, it is as full of pitfalls as the original problem HUD is trying to fix.

The ability to pass along some of the lenders' unrelated operational cost provides the opportunity for more uses to the system in several ways. Further, giving the lender the ability to decide whether or not to include credit as part of the GMP does not provide consumers with the protection they deserve to make sure the proper type of credit services required for their personal circumstances are obtained.

Additionally, further reduction in the number of credit reporting companies could prove very harmful in the long term for the competitive balance of the entire credit reporting industry. The three major credit repositories, each being the central facility to the rest of the industry's ability to exist with their role as both a wholesale supplier and a retail competitor, have a monopolistic advantage over everyone.

The safe harbor provisions would empower them with the ability to use some questionable business practices to virtually eliminate all competition except that of companies that could provide credit reports as lost leaders for other services such as that owned by title companies or even mortgage lenders directly.

Two of the largest non-credit repository mortgage credit companies currently in existence in the industry are producing the volume of reports similar to that of our 125 members combined are already positioned for this change.

Considering the credit report, depending on the type needed, is already one of the lowest cost services in the mortgage process, and that is also the only service with a direct impact on the price of

the most expensive part of the mortgage process, the interest rate changed on the actual loan. Should it be encouraged to be completed on a shoe string budget?

It seems far too risky to allow the credit report to be included in the GMP with the potential risk for access to the full spectrum of services available without regard to the impact on the consumer.

This is especially true when considering 38 percent of the mortgage applications reviewed in the 2002 Consumer Federation of American MCR study were found to be at high risk with credit report problems due to the extreme circumstances in their credit files.

Statistics revealed in the Federal Reserve presentation in May of 2002, based their own study of credit report data seems to collaborate several of the CFA MCR findings.

Thus, the proposed statements associated with the credit report as part of the GMP could cost a significant portion of the population, many of whom are in the position to least afford it, more and higher interest charges in a matter of days or weeks than could ever be saved by the proposal. HUD's quest to save a few dollars from one of the least expensive items in the entire mortgage process could for some keep the American dream of home ownership only a dream.

Thank you.

[Mr. Clemans' statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much.

I've just got a couple of questions, but I want to address this statement to Mr. Weicher and Mr. Kennedy. The reason I get so passionate about small businesses is the area that I represent, Rockford, Illinois, in 1981 led the nation in unemployment at 24.9 percent. We could lose the entire town because of the collapse of the manufacturing sector in this country, and the desperation that you see expressed through this Chairman is what my constituents are feeling because of depression that this country presently is in.

And our goal and my goal as a member of Congress and as Chairman of the Small Business Committee is to try to keep open as many businesses as possible, and that is the reason I get upset, at times I get angry, but if I have to do that to save the businesses in this country I'll continue to do that, and that is the purpose of this Committee.

To each of the members here, do you feel that the regulatory flexibility analysis done by HUD thoroughly examined your profession; did a substantive economic impact as to what would happen to your profession in the event that the RESPA final rules are passed?

Let's start down here. Mr. Hummel?

Mr. HUMMEL. In the appraisal profession, it did not, sir.

Chairman MANZULLO. Mr. Kosin.

Mr. KOSIN. It didn't specifically address the title insurance industry, title agents or abstractors, and to look at the study that was being discussed and that you were questioning the people from HUD on, by their own admission, it having a multi-billion dollar impact on small business to me is credible that they would not do a better job of doing their homework.

Chairman MANZULLO. Mr. Birnbaum.

Mr. BIRNBAUM. One sentence, page 43, and the truth is if this rule were to be implemented the vast majority of my constituency would be out of business.

Chairman MANZULLO. Mr. Acosta.

Mr. ACOSTA. Yes. Our organization is made up of the entire spectrum of small business professionals, so I would say that there elements that were not adequately address.

Chairman MANZULLO. Mr. Fendly.

Mr. FENDLY. Absolutely not. They have some numbers in there but there is no documentation, no empirical data, and in fact several times in the proposed rule HUD acknowledges that they are completely unleveling the playing field for mortgage brokers.

Chairman MANZULLO. Ms. Clemans.

Mr. CLEMANS. Mr. Chairman, that is one of the most disturbing parts in regards to the credit reporting industry. We are only mentioned as a line item as part of the settlement services industry. Since we operate in a monopolistic environment, we find it very disturbing that we do not even get a sentence as some of the industries.

Chairman MANZULLO. Ms. Whatley.

Ms. WHATLEY. Mr. Chairman, certainly as real estate professionals we are the ones who are most intimately connected with the consumer. And there is a lot of ongoing dialogue that will have to take place relative to these particular proposed modification, and I do not think those were all adequately address.

Chairman MANZULLO. Now, did all of you address your concern as to the lack of evidence with regards to your profession? Did you discuss that with HUD? Mr. Hummel?

Mr. HUMMEL. Mr. Chairman, we have had one-way conversations with HUD. Since the actual proposed rules, we have additionally expressed our concern, but we have not had the opportunity to have—sit down and have a two-way conversation with HUD.

Chairman MANZULLO. Did you request those?

Mr. HUMMEL. It would have been in our writing, yes; that we made ourselves available to address our concerns personally with them.

Chairman MANZULLO. Mr. Kosin, the same question.

Mr. KOSIN. We have had a meeting with HUD but these concerns were not specifically addressed by them.

Chairman MANZULLO. Mr. Birnbaum?

Mr. BIRNBAUM. We had two meetings and this issue was not addressed.

Chairman MANZULLO. Did the issue of—did you ask why the attorneys were not involved in it?

Mr. BIRNBAUM. Right.

Chairman MANZULLO. What was your response?

Mr. BIRNBAUM. Well, the thing that I got—that we tried to point out is that we felt that the regulation, the proposed regulation has got a bias that, based upon practices in other states where lawyers are not involved, and we cited the fact that in 20 some states lawyers are actively involved in conducting closings for clients, and that that reality is not addressed in the regulations.

And to date we have not received——.

Chairman MANZULLO. To whom did you express that?

Mr. BIRNBAUM. To the HUD staff.

Chairman MANZULLO. So you got no response?

Mr. BIRNBAUM. No response to date.

Chairman MANZULLO. Mr. Acosta.

Mr. ACOSTA. Yes, I have to say that HUD has had an open door policy with our organization, and we have had access because of Secretary Martinez's office, and we have expressed our concern with respect to small business.

We did not address the specific issue with regards to the research, but they seem to be receptive to our input, and suggested that they would look further into our concerns.

Chairman MANZULLO. Did they ever offer to make an amendment so that the regulatory flexibility analysis would have been correct?

Mr. ACOSTA. Not specifically, but they gave me the distinct impression that it was still a work in progress.

Chairman MANZULLO. It is a work in progress all right.

Mr. Fendly.

Mr. FENDLY. We have had two meetings with HUD. We have not discussed that particular issues. Both meetings were last fall. However, it is well documented in our comment letter, and HUD very well knows who the mortgage brokers feel about this issue.

Chairman MANZULLO. Mr. Clemans.

Mr. CLEMANS. We also have had two meetings with HUD, although we got the feeling that a lot of this was pretty much decided as they were very late meetings prior to the proposed rule coming out. They were both this spring.

Chairman MANZULLO. Ms. Whatley.

Ms. WHATLEY. Mr. Chairman, I will say that HUD always has an open door, and we have a great opportunity for dialogue between HUD and the National Association of Realtors.

We have commented to them several times that we encouraged further research and analysis, understanding that once HUD proposed its rule they are somewhat distance to be able to communicate back to us what—you know, where they are thinking they are going. I think that hampers the dialogue, which is why we certainly would recommend a second proposed rule after they have gathered all this because it is very difficult to engage in a dialogue to know what they may be changing or what they may be doing in research and analysis without having a way——.

Chairman MANZULLO. You will not know until the final regulations are issued.

Ms. WHATLEY. That is correct, unless they issue a second proposed rule.

Chairman MANZULLO. That is all the industries are asking for, is that not correct? To get some half decent research here with some substantive evidence.

Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Acosta, I am interested in your comments regarding how—what hurts the Latino businessmen would also hurt the Latino consumers. Would you please expand on how this rule will hurt your business in particular, and what special services you provide as a Latino to Latino consumers?

Mr. ACOSTA. Well, the barriers to home ownership with respect to the Latino community I think are fairly clear from our standpoint.

One, there is just a general lack of information about the home buying process that is out there; two, Latino consumers tend to have a limited amount of resources for a down payment. Language barriers is significant. Latinos also tend to have thin credit files. We are not big consumers of credit, especially immigrants, so having no credit is a much better issue than say bad credit, and the income documentation. Those are really the five primary areas.

So if you are—when you are talking about how to best serve that segment of the market, you need a professional that is very acclimated, very fluent in both the language and the culture, and understands those unique dynamics. And we have found that some of the larger lenders just do not have the mobility, the flexibility, and the personnel to best serve our industry.

So it has been small business professionals that have done the heavy lifting, at least from our analysis, in our communities throughout the country.

Ms. VELAZQUEZ. So do you think that in issuing this rule they way they are proposing it will take into consideration what, exactly what you are explaining here?

Mr. ACOSTA. Well, we have a concerns that that has not been adequately addressed. We do believe that, especially with regards to the mortgage process, that small business professionals can be at a handicap. And I do have a challenge, understanding what the consumer benefit is when we are looking at two identical loan products, same rate, same terms, only one is coming from a broker, one is coming from a mortgage banker, and there is two entirely different disclosures, which I think would be very confusing to the consumer, and I also think may be bias the consumer against the broker which could challenge their viability, and the less brokers that are in business from our view the worse it is for the Latino community.

Ms. VELAZQUEZ. Mr. Birnbaum.

Mr. BIRNBAUM. Yes, if I could also response. In my home town of Chicago, and I think your home town of New York City, the Hispanic borrowers are often represented by Spanish-speaking lawyers.

My belief is that that brings real value to this process, and specifically it is true that Hispanic borrowers are among a group that is most vulnerable to predatory lending. So if lawyers are there to counsel them and protect them, there is a real benefit.

My fear is that under the proposed rule if the lawyer is eliminated, who is going to represent the borrower? Is it going to be the mega-bank? I would think not.

Ms. VELAZQUEZ. Thank you.

Mr. Fendly, as you are aware there is widespread concern that it is unfair and unrealistic to expect lenders and brokers to guarantee interest rates for 30 days when the consumer is not locked in with the lender. This causes the business to hedge many more loans than they will actually make.

Do you believe these concerns are valid.

Mr. FENDLY. Absolutely. It is a very—mortgage interest rates are very, very volatile. They can change several times a day. The ultimate cost is going to be on the high side, not the low side, so you are going to get increased cost. The hedging is going to go up. There is absolutely no index that exists out there. HUD is well aware of this; that you can track an interest rate.

Ms. VELAZQUEZ. So how do you think these concerns could be most easily mitigated within the rulemaking process?

Mr. FENDLY. Actually, to be perfectly frank, I think it needs to be eliminated, that whole section concerning the index. This is simply not workable. It is not realistic. If a customer wants to shop, they are going to have to shop within a relatively compressed period of time to compare apples to apples. If they are more conservative, lock the loan, lock the rate. That is the way it should be addressed.

Ms. VELAZQUEZ. Thank you.

Thank you, Mr. Chairman.

Mr. BARTLETT. Thank you very much.

In a former life, I was a home builder and a land developer, and so I have sat at the settlement table many, many times. I was so busy with the land development and the home building that I had too little time to look into what went on in preparation for settlement, and I just had a lawyer that I trusted, and I asked him is it okay for me to sign here, and he would tell me yes, and I would sign there.

I understand that what is happening now is that a rule has been promulgated, that the period for comments has ended, and HUD is now looking at those comments, and they are going to modify the rule a little or much, depending upon what they think they need to do.

I would note that the law requires them to look at the concerns of small business. The law does not require them to, and I do not know how the law could do that, to have a final rule which really addresses the concerns of small business. so let me ask you the question that I asked the Secretary's people.

At the end of the day they are going to come out with a rule, and it will be a fait accompli, and it may or may not address your needs. And I asked them with whom would they seek counsel to know if the changes they have made in the rule meets the concerns, addresses the concerns that the small business community has.

You know, it is very nice that the law requires them to look at your concerns, but I do not know how a law could be written that requires them to really address your concerns. They need to consider them. If they consider them and they are not going to change the bill, I think they will change the bill, but I am not sure they will change it so that it addresses the real concerns that you have.

Which honest broker, which mediator, how should rulemaking like this be addressed so that you can—I asked them, for instance, would the Office of Advocacy of the Small Business Administration be at the table when the final rule was written. They hedged, and I gathered the answer to my question was no, that they were not going to be there.

I would like some entity there that could just yell and scream you are not meeting the needs of small business if in fact the final rule does not meet the needs of small business. Who should that be and how could we do it?

Yes, well, let us just go down the line. Who being at the table would make you comfortable that your needs are going to be addressed?

Mr. KOSIN. ALTA feels very strongly that HUD does not have the statutory authority in which to make these sweeping changes. We feel that market-driven change is ideal, and we see some entity, some companies from large and small reacting to the changing market dynamics by going into some type of packaging of services and offering one-stop shopping.

So it would seem to me that I do not know if there any one entity out there that is going to give us the guiding light to the answer to your question, Mr. Vice Chairman.

I believe that market-driven change and changes that are taking place within the market today are sufficient for continuing the tremendous real estate transfer practice that we have in this country.

Mr. BIRNBAUM. I think that this is a statutory process, and I believe it's well within Congress's jurisdiction to address this issue.

When it comes to RESPA, it is not unprecedented for Congress to put together a working group with HUD to study and to try to reach consensus. So I would love to see the ball stay with Congress where I believe it should have initiated and I believe that at the end of the day would be a better process.

Mr. BARTLETT. So you would feel reasonably comfortable if we had a seat at the table, if Congress in its oversight could have had a seat and the table when the final rule was written?

Mr. BIRNBAUM. Absolutely.

Mr. BARTLETT. Thank you. Thank you for that confidence. Not every American shares the confidence.

[Laughter.]

Mr. BARTLETT. Thank you.

Yes, sir?

Mr. ACOSTA. I would concur with that, Mr. Chairman. I am very comfortable with Congress serving in that capacity and the idea of setting up a consortium of professionals that might——.

Mr. BARTLETT. Would you move closer to the microphone? They are having trouble hearing you.

Mr. ACOSTA. I am sorry about that.

Yes, I concur. I do feel comfortable with Congress serving in that capacity, and I also support the idea of potentially putting together a consortium maybe selected by Congress who might be able to work with HUD in this effort as well.

Mr. BARTLETT. When do they anticipate publishing their final rule? Do you know how long a window we have? End of spring, early summer. Okay. Okay. Summer does not begin until June 22, right? So if their summer begins at the same time ours does, why we have that long a time at least.

Yes, sir?

Mr. FENDLY. I would also agree with the two gentlemen to my right. In fact, it is obvious that several members of this Committee have a real strong grasp of the marketplace and how it operates,

and how it works out there in the real world, and clearly HUD does not. So I would be very comfortable with the congressional.

Mr. BARTLETT. Gee, it be nice if every committee had this kind of confidence from the public. Thank you.

Mr. FENDLY. I am going to continue that sentiment. We feel Congress was very wise in the initial RESPA ruling. Yes, it does have some problems that need to be addressed, but it is also old and it has been attempted to be addressed through these HUD proposals, and when we see proposals that come out that seem to be 180-degree turn from the initial incentive of RESPA, we really much question that.

And as was previously pointed out, this Committee has a great grasp of the issues that pertain to this problem, and we would feel very comfortable that Congress handle this.

Mr. BARTLETT. Thank you.

Ms. WHATLEY. Mr. Vice Chairman, I would say that certainly in an absence of research and analysis that potentially that Congress might ask for a GAO study to do further analysis on this prior to submittal of the final rule. Whether there is anything that needs to be concluded and done following that, I think first you have to start with the research. That is what you have been talking about most of the afternoon. And so I think you really do have to have that substantive underlying research and analysis in order to be able to determine what are the impacts.

Mr. BARTLETT. Thank you.

Let me ask you if you might do something to help us, if you were sitting up here when the Secretary and his people were answering our questions, what questions would you like to have had asked that were not asked? If you could please communicate that those questions to our staff, I am sure our Chairman will keep the record open for additional questions that the Secretary and his people will answer. So we would be very pleased to get your suggestions for questions that were not asked that you would like to have seen asked.

Do either of my colleagues have any questions or comments before we thank our panel and excuse them.

Mrs. CHRISTENSEN. No, I do not think so. I think you have asked most of the questions, and being the last person here to be following up with questions, I think I will give you break. You have been extremely patient, and we thank you for your patience and for your very thoughtful testimony and your suggestions that you have already made, and I think in answering some of the questions that have been asked, you have added further clarification to some of your recommendations.

I think the reality that RESPA need some reform to better meet the purpose for which it was enacted and that the current revision does not quite hit it, and in terms of improving the process for getting mortgages and reducing the cost to consumers, it does hurt small business, I think I heard one of the panelists say. If this provision takes place, perhaps as many as 90 percent of businesses involved in this process could be put out of business, and of course it us unlikely to help consumers and it is likely to hurt consumers.

I support the recommendations that I have heard for a supplemental IRFA. I do wonder though if anyone had a thought that

maybe expanding the authority of the Office of Advocacy to do more than just make a recommendation might be helpful as well. And if I could get an answer perhaps from one or two of the panelists to that question, I would not have anything further to ask if anyone wanted to answer.

The Office of Advocacy has recommended that we have a supplemental IRFA, but because of EPA or OSHA they have a little stronger authority, and many of you have recommended that Congress, you feel comfortable with Congress having more role in the final outcome on this, but would the Office of Advocacy as well, would that also be of assistance in making the rule such as this be more open to the advice of the businesses involved, and enforcement on the part of advocacy, the Office of Advocacy would make you more comfortable in this process?

Mr. BIRNBAUM. Actually speaking for my group, I am not familiar enough with the Office of Advocacy to express an opinion.

Mr. BARTLETT. Excuse me. I do not know how many of you are familiar with the Office of Advocacy. There is a joke that you can tell at public meetings that always gets a response, and that is, I am from the government and I am here to help you. Almost nobody thinks that somebody from the government is really there to help them.

But the Office of Advocacy, even under the prior administration, was headed by a person that when he said "us" he was talking about the small business community. And when he said "them" he was talking about government. This is an office that too few of us small businesses knows that it is available. They have a lot of lobbying leverage, and I think you are suggesting it is a good one, that they maybe could have a veto kind of a responsibility. If what was finally promulgated they did not think met the needs of small business, they could yell foul, and that would result in a second consideration of this. I think that is the kind of thing you are pointing at.

Mrs. CHRISTENSEN. Exactly, Mr. Chairman.

Mr. BARTLETT. Yes. Well, I think that is a good idea. That is something that needs to law, of course, and it is something that we might very well consider.

Are you okay?

Ms. VELAZQUEZ. Yes, I am fine.

Mr. BARTLETT. Okay, thank you.

I would note that many of you have come from considerable distances to be with us today. Thank you very much for honoring us with your presence. Thank you for your testimony, and know that we value your testimony. Thank you very much and this meeting will be in adjourned.

[Whereupon, at 6:00 p.m., the Committee was adjourned.]

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
108th Congress
Committee on Small Business
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Statement of
Representative Donald A. Manzullo
House Committee on Small Business

"RESPA Reform and the Economic Effects on Small Business"

March 11, 2003

Good afternoon. Today, we heard from the Secretary of the Department of Housing and Urban Development (HUD) on proposed regulatory changes to the Real Estate Settlement Procedures Act (RESPA). While the official title of this hearing is "RESPA Reform and the Economic Effects on Small Business," the underlying question is "RESPA Reform: Are Small Business Being Treated Fairly?"

Congress passed the Real Estate Settlement Procedures Act in 1974 with the intention of providing greater clarity to the home buying settlement process for consumers. Congress passed the Regulatory Flexibility Act in 1980 with the intention of providing greater clarity to federal regulatory process for small businesses. Ironically, we are here today to determine whether HUD, in its efforts to improve the clarity in the home buying process for consumers, has provided the adequate and necessary disclosures to small businesses for clarity in the federal regulatory process. I believe that HUD has not.

In the same way that HUD proposes to require the real estate industry to put forth a firm Good Faith Estimate to consumers on the costs of settlement, the Regulatory Flexibility Act requires federal agencies to put forth a "Good Faith Estimate" known as an Initial Regulatory Flexibility Analysis to let small businesses know the cost of regulations up front. In either case, there should be no surprise costs or added charges by the time a real estate settlement reaches the table or by the time an agency's final regulation reaches the table.

HUD's proposal to revise the RESPA regulations is an ambitious and complex effort. While I support simplifying and clarifying the process so that more first-time homebuyers can enter the market, I believe that HUD's rush to finalize its proposal may jeopardize our robust real estate market in the short-term. In addition, the proposal, if adopted, will make fundamental,

and perhaps, irreversible changes to the process that may undermine the long-term goals of providing affordable housing and consumer benefits within the residential real estate market.

HUD readily admits that the small business community may lose anywhere from $3.5 to $5.9 billion annually, and this is a conservative figure. However, HUD does not break down the costs in its economic analysis for each segment of the industry. There is no detailed economic analysis for the community banks – small realtors – small title agencies – small appraisers - small pest management companies, just to name a few among the many other small businesses not specified in the analysis.

All that the small business community really understands is that they will face billions of dollars of annual costs under this proposal to comply with the revised Good Faith Estimate and many billions more if small businesses must compete against large lenders offering Guaranteed Mortgage Package Agreements.

In fact, HUD was so deficient in its small business regulatory economic analysis that the federal government's small business watchdog, the Office of Advocacy of the Small Business Administration, requested that HUD issue a supplemental regulatory analysis in order "...to provide small businesses with sufficient information to determine what impact, if any, the particular proposal will have on [the small businesses'] operations."

In addition, the White House's Office of Management and Budget in its August 6, 2002 letter to HUD recognized that HUD needs additional work to improve its economic and regulatory analysis before the RESPA proposal can be finalized.

HUD added even more confusion to the RESPA proposal by asking 30 specific questions that would have be more appropriate as part of an Advanced Notice of Proposed Rulemaking. The questions were designed to elicit detailed concerns on how the Good Faith Estimate and the Guaranteed Mortgage Package Agreements should be implemented. However, it was unclear as to whether the answers to the questions would be made part of any final RESPA rule.

For example, question 22 on the Guaranteed Mortgage Package Agreement proposal requests whether state laws that are inconsistent with the proposed package arrangements should be preempted. Without knowing whether HUD intends to include state law preemption in the final rule, it is extremely difficult for small businesses to adequately comment on the regulatory burdens of the proposal. Ideally, HUD should issue a revised proposed rulemaking incorporating the answers to these pertinent questions and seek public comment. At a minimum, HUD should issue a supplemental Regulatory Flexibility Analysis to clarify the exact burdens to be faced by small business. I do not believe that HUD can cure the deficiencies in the final rule as it would deprive small businesses the ability to comment on any major revisions or changes in economic assumptions.

In addition, HUD needs to further explore the long-term economic ramifications of permitting Guaranteed Mortgage Package Agreements with a safe harbor from section 8 liability. On pages 73 through 75 of the Regulatory Flexibility Analysis, HUD insists that

small loan originators and small third party service providers can compete effectively against large lenders and service providers in packing settlement services. Unfortunately, HUD offers no economic analysis to support such claims.

In October of 2002, the Administration through the Office of Management and Budget undertook a government-wide initiative to end federal agencies from bundling federal contracts for large businesses. The Administration believes that contract bundling is not good for our economy as it reduces long-term competition in the marketplace.

HUD appears to be taking the opposite position with the Guaranteed Mortgage Package Agreements. HUD will permit lenders, which are most likely to be large lenders, to put together packages for bulk discounts while allowing minimal disclosure on the costs of the items of the package. Small businesses must attempt to compete with detailed itemized listings under the proposed Good Faith Estimate reforms. According to the American Banker, the top 10 mortgage originators account for more than 53 percent of the industry. With the Guaranteed Mortgage Package Agreements, it is anticipated that that figure will climb quickly.

Overall, I believe that the current RESPA proposal and small business regulatory economic analysis raise more questions than they answer. It is imperative that HUD addresses all of these issues and permit small businesses to comment prior to finalizing the proposal. Only with a more realistic regulatory economic analysis will small business be able to comment effectively.

Before we tinker with the successful formula that has created our very strong residential real estate market, we should carefully and deliberately consider the reform proposals before us. Rushing to finalize the proposal may cause unintended, and perhaps, irreversible harm to competition in residential real estate market and prevent us from achieving meaningful consumer benefits.

In order to provide small businesses with a "Good Faith Estimate"/Initial Regulatory Flexibility Analysis on the RESPA proposal, HUD needs to provide a realistic economic analysis for the small business community comment. Just as HUD does not want consumers to face surprises at the real estate settlement table, HUD should not provide surprises to the small business community in a final RESPA rule and its Final Regulatory Flexibility Analysis.

Before we begin the small business panel, I would like to enter into the record a letter that the National Federal of Independent Business sent to HUD on March 7, 2003, urging HUD to issue a supplemental Regulatory Flexibility Analysis as recommended by the Office of Advocacy of the Small Business Administration.

STATEMENT
of the
Honorable Nydia M. Velázquez
Impact on Small Businesses of Real Estate Settlement Rule Change
House Committee on Small Business
March 11, 2003

Thank you, Mr. Chairman.

Today individuals searching for the American dream find it when they purchase a home of their own. Even though buying a house is a big step forward for many Americans, the path to home ownership is often confusing, complicated, and time-consuming.

The U.S. Department of Housing and Urban Development created the Real Estate Settlement Procedures Act, or RESPA, to help consumers navigate the problems and pitfalls encountered in the settlement process. The residential real estate market was badly in need of regulation, clarity, simplification and consumer protection, and RESPA was designed to provide these things.

But RESPA's overall effectiveness has been regularly called into question by industry groups, Members of Congress, as well as Democrat and Republican administrations, even though homeownership rates are on the rise. One of RESPA's biggest problems has been its inability to create a system that allows consumers to comparison shop for identical products.

So HUD had good reason to overhaul RESPA, which it did last July. But many industry groups and others familiar with RESPA don't believe that HUD's proposal does what it was intended to do - make the settlement process more consumer-friendly while adding in safeguards and transparency for homebuyer protection.

Not only does this proposed rule not bring about the intended positive effect for consumers, but it also harms small businesses - the main driver of this nation's economy. Small enterprise makes up a large percentage of the $2.4 trillion residential real estate industry. Mortgage brokers, appraisers, land title and real estate agents are all predominantly small businesses.

And by providing incentives for volume discounting of settlement services, HUD is creating an environment that encourages big banks to contract with large service providers, driving small businesses onto the sidelines - and out of business. Once again, this scenario puts the interests of corporate America over those of Main Street.

Part of the problem is that federal agencies like HUD don't see the economic fallout their rules have on small businesses because they fail to comply with the Regulatory

Flexibility Act.

The Reg Flex Act was passed into law in 1980 to battle federal agencies' one-size-fits-all approach to rulemaking. Federal rules can put small businesses at a competitive disadvantage with large businesses - or drive them out of the market altogether.

HUD's economic analysis of its proposal was insufficient because it broadly grouped together all small businesses instead of undertaking a more detailed sector-by-sector analysis. HUD also appears to have underestimated how heavily the burdens of this rule would weigh on small business.

In addition, HUD failed to examine alternatives that would minimize the impact on small businesses, estimated at $3.5 billion for compliance alone. If HUD were unable to come up with alternatives because none exist, that would be one thing. But virtually every industry player came up with alternatives that made the process easier for consumers, while not overburdening small businesses.

Everyone in this room agrees that RESPA is in need of an overhaul. And from what I've heard, everyone agrees that this rule is not the answer. HUD set out to improve customer protections and make the process of shopping for a mortgage simpler, yet consumer advocates would argue that this rule fails to do this. Even worse, this rule harms small businesses while introducing uncertainty into an already volatile market.

Given the weak state of the American economy, now is not the time to make such a sweeping change that would put small businesses at a disadvantage when we need their strength the most. We should be doing everything we can to encourage their growth - not threaten their very existence. It's time for HUD to go back to the drawing board and propose a new rule that takes small business into account.

Thank you.

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STATEMENT OF MEL MARTINEZ
SECRETARY
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE
UNITED STATES HOUSE
COMMITTEE ON SMALL BUSINESS

MARCH 11, 2003

Chairman Manzullo, Ranking Member Velazquez, Distinguished Members of the Committee:

Thank you for the opportunity to join you this afternoon to discuss the impact on small businesses of a major initiative of the Bush Administration: our unprecedented effort to better protect consumers and increase homeownership by making the home financing process more transparent, simpler, and less costly.

The emphasis Americans place on homeownership sets us apart from many other nations of the world. In this country, homeownership provides financial security for families and stability for children. It creates community stakeholders who have a vested interest in what happens in their neighborhoods. It generates economic strength that fuels the entire nation.

The Bush Administration is committed to helping more families achieve the American Dream of homeownership.

To do this, we must eliminate the homeownership gap that exists between the minority and non-minority populations. Last year, the President set a goal of creating 5.5 million new minority homeowners by the end of this decade, and he challenged the real estate and mortgage finance industries to work with us to boost homeownership among minorities.

Our partners have responded enthusiastically, by making specific commitments that will move us toward the President's goal. The Administration is doing its part by proposing a number of new and expanded homeownership initiatives in HUD's Fiscal Year 2004 budget. Each will help us break through the barriers that prevent too many Americans from knowing the security that comes with owning their own home.

The mortgage finance process and the costs of closing remain major impediments to homeownership. Every day, Americans enter into mortgage loans – the largest financial obligation most families will undertake – without the clear and useful information they receive with most any other major purchase. This makes them vulnerable to predatory lending practices more often pushed on members of minority or elderly populations.

After agreeing to the price of a house, too many families sit down at the settlement table and discover unexpected fees that can add hundreds, if not thousands, of dollars to the cost of their loan. As a result, many homebuyers find the settlement process to be filled with mystery and frustration.

This Administration is committed to streamlining the mortgage finance process, so consumers can shop for mortgages and better understand what will happen at the closing table. For these reasons, HUD has proposed a major overhaul of the regulations governing the Real Estate Settlement Procedures Act (RESPA).

RESPA has been a priority of mine since I came to HUD. Shortly after taking office, I was faced with a major RESPA issue: the legality of yield spread premiums. Yield spread premiums are payments from lenders to mortgage brokers that are reflected in a higher interest rate. Since yield spread premium entails a higher

interest rate, it can be unclear whether the higher rate results in the borrower being given a higher cost loan or whether it being used to offset origination costs. In response, we issued a policy statement repeating our view that as long as the broker's compensation is for goods, facilities, or services, and the total compensation is reasonable, yield spread premiums to the mortgage broker are legal under RESPA.

At the same time, we recognized that there were serious disclosure problems involving yield spread premiums. We noted that less-scrupulous brokers often used yield spread premiums to generate additional profits, placing unsuspecting borrowers in higher-rate loans without their knowledge. And so in the process of issuing the policy statement, I committed HUD to establishing clearer disclosure rules for mortgage broker fees, and to simplifying and improving the mortgage origination process for everyone involved. There was general – virtually unanimous - agreement among all the industry groups, as well as consumer advocates, about the need for better disclosure: simpler, clearer, and on a timely basis so consumers could shop for the best loan.

Beginning last year, we undertook a major reform of RESPA's regulatory requirements. From day number one, we reached out to the affected industry groups to ensure their involvement.

As you know, the real estate settlement services industry is not a single industry but several that provide settlement services needed to help originate and close mortgage loans. Settlement service providers include mortgage lenders, mortgage brokers, real estate professionals, title insurers, title and settlement agents, pest inspectors, appraisers, credit bureaus, and others. These businesses range from the very large to the very small, and include many sole proprietors. The combined efforts of settlement service businesses, large and small, have helped to make the mortgage finance system in this country the envy of the world.

At the start of our reform process, we met with industry groups, consumer advocates, and other interested parties to solicit their concerns about the RESPA regulations and their suggestions for reform. Many of their recommendations helped shape the direction of our proposal.

As we were drafting our reform proposal, we continued to meet with industry groups, consumer advocates, and other interested parties to ensure that, to the best of our ability, their concerns were addressed in our draft proposal. We were methodical and deliberative in our planning, and we took the time to get it right.

Nine months after first publicly announcing our intention to reform RESPA's regulatory requirements – and well over a year after our internal work had begun – HUD published its reform proposal for public comment. Within the rule itself, we solicited additional input from the industry groups, consumer advocates, and other interested parties we had been communicating with throughout this process. The rule asked 30 specific questions to help us gauge the impact of our proposal on these various stakeholders. We felt it was critical to know whether the approaches we have proposed are the right ones – and if not, what alternatives may work better.

HUD received nearly 43,000 public comments in response, although many of them were form letters. The 18 weeks since the comment period closed on October 28th, 2002, have been spent carefully studying the written comments. Many have

come from mortgage brokers and title agents. Also, there were many detailed letters from trade associations for these industries. As you can imagine, reviewing and cataloguing the comments has been a lengthy process due to the sheer volume we received.

These comments, along with the meetings we have continued to hold since October with industry groups, consumer advocates, and other interested parties have been helpful in assisting the Department as we examine the impacts of the proposal on small businesses, and consider how best to minimize such impacts. All the while, we are keeping in mind that the goal of RESPA is to ensure that settlement costs for consumers are reduced.

Since the proposed rule was published last summer, alternatives have been brought to our attention. Our thinking is evolving on how portions of the proposal can be revised for the final rule, to ensure that all businesses, large and small, can take advantage of the opportunities presented by the rule.

We remain committed to addressing the concerns raised by small businesses, and we are continuing to work with the Small Business Administration's Office of Advocacy as we develop the final rule. I want to assure the Committee that our final rule, and the economic analysis to be issued with it, will address the concerns raised by the affected small businesses. The Department is committed to issuing a final rule fully mindful of impacts on small businesses.

Because they ensure greater transparency, our proposed reforms will make it more difficult for unscrupulous lenders to abuse borrowers. But let me be clear that RESPA reform alone will not end predatory lending. Efforts HUD has undertaken in the past two years to target abusive lending practices include at least 15 new rules focused on, among other priorities, weeding out unscrupulous appraisers, ending the practice of quick re-sales or "flipping," and helping us to identify problem loans and lenders early on. We intend to do even more to address predatory lending while preserving a source of credit for those with less-than-perfect credit histories.

HUD is committed to creating a homebuying and mortgage finance process grounded in transparency and simplicity. By reforming the rules governing the purchase and financing of a home, we will create new opportunities for first-time homebuyers, keep the American dream of homeownership alive for more families, and inspire greater public confidence in the mortgage lending industry.

I would again like to thank the Committee for the opportunity to meet with you today. I welcome your continued counsel as we work together on behalf of the American people.

STATEMENT OF
GREGORY M. KOSIN
PRESIDENT,
H.B. WILKINSON TITLE COMPANY,
GALENA, ILLINOIS,
CHAIR, GOVERNMENT AFFAIRS COMMITTEE

ON BEHALF OF
THE AMERICAN LAND TITLE ASSOCIATION

BEFORE THE
COMMITTEE ON SMALL BUSINESS
US HOUSE OF REPRESENTATIVES

RESPA REFORM
AND THE
ECONOMIC EFFECTS ON SMALL BUSINESS

MARCH 11, 2003

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Mr. Chairman, my name is Gregory M. Kosin, and I am the President of H.B. Wilkinson Title Company, Inc., in Galena, Illinois. I am also the Chairman of the Government Affairs Committee of the American Land Title Association,[1] and serve as an Abstracter and Title Agent Representative on ALTA's Board of Governors. I appreciate the opportunity to appear today at this very important hearing on behalf of the ALTA, which represents over 1,750 title insurance agents, most of which are small businesses. Accompanying me is Ann vom Eigen, ALTA's Legislative and Regulatory Counsel.

The title and settlement services industry has traditionally been an industry in which there have been few barriers to entry by small businesses and in which small businesses have thrived. This is due in part to the local nature of our business – serving the needs of customers in local real estate transactions – and to the fact that we are also a highly service-oriented business where meeting the needs of local customers has been an important factor, in addition to having competitive fees.

We believe that the HUD proposed revisions to the RESPA regulations, particularly the Guaranteed Mortgage Packaging proposal, would have a very serious adverse effect on small businesses in our industry, and on our ability to compete for consumer business. Equally important, we believe that the proposals, if implemented in their present form, would effectively close the door to future entry into this business by small businesses.

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[1] The American Land Title Association membership is composed of 2,300 title insurance companies, their agents, independent abstracters and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders against losses from defects in titles. Many of these companies also provide additional real estate information services, such as tax search, flood certification, tax filing, and credit reporting services. These firms and individuals employ nearly 100,000 individuals and operate in every county in the country.

It is clear that HUD is aware of these consequences, but believes that the adverse impact on small business is outweighed by (a) the likelihood that major lenders will be able to obtain deep discounts from settlement service companies who will want to be part of their packages, and (b) the prospect that mortgage lenders will pass through to their borrowers the benefits of such discounts. HUD estimates that small businesses will lose somewhere between $3.5 billion and $5.9 billion in annual revenues if their proposals are implemented. Whether these estimates are accurate – or too low – is not the critical issue. The critical issues that we hope this Committee will focus on are:

- why is HUD so willing to tilt the playing field in favor of large lenders; and
- why is HUD so cavalier about the adverse impact on small businesses, which have been a mainstay of this industry, an industry that has provided opportunities for employees of larger companies to strike out on their own and develop their own businesses.

Why do we believe that the HUD proposals will undermine the role of small business in the title and settlement services industry?

First, because of the incentives HUD has provided for packaging, it is clear that the market will move substantially in that direction, rather than towards the revised good faith estimate (GFE) regime.

Second, while HUD maintains that "anyone can provide packages" under its proposed Guaranteed Mortgage Package regime, because the GMP Agreement offered to consumers must include a loan at a guaranteed interest rate it is highly unlikely that anyone other than lenders will be in a position to effectively offer GMPAs. The mortgage lending industry has become increasingly concentrated. In the last 5 years the top 10 mortgage originators have

doubled their market share from 25% to 50%.[2] The HUD packaging proposal will also have the effect of increasing the concentration in the title and settlement services industry.

Third, by granting a broad exemption from RESPA § 8 for its GMPA proposal, HUD is encouraging lenders to seek, and settlement service providers to offer, discounts and other benefits in order for the providers to be included in the lenders' packages. In that kind of environment – where the lender rather than the consumer is going to make the choice of provider – the bigger title and settlement service companies are far better positioned to offer such discounts and inducements than the small business provider.

Fourth, if the packaging regime becomes widespread, as is likely to happen because it has the backing of the major mortgage lenders in the country, providers of title and settlement services will only be able to market their services to and through lenders. Lawyers and title companies that today are able to obtain business by direct contacts with the consumer will be faced with the situation where the lender, and only the lender, decides which attorney or which title company will be part of its package, and the consumer will have to accept that selection if it wants a loan from that lender. These adverse effects will be particularly severe in rural areas of the country where local attorneys and title companies will inevitably find that they cannot gain entry to the packages of the major lenders operating in that area.

The competitive advantage of small businesses – service to the consumer – will be undermined because the only successful marketing approaches will be those that enhance the profitability of the packages sold by the lenders. Likewise, there will be fewer competitive opportunities for new small businesses to enter this market since the only way they will be able break into the market will be to offer even greater discounts to lenders than those lenders can obtain from the major settlement service companies. This is unlikely to happen.

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[2] "Consortium Approach Gains in Home Loans," American Banker, July 12, 2002, at 1, 10.

A review of the economic analysis on which HUD has based its evaluation of the savings associated with the changes proposed in their rule raises many questions. HUD appears to have relied heavily, in their assumptions, on an extrapolation of data from FHA loans, which represent a small portion of the mortgage market, are typically lower priced homes, not typical examples of the residential housing market. Consequently, the sample on which the analysis is based is not typical.

In essence, the HUD packaging proposal is predicated on the expectation that there will be a substantial shift of revenue from settlement services providers to the major mortgage lenders, who will have the economic clout to obtain discounts as the price of entry into their packages, and that most or all of this revenue shift will be passed on to consumers. Apart from the fact that this is an artificial shift in revenues for which there is no significant justification, it is questionable how much of these discounts and rebates will trickle down to the consumer. The fact that so many major mortgage lenders are so strongly in favor of packaging suggests that they believe the profits from packaging are likely to be significant.

HUD also estimates substantial savings to both consumers and service providers through reduced time spent in shopping for services and responding to consumer concerns. While we believe the source and estimate of these savings is very uncertain, we also question whether elimination of time spent with consumers is a worthwhile goal. Consumers deserve to make informed decisions about the financial products and the services they choose.

In this environment, the backbone of our industry – the smaller abstractors and title agencies – will not have the resources to be able to offer the kind of discounts and payments that the larger companies can provide. Based on a survey conducted by ALTA in 2002, which was a boom year for the real estate industry, 51% of the title insurance agents and abstractors in the country had less than $500,000 in gross revenue in 2001, and 72% had less than $1

million. 68% had 10 or fewer employees, and 42% had less than 5. These individuals and companies have demonstrated that they can effectively compete with anyone for the consumer's business, but in a world in which major lenders are able to use the clout derived from the volume of transactions they handle to extract discounts from major providers, these small businesses will simply be unable to compete on that basis.

HUD's economic analyses concludes that lower prices for originators and third party settlement service providers will drive out the less efficient firms, with the more efficient firms surviving and doing the work. This fails to recognize the current reality of the local marketplace and its potential evolution. Many counties in this country currently have only one closing or title agent. Some of these firms may be inefficient. However, particularly in rural areas, implementation of packaging could eliminate some of those providers, and consumers may not have <u>any</u> access to those services. HUD has even posed questioned in its proposed rule, the validity of State law. Specifically, HUD has asked what State laws merit pre-emption. Many state laws relating to title insurance, such as rate regulation, are designed as consumer protection measures which ensure adequate access to these services at a reasonable price.

Mr. Chairman, if small businesses cannot compete effectively with their larger competitors for the consumer's business, then, in the long run, they are not going to survive. But HUD's proposals do not create a playing field in which the most efficient, or the best, competitors end up winning the race. Rather, HUD's proposals create a playing field in which those lenders with the most clout, or those service providers who are best able to offer significant inducements to lenders to get into their packages, will end up winning the race. Small lenders may be very efficient at making mortgage loans, but if they lack the clout to obtain the kind of discounts that their larger lender competitors can squeeze out of service providers, they will not be able to compete effectively. In other words, they will lose market share not

because they are inefficient lenders, but because they cannot command the kind of discounts from third-party providers that their larger competitors can command.

Similarly, smaller title companies or smaller providers of settlement services have demonstrated that they can compete effectively with their larger competitors in providing title and settlement services. But in the competitive world that HUD wants to create, these companies could well lose market share to their larger competitors who are in a better position to offer discounts or other things of value to lender-packagers. This would enable those lenders to realize greater profits on their packages than by including smaller providers in their packages. Again, smaller title companies and other settlement service providers will lose market share not because they are inefficient providers of settlement services, but because they cannot provide the kind of discounts that their larger competitors can offer.

The bottom line is that consumers will effectively have fewer choices in their selection of providers of legal and title-related services for their real estate transactions. Under HUD's approach, the consumer selects the lender and must accept whatever service providers are in that lender's package. This is a problem with regard to services, such as those provided by lawyers and title companies and agencies that are provided for the benefit of the purchaser and seller of the real estate.

Consumers should have choice in the selection of their service providers, and this will not be possible under the Guaranteed Mortgage Package Agreement. In addition, HUD has estimated that some of the economic benefits of packaging will be time savings because consumers will not shop for settlement services, and lenders and settlement service providers will not have to answer questions. Achieving savings through reduced knowledge and understanding by consumers of their personal financial investments is not a good result.

The ALTA Board has agreed to explore litigation should HUD come out with a final rule similar to the proposed rule. In fact, the HUD proposal is particularly objectionable is that the Agency lacks statutory authorization to take this step. Indeed, the proposal is in conflict with the disclosure regime that Congress did adopt in RESPA. If HUD was implementing the clear will of Congress, then we would have to accept the consequences of the policy decisions reflected in the laws of the United States. But that is not what is going on in these proposed regulations. Here, HUD believes that it has come up with a better regulatory regime than the one Congress adopted and is prepared to have small business squeezed out of the lending and settlement process because it believes that the discounts and rebates obtained by the large lenders will, as a result of competition among mortgage lenders, be passed on to consumers. This is a questionable assumption at best. But, what is of overriding importance, is that it does not implement – or, indeed, even reflect – any policy judgment that has been made by Congress.

HUD should not undermine the historic role of small business in one of the key sectors of the American economy without clear legislative authorization and direction. In this regard, ALTA's outside counsel has prepared an analysis of HUD's lack of statutory authorization, which I will submit for inclusion in the record of this hearing. It is particularly ironic that, at the same time HUD is pursuing a "packaging" approach that so clearly favors large companies over smaller business entities, the Bush Administration has proposed a strategy to all federal agencies calling on them to reduce the adverse impact on small business resulting from the "bundling" of federal contracts. As discussed in the October 2002 OMB report entitled "Contract Bundling: A Strategy for Increasing Federal Contracting Opportunities for Small Business," bundling of federal contracts has been an increasing practice in recent years so that fewer, larger groupings of contracts are put out for bid. While such bundling has made things easier for federal contracting officers and their agencies, it has had the effect of eliminating competitive opportunities for small businesses which want to compete for government contracts. To

counteract that trend, OMB has urged executive branch agencies to revise their regulations to eliminate unnecessary contract bundling and, in the words of the Administrator of OMB's Office of Federal Procurement Policy, to make "a significant step forward towards ensuring that small businesses and entrepreneurs have access to federal contracting opportunities." It seems to us that HUD's packaging proposal is completely out of step with the thrust of OMB's "unbundling" approach to government contracts.

We are deeply concerned that the HUD packaging proposal will unfairly and unreasonably eliminate competitive opportunities for small business. We thank you for holding this hearing to address this issue.

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Testimony of
Alan Eugene Hummel, SRA
President, Appraisal Institute
Chief Executive Officer, Iowa Residential Appraisal Company
Des Moines, Iowa

On Behalf of the
Appraisal Institute and
American Society of Appraisers

Before the House Committee on Small Business
On

"RESPA Reform and the Economic Effects on Small Business"

Presented by
Alan Eugene Hummel, SRA
President, Appraisal Institute
Chief Executive Officer, Iowa Residential Appraisal Company
Des Moines, Iowa

March 11, 2003

Testimony of Alan Eugene Hummel, SRA
On Behalf of the Appraisal Institute and American Society of Appraisers
Before the
Committee on Small Business
United States House of Representatives

Mr. Chair and members of the Committee, I am Alan Eugene Hummel, SRA, President of Iowa Residential Appraisal Company in Des Moines, Iowa and 2003 President of the Appraisal Institute. I am pleased to be here today on behalf of the Appraisal Institute and American Society of Appraisers, which together represent more than 25,000 real estate appraisers in the United States.

I want to thank you for holding this hearing. The Department of Housing and Urban Development (HUD) Proposed Rule on the Real Estate Settlement Procedures Act (RESPA) is of great importance to consumers and the financial community. This issue is also important to members of our organizations, who together constitute the leading professional organizations of appraisers in the United States.

Our organizations have concluded the proposed RESPA rule not only poses a threat to consumer protection, but also threatens the ability of real estate appraisers to continue offering real estate appraisal services, particularly in non-metropolitan markets. HUD's economic analysis of the proposed rule's impact on small businesses is deficient in a number of respects, and the very premise with which HUD is operating is flawed, which I will explain in detail below. It is our view the proposed RESPA rule is in need of considerable modification before it should be accepted as a Final Rule.

The Role of Real Estate Appraisers

First, I would like to explain the role real estate appraisers play in the real estate market. The expertise of a real estate appraiser is commonly used in situations involving the transfer of ownership, financing and credit, litigation, taxation and investment counseling and in other business decision making. For example, real estate appraisers can help prospective homebuyers set an offering price or help prospective sellers determine acceptable selling prices. Appraisals are also oftentimes essential in litigation, eminent domain, property divisions and environmental litigation proceedings, as well as tax matters in terms of developing and reporting an opinion of assessed or market value.

As it pertains to the HUD RESPA rule, real estate appraisals are used in a decision to underwrite a loan on real property. Under these circumstances, by law, the real estate appraiser, an independent third party, is to be engaged by the financer of a mortgage to estimate market value of the property for underwriting purposes. However, the cost of these services is passed on to the consumer applying for a mortgage. Under current federal requirements, the appraisal costs are stated as a line item on the HUD-1 statement provided to the consumer at closing. As required by the Truth in Lending Act, the consumer has the right to obtain a copy of the appraisal. It should be noted that although the appraisal is paid for by the consumer, the appraiser's client is the financer of the mortgage. However, I will speak to how we, and HUD, believe that the appraisal is of interest to consumers.

There are many different types of appraisal or valuation services that can be provided by an appraiser. Federal law requires compliance with minimum standards in certain circumstances and market forces dictate the rest of the appraisal services market. Officially, an "appraisal" is the act or process of developing an opinion of value. Appraisals conform to industry-wide standards known as the Uniform Standards of Professional Appraisal Practice (USPAP) and are performed by licensed or certified professionals. A "complete appraisal" is performed by an individual who has been trained in appraisal analysis and methodologies and holds, at minimum, credentials from a state appraisal licensing agency with requirements for education, experience and adherence to professional standards. The professional appraiser performs a detailed analysis of not only the macro-economic conditions that effect property values, but the individual characteristics of the property being appraised as well as comparable properties that have sold. Most times, an actual viewing of the property takes place by the professional to discern property characteristics, both good (updated features such as flooring and kitchens, amenities such as pools or finished space in the lower or upper levels of the home) and bad (leaking roofs, signs of structural instabilities, location next door to detrimental conditions). Many times these factors are not available through any other source than a visual viewing of the property, and the existence of the various items may have a substantial impact on the value of the property. These appraisals are often reported on a standardized industry-recognized form, which allows for the consistent review and audit of appraisals.

Services short of this are known as a "valuations" or "evaluations" and may be computer assisted and performed by the lender, broker, or by someone that may have an interest in the transaction. Various levels of property analysis may be utilized in estimating the market value of a property. Automated Valuation Models (AVM's) are a form of computerized statistical modeling. They offer the least in human verification of real-time property condition and characteristics, as they rely primarily on public records and proprietary databases for information. AVMs are typically most reliable in areas of homogenous properties, and those that are not suffering from deferred maintenance or customized features. There are a wide variety of models in use across the U.S., with a wide range in the "confidence level" of the final value indicator. At their basic level, AVM's are operated by technicians with no valuation expertise or particular knowledge of the property they are appraising, nor the sales that are being used within the analyses. Typically the reports are transmitted in proprietary formats that vary from vendor to vendor, have limited detailing of the analysis and typically are not signed by an individual who could be held accountable for the conclusion.

The Title XI Financial Institutions Reform, Recovery and Enforcement Act of 1989 requires federally regulated financial institutions, such as federally insured banks, thrifts and credit unions, to use state certified or licensed appraisers to perform appraisals in connection with federally related transactions. However, guidelines promulgated by the five federal financial institution regulators in 1994 limited this requirement to residential transactions greater than $250,000, meaning a transaction lower than $250,000 is not required to be appraised by a state certified or licensed appraiser.

Size of the Appraisal Profession

The real estate appraisal profession is dominated by small businesses. There are approximately 71,000 licensed and certified real estate appraisers throughout the United States[1], and we estimate there are between 30,000-40,000 appraisers performing residential appraisals. Our research indicates the average

[1] National Registry of Appraisers, Appraisal Subcommittee, Federal Financial Institutions Examinations Council, 2003.

size of an appraisal firm is 1.3 employees[2]. Many states offer appraisal trainee or appraisal registrations, which allow new appraisers to work their way toward a state license. We understand there are several thousand appraisal trainees or appraisal registrants throughout the country.

According to the most recent statistics compiled for the Small Business Administration (SBA) by the U.S. Census Bureau, there are approximately 11,110 firms that identify themselves as "offices of real estate appraisal," and 97.2 percent of these firms are defined as "small businesses" by the SBA[3]. There are also many licensed and certified appraisers that perform real estate sales or brokerage activities that also offer real estate appraisal services but do not call themselves offices of real estate appraisal.

In terms of the economic impact real estate appraisers bring to the economy, I will try to provide you with a general description -- There are approximately 11 million home sales per year, and we estimate that appraisals are performed in 90 percent of these transactions. The lending community also performs appraisal reviews for quality control purposes, and the industry standard for this amount is 20 percent of all loans in the portfolio. There are 4-6 million refinancing transactions requiring an appraisal for a total of 16-18 million transactions per year. The aggregate fees generated by appraisal assignments totals approximately $5.1 billion per year.

RESPA Rule on Real Estate Appraisers

The proposed rule on RESPA impacts real estate appraisers in two areas: 1) HUD wants lenders to provide consumers a simple, clear and firm Good Faith Estimate (GFE), at no or nominal cost, so they can better understand the charges, including appraisal costs, and use it to shop for a home loan and service providers before they become so invested in the process that they cannot back out; and 2) HUD wants to allow certain entities to assemble and offer consumers "guaranteed mortgage packages" (GMP) - a guaranteed mortgage interest rate and a guaranteed price for a complete package of settlement services, including appraisal services. Section II of the GMP would state that this package price covers all services that are necessary to close the loan. The packager would, however, be required to inform the borrower if certain designated items are not anticipated to be included as part of the package including lender's title insurance, the pest inspection, and appraisal. Under the GMP, any pest inspection report, credit report, and appraisal would be provided to the borrower upon the borrower's request.

According to HUD, the proposed rule would remove regulatory barriers to allow a package of settlement services to be made available to borrowers. These transactions, HUD argues, would be simpler and more transparent for borrowers, and would allow market forces, borrower shopping, and competition to further reduce the costs of settlement services. To accomplish this objective, first HUD would establish a carefully circumscribed safe harbor under RESPA for GMP transactions. Any entity (a lender, broker, other settlement service provider, or other entity), hereinafter a "packager," may qualify for the safe harbor as long as it offers a GMP. The packager must offer the GMP to a borrower following his or her submission of application information, but before the borrower's payment of any fee to the packager.

The proposed rule offered an example of how these arrangements might work with real estate appraisers in a GMP:

[2] Appraisal Institute estimate from January 2003.
[3] Small appraisal businesses are defined by the SBA as those firms having less than $1.5 million in annual receipts.

"For example, a packager could contract to have XYZ Appraisal Company complete all its appraisals for a given period for $300 each rather than the $350 the company normally charges for a standard appraisal. The packager could rely on that discounted contract price in pricing the package of guaranteed costs to the borrower. With their own costs negotiated in advance, packagers could disclose the cost for the entire package early in the borrower's mortgage shopping process with certainty, and the borrower then could compare different vendors' packages."

We have a series of concerns relating to the HUD RESPA proposal which I will explain below:

Concern 1: A primary assumption used by HUD to justify the proposed packaging arrangement is a false assumption. In the Summary of the Rule's Benefits and Impacts on Small Business, HUD states:

"Under packaging, those third party service providers (both large and small) who are currently charging high prices for their settlement services would experience reductions in the prices of their services....As in the case with the new GFE approach, firms suffering losers under packaging are originators and third party providers who are currently charging high prices for their services...."

"Still there is no strong reason to expect that locally-based small businesses could not continue providing third party settlement services under packaging, albeit at possibly lower prices and revenues, as noted above. Services that are local in nature (such as appraisals) will continue to be demanded under the packaging approach. Services that are national in nature and characterized by economies of scale (such as credit reporting) are already being conducted by larger firms on a national scale."

HUD's statement that appraisal service providers are charging "high prices" is contrary to research indicating the appraisal component of settlement service costs has not seen a pricing increase in over a decade. In fact, appraisal fees for many services have decreased in real dollars due to technology and efficiencies in the market and because the appraisal service market is highly competitive.

We asked our members whether their fees have gone up, gone down or stayed the same since 1993, and 80 percent of our members responded that their fees have stayed the same or gone down for an appraisal of a "typical residential property."

During this time, appraisers have increased their efficiency. According to our members, in 1993, 66 percent of appraisers performed a "typical residential appraisal" in two days or less. In 2003, 86 percent of appraisals were completed in two days or less.

Concern 2: Through the promotion of a guaranteed price for an assemblage of settlement services by HUD, we expect the market for real estate appraisal service providers to contract, resulting in less capacity to service the continuing demand, particularly in non-metropolitan areas. As a result, any potential temporary cost decreases from volume discounts will be negated by contraction of the real estate appraisal industry.

HUD estimates that consumers will save $3.6 billion annually under its proposal from settlement service industries, including real estate appraisals. However, in making this estimation, HUD not only has failed to acknowledge market forces are currently lowering appraisal costs, but has exacerbated the problem by creating a disincentive to perform mortgage appraisal assignments.

Even with all of the efficiencies adopted by appraisers in recent years, it is not feasible for appraisers to continue to provide consistent, quality appraisals for less, especially if they are unable to charge market prices for complex assignments. HUD has projected that appraisal fees will become less competitive[4]. Because of this, we expect fewer appraisers will choose to deliver mortgage appraisals and will divert their services to more lucrative clients such as commercial appraisal, eminent domain, estate appraisal and expert witness services.

We surveyed our members on this issue[5], asking them whether they would be inclined to divert their services to other clients and not accept mortgage assignments if the HUD rule were to be implemented. Fifty-nine percent of our members said they would be inclined to divert their services to other clients should the HUD rule go into effect.

Should this occur, finding a qualified appraiser, particularly in non-metropolitan markets, will be more difficult, which we understand is of great concern to many lenders, brokers and realty agents. According to our members, 12 percent of them perform 91-100 percent of their assignments for properties outside a metropolitan area. Meanwhile, 62 percent of our members perform in upwards of 30 percent of their assignments in non-metropolitan areas.

Concern 3: The 10 percent tolerance outlined in the Proposed Rule is too restrictive. Additionally, HUD has demonstrated itself to be misinformed on the issue of how real estate appraisers charge for services.

The proposed rule outlines a one-size-fits-all concept of a 10 percent tolerance, or upper limit, on charges provided by third-party service providers. While appraisal fees average around $325 per assignment, fees can range from $200-$500 for a typical residential property. Appraisal assignments complex in nature routinely have fees 30 percent or higher due to the necessary additional research and analysis required.

The need for appraisers to have the latitude to quote fees on a job-by-job basis versus one fee for all "residential mortgage appraisals" is because no two appraisal assignments are alike. Not only are there vast variations of property types, ownerships and physical and locational factors that make each assignment unique, but for any given assignment there is a large array in types of analyses that can be requested due to the risk involved or loan type (i.e. FHA, VA, conventional, home equity) and report types requested by the lender.

In addition, we have great concern over HUD's apparent lack of understanding of how appraisal fees operate. The Proposed Rule also makes the following statement in regards to the new GFE:

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[4] HUD states, "Still, there is no strong reason to expect that locally-based small businesses could not continue providing third party settlement services under packaging, albeit at possibly lower prices and revenues."

[5] Survey was sent to 500 SRA members of the Appraisal Institute selected on a random basis.

"The loan originator's own fee/compensation, which is entirely within the originator's control, can be stated with certainty, absent unforeseeable and extraordinary circumstances. Moreover, most third party costs such as appraisal charges, pest inspection fees, and tax/flood reviews, are fixed, and others, such as upfront mortgage insurance premiums, and title services and insurance, typically only vary depending on the value of the property or the loan amount."

HUD's statement is incorrect as it pertains to real estate appraisers for the reasons I just stated. In addition, USPAP forbids an appraiser from accepting compensation for performing an assignment when it is contingent upon the amount of the value opinion.

Concern 4: Limiting the upfront fee a borrower pays to the lender for the cost of preparing a GFE, and encouraging packaging arrangements will increase appraiser exposure to inappropriate client pressure. The presence of volume contracts also creates moral hazards between appraisal clients and appraisers. These moral hazards should be avoided to insure the highest quality of appraisals.

Real estate appraisers, who are predominately small businesses, too often face inappropriate pressure from more dominant players in the mortgage financing transaction to produce unsupportable values that facilitate mortgage transactions. To capitulate to such pressure, an appraiser would violate the Ethics Rule of the USPAP[6]. However, failing to deliver a predetermined value under these circumstances often results in an appraiser being labeled "difficult to work with" or ostracized by clients in the marketplace. Unfortunately, many lenders and brokers seek out appraisers willing to conform to such unscrupulous demands.

Under the proposed reforms, lenders will likely face a dilemma on when to order a credit report and appraisal. Without advance payment, lenders who order a credit report and appraisal for a given loan will be liable for these costs and face exposure to loss should the borrower not go through with the loan, which is likely to happen with greater frequency when more shopping takes place. In order to limit their exposure, lenders are likely to defer ordering the credit report and appraisal until the borrower commits to the loan, which is likely to slow down the loan process. This is contrary to the mortgage industry's desire to expedite the loan process.

Lenders that are exposed to unpaid fees are more likely to exert greater pressure on appraisers to "bring in the numbers" so those loans can be made with reduced "kick out" risk. Historically, the borrower pays the appraisal and credit report fee at the time of application. Under this arrangement, the appraiser was somewhat, although not entirely, insulated from collection and lender pressure issues since the money was held in escrow by the lender.

The existence of inappropriate client pressure has negative market consequences, as consumers face a greater threat of entering into a mortgage that is greater than the value of their new home. HUD and the lending community in general also face a threat as well, as these inaccurate appraisals do not accurately reflect the value of their mortgage portfolios and thus, increase the exposure to risk. Furthermore,

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[6] "An appraiser must perform assignments ethically and competently, in accordance with USPAP and any supplemental standards agreed to by the appraiser in accepting the assignment. An appraiser must not engage in criminal conduct. An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests." Uniform Standards of Professional Appraisal Practice, lines 258-261, p.7, 2003 Edition. Source: The Appraisal Foundation.

transactions that are consummated at sales prices above their true market value can then be used to further exacerbate the overvaluation of other homes - leading to over lending on homes that are being refinanced - not just those being transferred in ownership.

Another possibility is that, in an effort to limit their exposure to loans that do not close, lenders and third party settlement service providers who order credit reports and appraisals early in the application process may attempt to negotiate contingent fee arrangements with vendors. Such arrangements are not allowed by USPAP and are barred in many states[7].

We surveyed our members on this issue, asking them whether they felt the proposed RESPA rule, if approved, would increase instances of client pressure. A resounding 91 percent of our members told us that it would. Our members are clearly concerned that volume contracts encouraged under the HUD rule will generate moral hazards which will result in lower quality appraisals, greater client pressure, lower financial stability for the nation's mortgage financing system and create a higher risk for consumers who may inadvertently commit to mortgages that are higher than the equity of their collateral. HUD should avoid creating a system that encourages volume contracts whereby a single client provides so much business that an appraiser's economic viability would be decimated upon losing that client.

Concern 5: The HUD proposal inserts new players into the transaction and hides fees, which decreases the likelihood that savings will pass onto consumers and results in less consumer awareness. The GMP agreement provides an exception to the Section 8 anti-kickback requirement for the packager as an incentive to enter into packaging arrangement. In order to get into the package, the service provider – including the real estate appraiser - will have to discount their services. Under these circumstances, larger appraisal firms, including the handful of national firms, will be able to discount more than the small appraisal businesses. Meanwhile, the packager will retain a "packaging fee." In our view, this merely shifts income from the provider, who is actually providing the service, to the middleman.

Allowing entities from within the package the ability to give referral fees and kickbacks is tantamount to slamming the door on small business' (appraisers) ability to economically compete with large businesses. Currently lenders purchase from servicers because of their ability to provide needed services at a competitive price. In order to economically provide referral fees and/or kickbacks the servicer would have to increase the price of the service – which is ultimately passed on to the consumer.

In our view, prices charged by packagers to administer and process GMPs will deflect any potential price savings that may occur in the appraisal service providers market, while inflicting severe market pressure on small appraisal firms.

HUD also states, *"A better shopper (the packager) is substituted for the borrower as the searcher for third party settlement services".* In reality, the lender currently does the shopping and engaging of the appraiser, not the borrower. In fact, for federally-related transactions the lender is required to engage the

[7] "It is unethical for an appraiser to accept compensation for performing an assignment when it is contingent upon: 1) the reporting of a predetermined result (e.g., opinion of value); 2) a direction in assignment results that favors the cause of the client; 3) the amount of a value opinion; 4) the attainment of a stipulated result; or 5) the occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment's purpose." Uniform Standards of Professional Appraisal Practice, lines 287-294, p.8, 2003 Edition. Source: The Appraisal Foundation.

appraiser. Under the current arrangement lenders actively "shop" for appraisal services, monitoring the fees charged because even though they often pass the cost on, they realize the borrower is looking at that cost and comparing it to what other lenders are quoting for the collateral valuation piece.

One additional point in this regard is that full disclosure of appraisal fees will also no longer exist under the HUD RESPA proposal, making it easier to hide appraisal fee markups. In light of recent mortgage fraud and predatory lending cases throughout the country, we believe it is important to honor safeguards which protect homebuyers from unscrupulous actors in the residential real estate market.

A fundamental goal of HUD's proposal is to protect consumers. It is our view that the packaging of services is inconsistent with the goal of seeking greater disclosures of costs to consumers. Today, an appraisal is a vital part of home buying or refinancing. The appraiser is an independent third party delivering an unbiased opinion of value. Although the appraisal services necessary to close a loan may be primarily for the benefit of the lender, we believe consumers benefit from an appraisal ordered by the lender as well. HUD even recognizes this dual function in its proposed rule, stating:

> "HUD believes however, that there are certain settlement services that are of specific interest and value to the borrower such as pest inspection, appraisal and the purchase of lender's title insurance (which may affect the cost of owner's title insurance)."

Under the GMP, the consumer will not know what kind of appraisal or valuation was performed, what was charged for those services, including whether any of these services were "marked up", and ultimately how much they are paying for these services at closing. Packaging may help simplify the process from the lender's perspective; however, the type of valuation performed and borrower's fees will be obscured. We believe the borrower deserves more protection.

As I stated before, there are many different types of appraisal or valuation services that can be provided during a mortgage application. Various levels of property analysis, ranging from AVMs to a complete interior appraisal, may be utilized in estimating the market value of a property.

We believe the type of appraisal or valuation performed and the costs associated with these services should be transparent to the consumer since the consumer is paying for the service. As HUD has recognized, the appraisal has a specific interest to the borrower, and we feel those services, and that interest, should be fully disclosed.

There is also good reason for identifying the appraiser in the documentation for the consumer, as it helps create a system of ensuring the credibility for the work product and the accountability for the appraisal fees. Withholding or obscuring this information has the potential only to harm the borrower.

RESPA Suggestions
To address these concerns, we offer the following suggestions:

Suggestion 1: Since packaging hides the type of valuation performed and obscures fees paid for valuation services from the consumer, **we encourage HUD to keep the contract appraisal fee under the GFE and out of the GMP**. Instead, we recommend that only the lender's charge for reviewing or

administering the appraisal function be included in the GMP, not the amount paid to a contracted appraiser.

Under our recommendation, the fee that is paid to the contracted real estate appraiser would not be included with application, origination and underwriting services and any other lender required services or other fixed fees. This suggestion would allow the contract appraiser to be considered an entity outside of the GMP package. It is our view that a GFE disclosure is adequate for consumers, in particular if the costs are itemized. Under these circumstances, the consumer could be given a copy of the contract appraiser's invoice at closing to document the actual cost of service. Lender fees for appraisal administration would then be transparent, and could subsequently be compared to the quotes in the GMP package. At the same time, it is likely that the "price point" of the appraisal services will continue to decline if it is not in the GMP because of market forces and technology. HUD should allow these natural market forces to work.

We do not recommend doing away with the GMP proposal altogether. We simply call for the rule to be modified to allow for full disclosure of the appraisal fees, which HUD has admitted is of interest and value to the consumer.

Suggestion 2: HUD should create an exemption for loans secured by historic and high-value or otherwise atypical properties with the requirement for accurate GFEs. A "one-size-fits-all" approach to packaging is likely to lead to greater standardization of fees for appraisal services. Such standardized fees will not allow for the premiums that are warranted for complex appraisal assignments.

Since the appraisal fee must be communicated to the borrower by the financial institution very early in the relationship, time will not allow for fees to be reflective of such premiums that are typically charged for complex residential appraisal assignments - e.g., historic properties, high-value residences, etc. So as to not stifle the public's ability to use these types of properties for collateral, the proposed RESPA final rule should contain a "carve out" provision that allows more flexibility with fees that need to be charged for these types of unique appraisal services. Failure to do so would result in higher fees being quoted up front to allow for the completion of appraisal on atypical properties, or worse, if fees were not commensurate with the difficulty in completing the analysis, it is more likely that a "sub-par" analysis would be completed, to the detriment of both the lender and the consumer.

Suggestion 3: HUD should include language in the final rule that prohibits inappropriate client pressure, make such policies accessible to appraisers, and require lenders to pay for all third-party services regardless of loan status. The proposed packaging of services will concentrate significant purchasing power among the largest national financial institutions and management companies. Coupled with the proposed requirement that definitive, upfront fee schedules be provided to prospective borrowers, these national purchasers of appraisal services will be able to exert unbridled pressure on independent fee appraisers. Therefore, it is critical that safeguards be included in the proposed RESPA final rule that squarely address the most critical and vulnerable areas for the appraisal community - client pressure and contingent fees. Both of these practices should be prohibited in the final rule through the inclusion of clear and unambiguous language.

HUD Mortgagee Letter 94-54 contains a section on "Pressure on Appraiser and Conflicts of Interest." This section states:

> "The Department requires that appraisers chosen under this new procedure not be supervised or directed by any loan officers or loan production personnel. Chosen appraisers should be supervised by the lender's underwriting or management personnel. Instances of undue pressure or influence on an appraiser reported to HUD will result in appropriate disciplinary actions against the lender involved."

Although we are pleased HUD has accepted that undue pressure of appraisers exists, we feel it could do much more by providing more information to appraisers on the existence of HUD's requirements. Most appraisers are simply unaware that HUD will accept complaints against lenders applying undue pressure. Typically, they do not know whom to contact within HUD, and HUD has established no procedure on how the appraiser is to submit his/her complaint.

We encourage HUD to establish a system that informs appraisers of HUD's requirements relating to inappropriate client pressure on appraisers and establishes common procedures for conducting investigations of complaints issued by appraisers. Such procedures would tell the appraiser what information must be provided in the complaint and whether HUD will hold the appraiser's identity in confidence during the investigation. HUD could even establish a "hotline," or clearly specify a staff member who could handle such investigations and make this known to licensed and certified appraisers. HUD, when receiving these complaints, should provide sufficient resources to conduct thorough investigations and conduct effective enforcement activities.

HUD should also prohibit any and all contingent fee arrangements in connection with appraisals. We recommend language be included in the final rule mirroring comments in the Management section of the Ethics Rule of USPAP wherein it is recognized that it is unethical for an appraiser to accept compensation for performing an assignment when the assignment is contingent upon (1) the reporting of a predetermined result; (2) a direction in assignment results that favors the cause of the client; (3) the amount of the value opinion; (4) the attainment of a stipulated result; or (5) the occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment's purpose. Including the above language in the proposed RESPA final rule would parallel what is now part of most state law.

On behalf of the Appraisal Institute and American Society of Appraisers, thank you for the opportunity to explain this issue to the Committee. I would be happy to answer any questions Committee members may have.

About the Appraisal Institute and American Society of Appraisers
The Appraisal Institute is the acknowledged worldwide leader in residential and commercial real estate appraisal education, research, publishing and professional membership designation programs. Its extensive curriculum of courses and specialty seminars provides a well-rounded education in valuation methodology for both the novice and seasoned practitioner. Members of the Appraisal Institute form a network of highly qualified professionals throughout the United States and abroad. They are identified by their experience in and knowledge of real estate valuation and by their adherence to a strictly enforced *Code of Professional Ethics and Standards of Professional Appraisal Practice*.

The American Society of Appraisers is an organization of appraisal professionals and others interested in the appraisal profession. International in structure, it is self-supporting and independent. The American Society of Appraisers is the oldest and only major appraisal organization representing all of the disciplines of appraisal specialists, including real property. ASA is diligent in its efforts to strengthen and uphold the *Principles of Appraisal Practice and Code of Ethics* in order to protect the client.

We appreciate this opportunity to provide our official comments for the record. Should you have any questions, please contact Don Kelly, Vice President of Public Affairs, Appraisal Institute at 202-298-5583, dkelly@appraisalinstitute.org or Ted Baker, Executive Vice President, American Society of Appraisers at 703-733-2109, tbaker@appraisers.org.

Testimony of
Peter J. Birnbaum
President, Attorneys' Title Guaranty Fund, Inc.
on
HUD's Proposal to Reform RESPA

Before the
Committee on Small Business
United States House of Representatives
Washington, D.C.

March 11, 2003

Good afternoon Mr. Chairman and Members of the Committee. My name is Peter Birnbaum. I am President of Attorneys' Title Guaranty Fund, Inc., a Chicago based title insurance underwriter. I am here today on behalf of the National Association of Bar-Related Title Insurers, the National Trade Association of Lawyer owned title insurance companies. We have 15,000 law firm constituents. Collectively, we conduct several hundred thousand real estate closings per year.

We are deeply concerned about the proposed revisions to the RESPA regulations being promoted by HUD.

When Congress enacted RESPA in 1974, it sought to lower housing acquisition costs by eliminating kickbacks in the real estate industry and to give consumers the opportunity to shop for the best products and services. The avowed goal of Congress was to make the transaction transparent to the consumer by requiring full disclosure of all costs associated with the purchase or sale of a home. Now, by regulation, the department would overturn this important corner stone of consumer protection in the U.S. housing market.

I would like to briefly articulate five concerns about the proposed rule:

First, the proposed rule has the practical effect, whether intended or not, of eliminating competition and giving banks a monopoly on the delivery of settlement services required to close residential mortgage loans. The proposed regulations would effectively allow only lenders to sell settlement services including title insurance and closing to the consumer as a part of a "package"

or "bundle." Under the proposed regulations, the lender can mandate the service provider or receive kickbacks from the service provider. Under the proposed regulations these activities will be done behind closed doors with virtually no disclosure, let alone input from the borrower.

Second, under the guaranteed packaging proposed by HUD, borrowers would pay a lump sum for all closing related fees. There would be no required itemization of charges, services or providers included in the package. Presumably, this is based on the notion that consumers do not care what services they are purchasing, how much they are paying for those services or from whom those services are being purchased. This is not only contrary to our everyday experiences as consumers but it is 180° opposite from the statutory scheme that Congress adopted for RESPA in 1974. We believe consumer understanding of the real estate process should be improved. From our perspective, disclosures to consumers should be strengthened and enhanced, not eliminated which is what this rule does.

Third, packaging occurs today under the present regulatory regime without the proposed safe harbor from the anti kickback provisions provided in the HUD proposal. While it is not now the primary method of providing services, it does exist. There appears to be no compelling reason to force HUD's version of packaging on the marketplace.

Fourth, Carl Sandberg called my ethnically diverse hometown of Chicago "a patchwork quilt." The settlement services industry is very much the same. It is a highly competitive business. The method of delivery of title services varies considerably not just from state to state, but literally from town to town. Depending on locale, closings and title work can be performed by big title underwriters, small title agents, lawyers, realtors or banks. The party paying for the closing and

title also varies from place to place. In some states, the seller pays for the bulk of the expense. In others the buyer pays. In others, the charges are split between the buyer and seller.

The proposed regulations will raise the buyers' costs to purchase a home. Not only will the buyer have to pay for the cost of the kickbacks that will be paid under this scheme, in seller pay states, closing and title costs will be shifted to the buyer, resulting in a doubling or tripling of the buyers' expense.

Finally, although the proposed rule does not explicitly say so, the only way that HUD's packaging scheme could be implemented would be to preempt the myriad state laws, regulations and rulings that have been developed to protect consumers. Throughout U.S. history, the regulation of real estate and insurance has been primarily the province of our state governments. Most states have a body of law that governs the transfer and/or insuring of real property interests. As we understand the HUD proposal, state statutes would be preempted in favor of a federal regime.

While we believe that HUD should be commended for recognizing that the current RESPA statute is not as effective as we all hoped, its proposed solution would not achieve the objectives established by congress and in fact, in our view, is at odds with those objectives. We would like to propose three steps to assure the objectives of congress are implemented.

First, we should recognize that the process of transferring and financing of residential real estate is complicated. There is no single path by which these ends are achieved. We should further

recognize that it is not realistic to assume that HUD will be able to establish and maintain a staff with the breadth of knowledge necessary to stay abreast of the constantly evolving marketplace.

We suggest that HUD take advantage of the expertise found in all of the settlement services industries and the consumer movement by forming an advisory body that could act as a resource to the department. This advisory body could act as a sounding board for HUD staff and a source of suggestions as to how the statute could be managed more effectively.

Second, we suggest that congress direct HUD to collect and analyze information on settlement costs and practices before suggesting any further significant regulatory changes. Congress has recognized the need for data before making decisions on housing policy. In 1970, it directed HUD and the VA to study settlement costs across the country. The 1972 report of this study was a primary basis for the RESPA statute. Recognizing the need for data, congress directed HUD in section 14 of RESPA to report back to congress on the effectiveness of the statute. In 1979, HUD and its contractors collected and analyzed thousands of HUD-1 forms and conducted hundreds of interviews with consumers and industry representatives. Based on these research findings, congress elected not to accept HUD's 1983 recommendation to adopt a package regime and, instead, amended the statute in other ways. Good, solid, empirical information should be the basis for policy making, not anecdote, hunch or pre-conceived notions.

Finally, and most importantly, significant changes to RESPA should be accomplished through the legislative process, not by regulation. Housing is a critical sector of our national economy and the foundation of wealth for most families. Changes that would significantly affect how residential properties are transferred and financed warrant careful scrutiny and deliberation.

Congress, and not an administrative agency, should decide whether the statutes it has enacted should be substantially revised.

Allowing these regulations to be implemented will do great harm to the citizens you serve. We believe that if these regulations are implemented closing costs will skyrocket, housing will become less affordable and an already complicated process will become even more mystifying and incomprehensible to the consumer. On behalf of our members, we would welcome an opportunity to work with all interested parties to revise RESPA in a way that would make the statute more effective in meeting its objectives.

Once again Mr. Chairman and committee members, thank you for allowing me to participate in today's hearings. I would be happy to answer any questions you may have.

Prepared Testimony of Gary E. Acosta, CEO and Chairman-Elect

National Association of Hispanic Real Estate Professionals

On

HUD's Proposal to Reform RESPA

Before the

Committee on Small Business

U. S. House of Representatives

Tuesday March 11, 2003 RHOB 2360

Chairman Manzullo, ranking member Velazquez, members of this committee, I am Gary Acosta, the president of SDF Realty in San Diego California and the CEO and Chairman-elect of the National Association of Hispanic Real Estate Professionals (NAHREP), a non-profit trade association dedicated to increasing the Hispanic homeownership rate. NAHREP is the nations fastest growing real estate trade organization and is a partner in President Bush's "Blueprint for the American Dream" minority homeownership initiative. We appreciate the opportunity to address the committee today on the views and planned actions of the Department of Housing and Urban Development (HUD) on the proposed amendments to the regulations implementing the Real Estate Settlement Procedures Act (RESPA).

NAHREP has over 10,000 members in 43 states. Our members come from all segments of the housing industry including but not limited to real estate agents and mortgage professionals. NAHREP provides professional education, industry representation, publications and technology solutions for those real estate professionals primarily dedicated to serving Hispanic homebuyers.

Hispanic homebuyers are underserved

Today, the homeownership rate in the U.S stands at 68%; however for Hispanic Americans it is about 47%. This disparity is driven by a number of factors including the

lack of competitive mortgage financing in those markets. In addition, NAHREP estimates that approximately 80% of Hispanic homebuyers are first time buyers – double the percentage of the overall market. Particularly for the first time buyer, purchase of a home is both a complicated and emotional experience, which create a more labor-intensive real estate process for the professional.

According to a recent study produced by Pepperdine University and the La Jolla Institute, up to 65% of Hispanic homebuyers prefer to communicate in Spanish, a skill possessed by a small percentage of real estate professionals. Additionally, many Hispanic consumers have thin credit files, little money for downpayment, and multiple sources of income. In order to serve this market effectively, mortgage and real estate professionals must have specialized skills and have keen understanding of this market.

Accordingly, NAHREP supports policy and legislation that increases awareness, reduces cost, and simplifies the process of buying a home. In this regard, NAHREP applauds President Bush, and Secretary Martinez for their demonstrated commitment to make homeownership attainable for more Hispanics, minorities and other underserved Americans. In particular, we strongly support Secretary Martinez' effort to simplify and improve the process of obtaining home mortgages, and to reduce the costs for future homebuyers.

Hispanic consumers are primarily served by Small Business Professionals

A recent NAHREP member survey indicated that 81% of our members who are real estate agents "regularly use the services of a mortgage broker to arrange financing for their clients". Latinos are more likely use mortgage brokers and other small business professionals because they tend to live and work in the communities they serve and have strong language skills and cultural understanding. Today's mortgage industry is increasingly a formula driven, high volume, low margin business. Larger players generally lack the flexibility and diverse personnel necessary to adequately serve homebuyers that don't always "fit in the box". For this reason, NAHREP believes that the growth in Hispanic homeownership will depend on Hispanic-owned small businesses in those communities.

HUD's proposed rules may have an unintended impact on small real estate and mortgage companies

NAHREP believes that consumers should have access to the best mortgage rate possible and be given maximum choice of mortgage products and services. We also believe that this outcome for the consumer could not be possible without real competition in the mortgage market. However, this proposed rule in connection with the Enhanced Good Faith Estimate results in "different treatment of compensation in loans originated by lenders and those originated by mortgage brokers". In effect, a mortgage loan originated by a mortgage broker – who now has additional disclosure requirements -- may look more expensive to the consumer than an identical loan originated through a direct lender. Disclosure of compensation of a mortgage banker or a national bank is not required under

the proposed rule. In some cases, a consumer could select a more expensive product by assuming that the loan with no origination fee is always a better deal.

Additionally, NAHREP believes that because interest rates change several times daily, the proposed rule may cause consumers to focus too much on the compensation to the loan originator, rather than the ultimate interest rate and terms. The different disclosure requirements between brokers and bankers could bias consumers against small businesses, which may affect their long-term viability.

Supporting small business is good for the Hispanic community

In addition to working to increase the Hispanic homeownership rate, NAHREP uses education and advocacy to preserve and create more business opportunity for Hispanic Americans. As more Latinos strive for homeownership, the housing industry will need more Latino real estate and mortgage professionals to serve them. Latinos today have, in general, limited access to start-up capital. Aspiring entrepreneurs have few opportunities equal to mortgage and real estate that have the potential for success with a relatively modest barrier for entry.

Fourteen years ago my wife and I started our own business as a mortgage broker with only $5000 from our personal savings. Today our company generates over two million dollars per year in revenue, and employs 14 people including 8 other Latinos. The mortgage and real estate business has provided my family with more opportunity than we would have likely recognized elsewhere.

NAHREP appreciates the opportunity to share our views

The housing sector has been one of the few bright spots in our economy and Hispanic homebuyers have fueled the strength of our housing industry. Over the next two decades, nearly 80% of all new homebuyers will be minorities and/or immigrants. NAHREP strongly advocates that consumers must have access to the best mortgage rate possible and stands ready to support Secretary Martinez' effort to improve the process and reduce the cost of mortgage finance. I look forward to working with this committee and HUD to ensure that the proposed rule encourages more minority-owned small businesses to enter the mortgage market and thereby help to increase homeownership opportunities particularly for minority families. Thank you.

Prepared Testimony of Neill Fendly, Government Affairs Chair & Past President

National Association of Mortgage Brokers

on

RESPA Reform and the Economic Effects on Small Business

before the

Small Business Committee

U.S. House of Representatives

Tuesday, March 11, 2003

Chairman Manzullo, Ranking Member Velazquez, I am Neill Fendly, Government Affairs Committee Chair and Past President of the National Association of Mortgage Brokers (NAMB). I appreciate the opportunity to discuss issues of vital importance to the small business community and specifically, mortgage brokers. NAMB is the nation's largest organization exclusively representing the interest of the mortgage brokerage industry and has more than 16,000 members and 46 state affiliates nationwide. NAMB provides education, certification, industry representation, and publications for the mortgage broker industry. NAMB members subscribe to a strict code of ethics and a set of best business practices that promote integrity, confidentiality, and above all, the highest levels of professional service to the consumer.

Today, mortgage brokers originate more than 60% of all residential mortgages.[1] There are many reasons for this large market share. Mortgage brokers are typically small businesses[2] who operate in the communities in which they live, often in areas where traditional mortgage lenders may not have branch offices. As stated in HUD's own Economic Analysis, many mortgage broker firms consist of one office and five employees, including the owner.[3] Mortgage brokers provide lenders a nationwide product distribution channel that is much less expensive than traditional lender branch operations.

Mortgage brokers are also the key to bridging the gap in minority homeownership. A recent study performed by Wholesale Access, a research, advisory and publishing company, on minority lending stated that two of the key findings of this research are: "(i) brokers reach more minorities than lenders; and (ii) the explanation for this is found in their locations, products and staffing."[4] Many of these communities would not have the availability of mortgage loans currently enjoyed today were it not for mortgage brokers. In its current form, the Proposed Rule would hamper the ability of mortgage brokers to continue to assist minorities and indeed all consumers.

Without question, the number one issue that mortgage brokers are deeply concerned with is the Department of Housing and Urban Development's (HUD) Proposed Rule to reform Regulation X, the implementing regulation for the Real Estate Settlement Procedures Act (RESPA).[5] NAMB has many concerns with HUD's Proposed Rule and the Economic Analysis HUD used to formulate the Proposed Rule. NAMB believes the Proposed Rule creates an unlevel playing field in the market place for mortgage brokers, limits consumer choice and access to credit and is unworkable in the real world. HUD's Proposed Rule would significantly reduce small business revenue while substantially increasing the regulatory burden on small business. If the Proposed Rule is finalized in its current form, many small businesses involved in the mortgage industry, will no longer be in business, including mortgage brokers.

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[1] "Economic Analysis and Initial Regulatory Flexibility Analysis for RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, Office of Policy Development and Research, July 2002, at p. 12.

[2] The Small Business Administration Office of Advocacy cites that a mortgage broker is a small business if its annual revenues do not exceed $6 million. *See Attachment 1*, Comment Letter, Small Business Administration Office of Advocacy, "RESPA: Department of Housing and Urban Development: Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs for Consumers; Proposed Rule; Docket Number: FR-4727-P-01," October 28, 2002.

[3] "Economic Analysis" at p. 12.

[4] Press Release, Wholesale Access, Study of Minority Lending Completed, (Sept. 24, 2002) (www.wholesaleaccess.com).

[5] "Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, Docket Number: FR-4727-P-01, July 29, 2002.

While HUD continues to assert that their Proposed Rule will simplify and improve the mortgage process, you would be hard pressed to find any market participants who would agree.[6] HUD's Proposed Rule will in fact further confuse the consumer while placing a disproportionate burden on small business - a fact that HUD even admits in their Economic Analysis.[7] NAMB believes that the Proposed Rule will directly affect their livelihoods. Our members are not just upset and frustrated, they are actually scared. To our members, this Proposed Rule will lead to the loss of their careers and the mortgage broker industry.

The Proposed Rule will not only adversely impact mortgage brokers, but exponentially, small third party settlement service providers who mortgage brokers work with every day, driving them all out of business. This impact on small business will not be without consequences – the costs to consumers will eventually rise and many consumers will not have access to the range of mortgage products and choices that are available today.

NAMB's Concerns With HUD's Proposed Rule: Enhanced Good Faith Estimate

HUD's Proposed Rule recharacterizes the definition of a yield spread premium as a "lender payment to the borrower for a higher interest rate." This characterization creates unintended consequences and provides less clarity to consumers than as presently disclosed. The recharacterization is also inconsistent with HUD's Statements of Policy 1999-1 and 2001-1, in which HUD states that a yield spread premium is a payment for "goods, facilities or services furnished or performed," ***for the lender*** [emphasis added] as well as the borrower. The unlevel playing field presented in the Proposed Rule will prevent mortgage brokers, or those brokering a transaction, from appearing competitive (such as no longer being able to advertise a "no point" loan[8]) or from potentially offering certain products (such as FHA and VA-insured loans[9]). Litigation costs will continue to

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[6] *See Attachment 2,* Excerpts from the comment letters on the Proposed Rule from the National Association of Realtors and the Independent Community Bankers of America.

[7] "Economic Analysis" at p. vii.

[8] If the proposed characterization of yield spread premiums is implemented, mortgage brokers will not be able to advertise certain mortgage loans and remain competitive. For example, a mortgage *broker* who makes a "no point" mortgage loan at 7% interest rate on a $100,000 loan, but collects a $1,000 yield spread premium, must advertise that this is a one-point mortgage loan. A mortgage *lender*, who originates a $100,000 mortgage loan at a 7% interest rate, but collects $1,000 in compensation when the loan is sold, can advertise a "no-point" mortgage loan. These are the exact same loans with the exact same costs to the consumer. However, due to a federally regulated mandate (*i.e.* artificial) the mortgage broker appears more expensive as he or she must advertise that this is a one-point mortgage loan. This actually is a much larger issue. In converting indirect compensation to direct compensation, the "yield spread premium" will now be included in the calculation of the annual percentage rate. However, for the most part, the yield spread premium is already included in the annual percentage rate as a function of the interest rate. Thus, under the Proposed Rule, this amount would in essence be "double-counted" and will artificially increase the amount of the annual percentage rate. Mortgage brokers and those brokering mortgage loans will appear to be less competitive to consumers and will lose market share.

[9] In addition, by including a mortgage broker's indirect compensation in the calculation of the Net Loan Origination Charge, consumers will suffer a loss of available credit as many mortgage brokers will no longer be able to originate FHA and VA-insured mortgage loans. This is because direct originator compensation on these loans is limited to 1% of the loan amount in connection with FHA-insured loans, and direct originator compensation on VA-insured mortgage loans is limited to 1% of the total loan amount or closing costs. In characterizing yield spread premiums as a "lender payment to the borrower," indirect

plague small business as HUD's proposed recharacterization of a yield spread premium as a "lender payment to borrower" will create confusion for consumers leading them to question- "where is my check?"

NAMB believes that HUD has provided no evidence that their recharacterization of a yield spread premium will benefit the consumer by simplifying the mortgage process. Rather, the recharacterization will further confuse consumers and potentially lead them to choose mortgage products because they "appear" less expensive, appearances being deceiving. In fact, in their comment letter to HUD, the Federal Trade Commission (FTC) states that the "approach to the disclosure of broker compensation"[10] contained in the proposal could "confuse consumers and lead them to misinterpret the overall cost of a transaction." [11] Further, the FTC states in its comment letter that "if the additional information or revised formats confuse consumers, the proposed changes may not increase consumer welfare as much as HUD intends and, in the worst case, may actually result in consumer harm."[12] As a result, FTC requested that HUD conduct consumer research to determine whether the recharacterization will enhance consumer comprehension of the mortgage process.[13]

HUD states that it "designed the GFE to lessen any anti-competitive effects from the different reporting requirements of lenders and brokers on the new GFE."[14] However, HUD's Proposed Rule would require that mortgage brokers include the yield spread premium in the *calculation* of Net Loan Origination Charge, but not require the same of all originators. HUD is complicating the real estate settlement process because the consumer is unable to perform a true "apples to apples" comparison of the cost of the mortgage. FTC also expressed concern about this disparity. In their comment letter, FTC states that HUD's prominent emphasis of the yield spread premium and the asymmetric disclosure of compensation for mortgage brokers might inadvertently burden consumers and competition. [15]

Further, under the Proposed Rule, HUD would no longer require a good faith estimate of costs associated with the mortgage loan but rather a guarantee of many of the costs, including many third party costs, associated with the mortgage loan. This guarantee would be required early in the application process.[16] Many times during the processing of a mortgage loan, unforeseen costs arise. A good example of this is when the wholesale lender, after the review of the appraisal, requires additional comparables for the property in question. Another example is when, after an appraisal or inspection, damage to the property is discovered and a termite inspection or structural analysis is required. A

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compensation to a broker is artificially transformed into direct compensation and thus subject to the cap. This will impact many first time homebuyers who rely on FHA and VA-insured mortgage loans.

[10] Press Release, Federal Trade Commission, "FTC Staff Comments on Proposed Amendments to Regulations Implementing the Real Estate Settlement Procedures Act," November 4, 2002.

[11] Comment Letter submitted by the Federal Trade Commission, on the "Real Estate Settlement Procedures Act, Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, FR-4727-P-01 (July 29, 2002), p. 7.

[12] FTC Comment Letter at p. 1.

[13] FTC Comment Letter at p. 1.

[14] "Economic Analysis" at p. 87.

[15] FTC Comment Letter at p. 10.

[16] Under the Proposed Rule, the enhanced "good faith estimate" would continue to be required to be provided to consumers within three (3) business days of application.

mortgage broker cannot foresee every cost associated with a mortgage loan. While large lenders might be able to absorb these losses, small businesses like mortgage brokers cannot. Losses such as these can be enough to put mortgage brokers out of business.

NAMB's Concerns With HUD's Proposed Rule: Guaranteed Mortgage Packages

The Proposed Rule also sets up a new process for originating mortgages called the Guaranteed Mortgage Package Agreement (GMPA). Created by regulatory fiat, this regime requires an originator to offer a guaranteed mortgage package (mortgage, third party settlement services and closing costs) for a set price. Mortgage brokers, and other small settlement service providers, as small businesses, do not have the bargaining power to enter into volume-based discounts with third party settlement service providers, as do larger entities. The end result will be additional consolidation in the mortgage industry at the expense of small business. This economic burden will fall disproportionately on small business, and although they understate the costs associated with this burden, even HUD concedes that– "$3.5 billion of the $6.3 billion in transfers to borrowers comes from small originators ($2.2 billion) such as small brokers and small settlement service providers ($1.3 billion)."[17] Since the Proposed Rule would reduce mortgage broker revenue and significantly increase the regulatory burden for mortgage brokers, many brokers will be forced out of the business of placing people in homes- a perverse, but very real effect of a proposal intended to actually help put people in homes. Given the mortgage broker's significant involvement in originating mortgages, particularly for minorities, we firmly believe this Proposed Rule cannot be finalized in its current form.

Under the Proposed Rule, many mortgage brokers will not be able to compete with the larger entities and will be forced out of business, or become an agent for one lender or two utilizing their packages, or be left with the enhanced good faith estimate approach, which, as stated herein, discriminates against the small business mortgage broker.

HUD's Economic Analysis and NAMB's Economic Study

NAMB believes that the Economic Analysis prepared by HUD does not provide a clear picture of the potential impact on a market that is functioning effectively and does not accurately reflect the Proposed Rule's impact on small business. In fact, HUD's economic analysis is flawed, incomplete, and inaccurate.[18] NAMB also believes the Proposed Rule requires further analysis under the Regulatory Flexibility Act as detailed below.[19]

Basing a Proposed Rule on flawed economic analysis will result in a flawed final rule that harms consumers and could have devastating repercussions in a $2 trillion housing market. NAMB believes that further analysis is necessary to ensure that any proposed rule is based on a foundation of market realities and not just good intentions.

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[17] "Economic Analysis" at p. vii.
[18] *See Attachment 3*, "Discrepancies with HUD's Economic Analysis."
[19] 5 U.S.C. § 601 *et seq.*

As detailed in this testimony, NAMB has found evidence of incomplete or flawed analysis during its review of HUD's Economic Analysis and its submission to the Office of Management and Budget (OMB). This led to NAMB's commission of an economic study to be conducted on the underlying assumptions of HUD's Economic Analysis, and the effect the Proposed Rule would have, if implemented as written, on small business. [20] NAMB's study "anticipates that small originators/brokers and small TSPs [third party service providers] will lose more than 60% ... of their revenue arising both from a loss in market share and lower revenue sources, and reduced prices."[21] This is a tremendous loss and will cause many small businesses to go out of business, which ultimately will result in a loss to consumers in their choice and access to credit. The study also explains that "this lost revenue will not go to consumers, however, but is likely to go to larger businesses."[22] The study cites that "on balance, smaller businesses will be driven from the market or driven to join in business or even ownership with larger firms, but the overall benefit to consumers from this concentration and reduction in competition is questionable."[23] Unfortunately, when dealing with a $2 trillion housing market, such questions should not go unanswered.

Regulatory Flexibility Act of 1980 (RFA) [24]

When promulgating Proposed and Final Rules, RFA requires federal agencies to review the rules for their impact on small businesses and consider less burdensome alternatives. Pursuant to RFA, if a proposed rule is expected to have a significant economic impact on a substantial number of small entities, an Initial Regulatory Flexibility Analysis (IRFA) must be prepared. [25] The IRFA must describe the economic impact of the Proposed Rule on small entities including a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule.[26] The IRFA must also contain a comparative analysis of alternatives to the proposed rule, which would minimize the impact on small entities and document their effectiveness in achieving the regulatory purpose. [27]

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[20] *See Attachment 4*, Blalock, Joseph and Tyler Yang, "Analysis and Comments on HUD's RESPA Economic Analysis and Initial Regulatory Flexibility Analysis," IFE Group, March 7, 2003, p. 1.
[21] Blalock at p. 20.
[22] Blalock at p. 2.
[23] Blalock at p. 2.
[24] 5 U.S.C. § 601 *et seq*
[25] If the proposed rule will not significantly impact a substantial number of small entities, the head of an agency must certify as such and provide factual determination. When an agency issues a final rule, it must prepare a Final Regulatory Flexibility Analysis (FRFA), 5 U.S.C. § 603.
[26] *Id.*
[27] *Id.*

HUD prepared an IRFA in conjunction with Executive Order 12866.[28] NAMB does not believe HUD sufficiently complied with the RFA when promulgating their Proposed Rule for two reasons; one, HUD's IRFA did not contain a sufficient comparative analysis of alternatives to the proposed rule that would minimize the impact on small entities; and two, HUD's IRFA does not accurately describe the projected reporting and recordkeeping requirements and other compliance requirements of the proposed rule, including an accurate estimate of the classes of small entities which will be subject to the requirement.

The Small Business Administration Office of Advocacy (SBA), the voice for small business, even expressed concern to HUD regarding their IRFA. Pursuant to SBA's statutory duty to monitor, examine and report agency compliance with the RFA, as amended by the Small Business Enforcement Fairness Act of 1996 (SBREFA), the SBA submitted a comment letter encouraging HUD to issue a revised IRFA "that takes into consideration the comments of affected small entities and develops regulatory alternatives to achieve HUD's objectives while minimizing the impact on small business."[29] The SBA recommended that HUD publish a supplemental IRFA to provide small businesses with "sufficient information to determine what impact, if any, the particular proposal will have on its operations" and "provide a meaningful discussion of alternatives that may minimize that impact."[30] To our knowledge, HUD has never considered the SBA's recommendation to issue a supplemental IRFA.

Although HUD's Economic Analysis states that $3.5 billion of the $6.3 billion (55%) in transfers to consumers will come from small businesses,[31] the SBA explained in their comment letter that HUD's Economic Analysis would be improved by a revised IRFA which clearly defines the impact on small entities, instead of citing the mere overall cost to small business.[32] Since HUD did not specifically compute the costs of compliance per small business, HUD could not and did not sufficiently analyze regulatory alternatives as required by RFA that would minimize the burden on small businesses.[33]

HUD's failure to accurately analyze the economic impact on small business can be illustrated through their own reported inconsistencies. HUD's Paperwork Reduction Act Submissions to OMB states that annual responses for Good Faith Estimates (GFEs) is 11 million.[34] However, HUD's Economic Analysis and Initial Regulatory Flexibility

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[28] Executive Order (EO) 12866 was introduced to, among other things, reinforce the RFA. EO 12866 directs federal agencies to assess all costs and benefits of available regulatory alternatives. The EO requires agencies to prepare a regulatory impact analysis for final rules that are deemed economically "significant" (that is, a final rule that would have an annual effect on the economy of $100 million or more in any 1 year, or would adversely affect in a material way a sector of the economy).

[29] SBA Comment Letter at p. 2.

[30] SBA Comment Letter at p. 5.

[31] "Economic Analysis" at p. 26.

[32] SBA Comment Letter at p. 4.

[33] It is important to point out that NAMB has spent countless hours and resources to strengthen, simplify and clarify the disclosure of costs provided to consumers in advance of settlement. NAMB submitted an alternative disclosure form set forth in our comment letter that satisfies the objectives of HUD to simplify the mortgage process, but not at the expense of small business or to the detriment of consumers. It will allow the consumer to perform a true "apples to apples" comparison of the cost of the mortgage while maintaining a more level playing field for mortgage originators.

[34] *See Attachment 5*, "Supporting Statement for Paperwork Reduction Act Submissions," U.S. Department of Housing and Urban Development, August 2001, p. 5.

Analysis, states that if the rule applied in the year 2002, it would impact 19.7 million applications.[35] This is significant because the submission to OMB underestimates the paperwork burden by at least 8.7 million GFEs and an additional $57 million.

In addition, HUD's Economic Analysis states that "originators and closing agents will have to expend some minimal effort in explaining to consumers the cross walk between the enhanced GFE and the more detailed HUD-1."[36] However, HUD did not perform their due diligence to ascertain these costs since the costs were not included in HUD's submission to OMB. The cost associated with explaining to consumers the new enhanced GFE and the more detailed HUD-1 is not "minimal." NAMB believes a detailed and accurate estimate should be provided.

HUD states that the program change being mandated by the Proposed Rule would increase the burden on the industry by 2,530,000 burden hours.[37] This is equal to 289 years. We find it hard to believe that HUD could not create another regulatory alternative that would have minimized this substantial impact on small business. The huge burden HUD's Proposed Rule forces upon small business will not only dismantle small businesses, but it will also alienate consumers from the ability to obtain credit, thereby, preventing consumers from achieving the dream of owning a home.

NAMB finds this very troubling in the sense that small business – particularly in the housing industry today – is one of the few pillars in this economy that has not fallen. NAMB is concerned that by arbitrarily reducing small business revenues while substantially increasing the regulatory burden on small business by 2.5 million burden hours, small business will be devastated in the mortgage industry. As a result, consumers will suffer an increase in the cost of credit and a reduction of choice and access to credit.

Conclusion

These inconsistencies compel NAMB to ask whether HUD must undergo a more expansive and realistic review of the economic impact this rule will have on the industry, as well as small business, as mandated by the Regulatory Flexibility Act, the Paperwork Reduction Act, the Unfunded Mandates Reform Act, Executive Order 12866, and President Bush's recent Executive Order 13272 to relieve the regulatory burden on, and protect, small business.

NAMB sincerely appreciates the opportunity to share our concerns with you and hopes the Small Business Committee will take interest in this issue. Resolving this issue will not only benefit small business, it will benefit all people who pursue the dream of homeownership.

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[35] "Economic Analysis" at p. 9.
[36] *Id.* at p. 25.
[37] "Supporting Statement," p. 7.

Attachment 1

National Association of Mortgage Brokers Testimony

Comment Letter of the Small Business Administration

Office of Advocacy

October 28, 2002

Office of Advocacy

October 28, 2002

Richard A. Hauser, Esquire
General Counsel
Office of the General Counsel
Department of Housing and Urban Development
451 Seventh Street, SW
Washington, DC 20410-0500

Re: Department of Housing and Urban Development: Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers; Proposed Rule; Docket Number: FR-4727-P-01

Dear Mr. Hauser:

As part of its statutory duty to monitor and report on an agency's compliance with the Regulatory Flexibility Act of 1980 ("RFA"), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),(1) the Office of Advocacy of the U.S. Small Business Administration ("Advocacy")(2) reviewed the Department of Housing and Urban Development's ("HUD") compliance with the RFA's requirements for the above-referenced Notice of Proposed Rulemaking ("NPRM").(3) On July 29, 2002, the Department of Housing and Urban Development (HUD) published a proposed rule on the Real Estate Settlement Procedures Act (RESPA) in the *Federal Register*, Vol. 67, No.145, p. on page 49134. The purpose of the proposal is to simplify and improve the process of obtaining home mortgages and reduce settlement costs to

consumers. The proposal addresses the issue of lender payments to mortgage brokers by changing the way that payments in brokered transactions are recorded and reported to consumers. It requires a Good Faith Estimate (GFE) settlement disclosure and allows for packaging of settlement services and mortgages.

After reviewing the NPRM and discussing it with affected small businesses,(4) Advocacy would like to encourage HUD to issue a revised initial regulatory flexibility analysis (IRFA) that takes into consideration the comments of affected small entities and develops regulatory alternatives to achieve HUD's objectives while minimizing the impact on small businesses.

RFA Requirements for a NPRM

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Unless the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities, the agency is required to prepare an IRFA. The IRFA must include: (1) a description of the impact of the proposed rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statues and minimize any significant economic impact of the proposed rule on small entities.(5) In preparing its IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or

alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.(6)

HUD's Compliance with the RFA

Pursuant to the RFA, HUD prepared an IRFA in conjunction with its Economic Analysis prepared under Executive Order 12866.(7) Section 605 of the RFA expressly permits agencies to perform an IRFA in conjunction with other analyses provided the analysis meets the requirement of the RFA. For the reasons stated below, Advocacy is of the opinion that further economic analysis prepared by HUD, in a revised IRFA, would improve the Final Rule.

Defining Small Businesses Affected by the RESPA Proposal

Section 601 of the RFA requires an agency to use the definition of small business contained in the U.S. Small Business Administration's ("SBA") small business size standards regulations,(8) promulgated by the SBA under the Small Business Act.(9) Below is a table of the SBA's definition of small business for the industries in which small businesses have contacted the Office of Advocacy to raise concerns regarding the impacts of this rule.(10)

NAICS Code	Industry Description	SBA Size Standard (revenues <=) in $ millions
531210	Mortgage Brokers (Real Estate Agents and Brokers)	6
522292	Real Estate Credit	6
541191	Title Abstract and Settlement Offices	6
531320	Offices of Real Estate Appraisers	1.5
561710	Pest Inspectors - Exterminators	6

The proposed rule will affect mortgage brokers, mortgage lenders, realtors, appraisers, pest inspectors, and settlement service providers. Although HUD acknowledged that the majority of the businesses in the

industries affected by the rule are small businesses, its economic analysis would improve by a revised IRFA that clearly defines the impact on those small entities.

HUD's analysis included the overall cost of compliance for the proposal in its analysis. A revised IRFA would allow for HUD to compute the compliance cost per small entity. This would enable HUD to identify and analyze significant regulatory alternatives to minimize the potential burdens on small businesses subject to the rule. In addition, this information would assist small entities in understanding the nature of the impact of the rule on their businesses.

Alternatives to Reduce the Impact on Small Entities

In addition to providing information about the economic impact of the action on small businesses, the RFA also requires an agency to consider less burdensome alternatives to the proposed action. In this particular rulemaking, there may be viable alternatives that HUD has not considered.

Good Faith Estimate (GFE) Provisions

Advocacy supports the notion of protecting consumers from predatory lending practices and providing the consumer with full disclosure about the mortgage lending process. Advocacy urges HUD to give full consideration to suggestions that reduce consumer confusion and are cost effective for mortgage brokers and community-based lenders.

Packaging

The purpose of packaging is to increase competition among settlement service providers and lower the cost of settlement services for the consumer. As with the GFE, Advocacy urges HUD to give full consideration to suggestions from the small business community concerning the packaging aspect of the proposal.

Conclusion

The RFA requires agencies to consider the economic impact on small entities prior to proposing a rule and to provide the information on those

impacts to the public for comment. As noted above, Advocacy recommends that HUD publish a supplemental IRFA to provide small businesses with sufficient information to determine what impact, if any, the particular proposal will have on its operations. In addition to providing the public with specific information about the economic impact on the proposal, the supplemental IRFA should provide a meaningful discussion of alternatives that may minimize that impact.

Secretary Martinez, Commissioner Weicher, and members of your staff in the Office of General Counsel, deserve credit for reaching out to small businesses and consulting with my office in the development of this rule. I am confident that we will continue to work together to ensure that these improvements to the mortgage financing process stimulate small-business growth and increased opportunities for homeownership. Thank you for the opportunity to comment on this important proposal. If you have any questions, please feel free to contact the Office of Advocacy at (202) 205-6533.

Sincerely,

Thomas M. Sullivan

Chief Counsel for Advocacy

Jennifer A. Smith

Assistant Chief Counsel

for Economic Regulation

Cc: Dr. John D. Graham, Administrator, Office of Information and Regulatory Affairs

ENDNOTES

1. Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601 et seq.) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

2. Congress established the Office of Advocacy of under Pub. L. No. 94-305 to represent the views of small business before Federal agencies and Congress.

3. 67 Fed. Reg. 49134 (July 29, 2002).

4. On October 9, 2002, the Office of Advocacy held a roundtable on this rule. Mortgage brokers, mortgage lenders, realtors, appraisers, and third party service providers participated in the roundtable. In addition, on October 25, 2002, Advocacy met with minority members of the real estate community in Baltimore, Maryland to discuss the impact of this rule on their businesses.

5. 5 U.S.C § 603.

6. 5 U.S.C. § 607.

7. Advocacy reviewed the summary of HUD's analysis published as an appendix to the proposed rule and the complete Economic Analysis and Initial Regulatory Flexibility Analysis for RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers, prepared by HUD's Office of Policy Development and Research and accessible on HUD's Website.

8. 13 C.F.R. § 121.

9. 15 U.S.C. § 632. Section 601 also provides that an agency can use an alternate definition if the agency obtains prior approval from Advocacy to use another standard (and publishes the standard for public comment) or the statute on which a rule is based provides a different definition of small business, then an agency may use that definition without consulting with the Office of Advocacy. 5 U.S.C. § 601 (3).

10. This information was obtained from http://www.sba.gov/size/sizetable2002.html.

Attachment 2

National Association of Mortgage Brokers Testimony

Excerpts from Comment Letters

On the Proposed Rule from

National Association of Realtors

And

Independent Community Bankers of America

Comments and Concerns of Selected Real Estate Settlement Service Providers

"HUD's regulation could increase concentration, reduce transparency, discourage innovation, reduce the quality of services provided and ultimately lead to higher closing costs."

"The GMP will reduce transparency in the transaction. Borrowers will shop for a loan based on an interest rate and a 'black box' of settlement costs. To move from a process today where borrower are fully informed of the various services required to close the transaction to one in which the borrower is assumed to only be interested in the lump price of the package is taking a step backwards in the are of consumer education."

Excerpts from the Comment Letter of the
National Association of Realtors
October 28, 2002

"In our view, elements of the proposal will further confuse consumers, enable dishonest brokers and lenders to hide unnecessary fees and overall increase mortgage costs...ethical smaller loan originators and settlement service providers will be driven from the mortgage industry because they will not have the volume necessary to compete if this proposal is adopted and consumer choice will be reduced."

"President George W. Bush has called for an increase in minority homeownership by 5.5 million families, a goal that HUD Secretary Mel Martinez has strongly supported and a goal that ICBA strongly supports...But we have grave concerns that HUD's proposed changes to RESPA will seriously undermine this goal and reverse the trend of overall homeownership growth."

"HUD's proposal will dramatically alter the manner in which mortgages are offered, making the process more confusing, removing consumer choice in the selection of individual settlement services, and decreasing consumer options for mortgage products. If the proposal goes forward, it will increase, not decrease as HUD predicts, the cost of homeownership."

Excerpts from the Comment Letter of the
Independent Community Bankers of America
October 28, 2002

Attachment 3

National Association of Mortgage Brokers Testimony

Discrepancies with HUD's Economic Analysis

Discrepancies in HUD's Economic Analysis and Initial Regulatory Flexibility Analysis[1]

1. On page 22 HUD states that currently, $7.5 billion of YSP payments "is not passed through to borrowers." Under this proposal, HUD assumes that consumers will recapture half of that, or $3.75 billion. The mandate requires a dollar for dollar offset, meaning that consumers should get all $7.5 billion. Where does the other $3.75 billion go?

2. On page 22, HUD states that origination fees are estimated at $15 billion. HUD asserts that the mandate will improve a consumer's ability to shop and therefore capture five percent ($.75 billion). Why wouldn't a broker try to charge more in origination fees if HUD takes away my ability to charge a yield spread premium? In other words, the analysis is static. A small businessman is not just going to voluntarily cut his rates by half – which is what the HUD model assumes. Most small businesses do not have a 50 percent profit margin.

By not producing a more accurate and dynamic model, HUD is overstating the benefits of this proposal and understating the devastating impact on small business who provides high quality service and expertise.

3. The Proposed Rule will allegedly improve a customer's ability to shop and actually facilitate shopping. If this proposal achieves that goal – and it remains unclear at this time – then a customer could go to ABC bank get the GFE and then get in his/her car and drive to Broker X and compare GFE's.

While the ability to shop may be a desired outcome of public policy, it is difficult to accept the notion that increased shopping saves consumers $826 million. The physical act of shopping is not a costless exercise – and, more to the point of HUD's estimate, it does not *save* money. That is, no one pays a consumer for shopping. However, HUD's Economic Analysis ignores this transaction cost and arbitrarily asserts a savings.[2] This overstates the benefits of this proposal.

This is another example of how the static and questionable analysis is fundamentally flawed. As a result, HUD's Economic Analysis provides no basis to understand the real burden of the proposal.

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[1] "Economic Analysis and Initial Regulatory Flexibility Analysis for RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, Office of Policy Development and Research, July 2002.
[2] "Economic Analysis," p. 54.

4. On page 54, HUD states that originators and third party settlement service providers will save time (and $850 million) by reducing the amount of time spent with a borrower. While this may be partially true, HUD does not account for the increased foot traffic and comparison shopping made possible by the new rule. An originator will spend more time answering people's questions that are "shopping." It is quite likely that originators will even be walking these shoppers through the new disclosures. This time and resources is not accounted for in HUD's analysis.

Again, HUD overstates the benefits with static analysis.

5. The last example is how HUD does not understand the marketplace and ends up creating an unlevel playing field for small business.

On page 30 HUD asserts that, "All broker income must be derived from direct fees while lenders who originate may continue to supplement their direct fees with yield spread premiums that continue to be unreported to borrowers. This may give lenders a competitive advantage over brokers." HUD goes on to say on page 32 that "A potential problem comes where a shopper is not knowledgeable. A lender trying to convince a borrower to take his loan instead of the broker's might focus the borrower's attention on the reported origination fee of the two charges...".

That is the point. Of course the lender is going to try to, as HUD says, "convince the borrower to take his loan." That is how the market works. The lender is not an unbiased party in this transaction. He is a competitor and will always try to convince the borrower to take his loan. This is why the current disclosure does not work in its current form – it creates an unlevel playing field.

Attachment 4

National Association of Mortgage Brokers Testimony

Joseph Blalock and Tyler Yang

"Analysis and Comments on HUD's RESPA Economic Analysis

and

Initial Regulatory Flexibility Analysis"

IFE Group

March 7, 2003

Analysis and Comments* on

HUD's

RESPA Economic Analysis and Initial Regulatory Flexibility Analysis

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March 7, 2003

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NAMB REPORT

I. Executive Summary

We have analyzed both HUD's "Economic Analysis and Initial Regulatory Flexibility Analysis" of July of 2002, (referred to as the "Economic Analysis") as well as HUD's proposed rule of July 29, 2002 for RESPA simplification. Our analysis focuses on the underlying economic assumptions of HUD's Economic Analysis and provides alternative scenarios of how the alternative rules may affect consumers (borrowers) as well as small businesses such as small lenders, mortgage brokers, and settlement services providers.

The Potential Impact on Pricing

The proposed rules create new risks for lenders that will thus create incentives for lenders and other service providers to offer borrower *higher* offered prices and higher costs to consumers. Only those lenders and service providers who are in a position to charge higher prices will benefit from the increase in pricing. Our conclusions are that eventually the lending industry will recoup from consumers any new costs arising from the proposed rules as well as the value of efficiencies. The composition of cost increases will change markedly, with an increase in the frequency of direct origination fees (points) in the case of both the new Good Faith Estimate (GFE) alternative and Guaranteed Mortgage Packaging Approach (GMPA).

The Potential Impact on Efficiency

The proposed rules are likely to decrease competition (increase consolidation) in the retail lending and settlement services market, inflicting disproportionate damage on small businesses without a reduction in borrower/consumer costs, and perhaps even an increase in costs to borrowers in the long run. To the extent that borrowers shop more for financing and settlement services, the effect of the rules may be beneficial, but the cost of borrower shopping time is substantial and it is not at all clear that borrowers will achieve net savings from their increased shopping efforts, since the rules may have the effect of raising offered and actual pricing.

The Potential Impact on Market Structure

Almost certainly, mortgage brokers will lose market share under the GFE alternative, and in both the GFE and GMPA alternatives the incentives favor a more concentrated market dominated by large lenders and packagers. A more concentrated market and concentration between firms that have interlocking ownership or other conflicted business relations is typically detrimental to consumers.

Effect on Small Businesses

Small businesses (brokers, small mortgage lenders, and service providers) will likely lose significant amounts of revenue under the rule(s). This lost revenue will not go to consumers however, but is likely to go to larger businesses. On balance, smaller businesses will be driven

from the market or driven to join in business or even ownership relationships with larger firms, but the overall benefit to consumers from this concentration and reduction in competition is questionable.

HUD needs to make sure the proposed rules will benefit consumers, certainly not make them worse off. Before embarking on a policy change with such far-reaching impacts, HUD needs to demonstrate that these rules do not have the strong potential for raising consumer costs and reducing competition. The analysis HUD has presented so far does not make the case.

The purpose of this paper is not to find fault with the economic analysis, but to point out the many additional risk factors that were not presented in the original study. Usually, there exist both pros and cons to any proposed policy change. Emphasis on only one side (the pros, or expected benefits) without properly considering the other side (the cons) could lead to the potential risk of achieving results that are the opposite of what the policy originally intended. This paper raises additional issues that demand careful consideration before proceeding with the proposed rules.

II. Review of HUD's Key Economic Assumptions

A. Background on Primary, Secondary Markets and how Pricing Works

Market Players at the Retail and Loan Origination Level

Mortgage brokers are one of several market participants in the mortgage market. Brokers have arranged for the financing of approximately sixty percent of loans in recent years and also have accounted for over fifty percent of loan volume per year for much of the past decade. Borrowers who do not deal with brokers typically deal with loan officers at thrifts, banks and mortgage bankers.

Consumers also deal with real estate brokers and settlement service providers such as settlement attorneys, inspectors and title insurers. Thus, between the buyer and seller of a financed property, there are a myriad of fees that must be paid for, including:

1.Realtor's commissions
2.Settlement Services
3.Direct Origination fees charged by the Originator
4.Direct Origination fees charged by the Mortgage Broker
5.Discount Points

It is not clear at the initiation of a sale (when a sales contract is signed), nor when a loan application is submitted, exactly which party will pay for these costs. Typically, the seller pays realtor's commissions and the buyer and seller pay for specific shares of settlement services according to law and custom, with the dominant share of settlement costs paid by the buyer. However, it is not unusual for the buyer and seller to negotiate arrangements where a seller pays certain origination fees or adjusts the purchase amount (and thus the loan amount) to facilitate the sale of a property. Additionally, the lender or broker may often contribute points, or fractions of points, or the realtor may give back part of his/her commission to make up for settlement costs or other amounts to facilitate the sale of a property. In choosing a change to RESPA, HUD should take care not to create obstacles to an existing system where several parties at the settlement table are able to contribute or adjust fees or prices that make a sales transaction possible and are in the best interests of the consumer (both the buyer and seller of a home).

Fee items 3, 4, and 5 on the list above may also be closely related to the contract interest rate on the loan. The contract interest rate on the loan must be sufficient to cover: 1) the required interest rate passed through to the ultimate holder of the loan, *required for a loan of that type*; 2) the cost of servicing the loan; 3) any type of additional financed mortgage insurance (mortgage insurance that is paid upfront does not become a factor in the contractual rate.)

Loan originators are compensated by receiving origination fees from the borrower plus possible so-called gains on sale from selling the loan. If the loan originator does not sell the loan, the originator receives no compensation other than direct origination fees. Originating a loan for resale also creates servicing fee income, but when measured separately from the value of

servicing created, loan origination can be a zero profit or even money losing exercise for many originators. For many small lenders, the premium they receive for selling loans to larger firms on a "servicing released"[1] basis is the only substantial revenue they receive from originating a loan and selling it into the secondary market.

Pricing of Loans

Given the multitude of loan programs, risk-based pricing, and secondary market investors, there is no such thing as *par pricing* or a *par interest rate* in the mortgage market. One of the reasons that there has been a proliferation of brokers over the past ten to fifteen years is the increasing securitization of mortgages and unbundling of the financial components of lending makes pricing differentials more common, and borrowers need assistance in seeking out these pricing differentials. For example, unlike a corporate bond where the par value is easily discernable based on the contract interest rate, a retail mortgage includes a variety of cashflows and market participants are willing to pay either more or less than the sum of these cashflows as a market price for the mortgage. Although there are figures that are widely quoted as minimum required yields on mortgages delivered to large secondary market agencies, these yields reflect pricing that is net of the cost to service mortgages, the credit cost of the mortgage (the guarantee fee and/or mortgage insurance fee), and other specific loan-based pricing.

The secondary mortgage market drives pricing (yields) in the secondary and primary mortgage market. Secondary market pricing for mortgage loans varies based on such factors as: the loan-to-value ratio of the loan (the loan amount as a share of home value), the size of the loan, the credit score[2] of the borrower, the level of documentation in the underwriting file and the geographic location of the loan. Among other things, mortgage investors will pay more for lower loan-to-value ratios, bigger loans (up to a certain size), better credit scores, and more thorough documentation. This willingness to pay a higher or lower price (demand a lower or higher yield) is the primary determinant of contractual interest rates. It is precisely because investors (or giant mortgage finance companies) have differentiated prices for different types of loan products that mortgage brokers have been able to create a market niche.[3]

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[1] Selling a loan "servicing released" means the seller of the loan sells all his interest in the loan and will no longer collect payments from the borrower. This function will be passed on to a wholesaler or large mortgage firm that will likely retain the servicing rights, and sell the underlying loan, "servicing retained" to a secondary market investor such as Fannie Mae or an MBS Trust, and continue to earn servicing fees for servicing the loan on the investor's behalf. The value of a servicing released premium (SRP) typically varies around 1-1.5% of the loan amount and economically, represents the capitalized value of expected profit from servicing fees over the life of the loan. Thus, total compensation to a lender who sells loans into the secondary market is composed of: origination fees; gain/loss on sale (if applicable): and either the retention of a mortgage servicing asset or receipt of payment for a servicing-released premium. These three components of a secondary market transaction create revenue for the lender/originator, but do not necessarily indicate that the loan origination and sale is, on net, profitable.

[2] The FICO score, from Fair Issac & Co. is the most commonly used credit score.

[3] It is a common misunderstanding that a loan has to meet only one underwriting hurdle for acceptance by Fannie Mae or Freddie Mac. The two agencies negotiate pricing (guaranty fees) with their largest customers based on the volume and quality of loans delivered. Although Fannie and Freddie will offer lenders a yes/no grade on whether a loan is acceptable, that lender's ultimate cost of doing business with the agencies will vary based on the type and quality of loans delivered - essentially what is known as risk-based pricing. Lenders who sell loans to private conduits (other than Fannie and Freddie) or issue their own private-label MBS immediately see the pricing effects of the loan-level characteristics.

In addition to the yield that the mortgage investors require, the borrower's contract interest rate must cover the cost of servicing the loan and the market's perceived cost of the interest rate risk inherent in the loan (the risk that the prepayment option will be exercised by the borrower). The value of receiving fees to service a mortgage is a financial component of the mortgage transaction that is recognized separately from other aspects of the lending business. This unbundled financial component[4], the mortgage servicing right (MSR), is also highly variable, and depends on factors such as the loan size and the geographic location of a mortgage.

Funding of Loans and the Connection between the Retail Originator and the Secondary Market

Once a loan is ready to close (at settlement), the loan must be funded. In most broker transactions the broker will use table funding, where an originator funds the loan in the originator's own name, not in the name of the broker. The originator (often referred to as a wholesaler) will pass through to the broker some of the value derived from the characteristics of that particular loan and its associated servicing as part of the compensation for the mortgage broker's origination efforts plus the value of the cashflow of the loan. For example, a wholesaler might pay premium pricing for loans with larger than average loan balances, lower than average LTVs, or borrower credit quality that is better than average. All of these factors may make the loan more salable or salable at a higher price to a secondary market investor. Some wholesalers are able to get superior pricing and execution when they sell to their MBS investors and know that they can sell loans into the secondary market at what are, on average, premium prices, so they are willing to pay premium pricing to attract loans from brokers or correspondent lenders that can deliver preferred loans to the wholesaler.

The fact that a wholesaler or other originator is willing to pay premium pricing does not mean that a broker is receiving an unlawful yield spread premium. The premium is to compensate for services, goods, and facilities that would otherwise be directly charged by the originator. A "yield spread" is by definition a yield that is above the prevailing market rate *for that kind of loan.* Not all loans are alike and thus there is no prevailing "par" yield for a loan. The issue of YSPs and RESPA arises when a premium is "unearned". If the premium is used to compensate the broker for services for which the borrower may otherwise have had to pay the broker, or where the borrower would have otherwise had to pay direct origination fees, the premium is unexceptional. Borrowers use brokers to find suitable loans at competitive rates. Originators/wholesalers use brokers to market loans to borrowers as well as to perform origination functions, usually at a lower cost than the originator could do themselves. Thus, the revenues of a broker are earned from both the borrower and the originator for helping the borrower search for a competitive loan and for performing marketing and origination services that the originator/wholesaler would otherwise pay. The "YSP" portion of this revenue is earned.

It should be noted that using brokers is only one option under the current market structure. The price shopping service provided by a broker can still be done by the borrower him/herself. The fact that over half of the borrowers use brokers over the last ten years, and this portion continues

[4] Accounting rules for mortgage finance recognize the financial components approach to mortgage banking and require a breakdown of the total cost of a loan into a loan amount, mortgage servicing right, and a gain/loss on sale. See Financial Accounting Standards Nos.122, 125 and 140, Financial Accounting Standards Board.

to grow, is an indication that the time, effort, and pricing advantages from hiring a broker outweigh the compensation to be paid.

It is a mistake to assume that any brokered loan where the broker receives a premium is a YSP loan.[5] HUD's proposed rule will define the par value of a loan as the loan's principal amount. Such a definition of a par amount will contribute to misleading calculations of YSPs and may in fact create more confusion about what is or is not an unearned payment for settlement and closing services.

In addition to finding pricing packages (combinations of contract rates, points, etc.) on behalf of borrowers, mortgage brokers exist in the market because they have a cost structure that is lower than typical originators. In several studies of the profitability of mortgage banking, the use of brokers is the second most profitable origination channel for large lenders (though by far the largest in terms of dollar volume). The originators are able to fund loans and pay small fees, including pass through of premium prices to mortgage brokers, to compensate the brokers for work that would cost the lender even more if done in-house. For comparison, one recent survey showed that the all-in cost (to the originator) for the production of a retail loan (in-house) was three times higher than for using brokers.[6] Even after allowing brokers to retain a considerable share of the revenue from the origination, (fees and premium payments) the profitability of using brokers remained compelling to the originators' lender and still more profitable than some alternative loan production channels that originators use.

Originators thus lower their costs or increase their market share by using brokers. Another advantage to lenders of using brokers is that the origination firm will not have to hire and fire additional staff or close offices if market volume changes drastically. Mortgage brokers allow large and small lenders to lower both their fixed and variable costs of originating loans.
A synergy has developed over the last 10 to 15 years where many lenders allow brokers to bring them business and perform pre-funding functions. Direct origination fees charged by lenders have fallen dramatically during this period.

The relationship between the contract yield and origination costs, including discount points, has been a research topic over the past 15 years and is still an ongoing debate among the most prominent academic researchers.[7] Both contract yield and original costs are different forms of price paid for borrowing the mortgage loan. The most influential factor being discussed in the literature is the borrower's expected tenure in the mortgaged house. Other important factors include the interaction between the market interest rate trend and volatility, the transaction cost of acquiring a refinancing loan, the borrower's credit quality, etc. Although the qualitative results of the recent academic papers are similar, the quantitative tradeoff relationship between the rate and points deviate substantially. That is, models of the ratio of changes in points to

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[5] One analysis by a plaintiff's consultant (see Jackson and Berry 2003) indicated that 85% of loans in their sample contained yield spread premiums. If mischaracterized based on comparison with an inappropriate "par" price it is easy to claim that a very large share of brokered loans involve YSPs, but one would need to do very thorough research of a large sample of loans, including their associated fees as well as the loan and borrower characteristics, before drawing a valid conclusion regarding the pervasiveness of YSPs.
[6] For example, see Stratmor/MBA 2001
[7] For example, Brueckner (1992), Yang (1992), Bird, Burton and Platau (1996), McMuray and Thompson (1997), Stanton and Wallace (1998), Johnson, Anderson and Webb (2000) etc.

changes in contract rates produce different results. In order to have an accurate estimate of the proper substitution factor, complicated option pricing models are required. Since there is no one universally accepted "correct" pricing model for mortgage contracts, lenders depend on their own best effort to develop contract offer lists to compete in the open market. Meanwhile, because the "correct" yield-points tradeoff formula is not available, it is almost impossible to come up with a reasonable measurement of the YSP based on HUD's definition.

B. HUD Analysis - Effect on Pricing Due to Proposed Rule

B1.GFE Alternative

Offering a YSP estimate (as well as a GFE of other origination fees) with inadequate information to analyze the borrower could create incentives for higher *offered* pricing. HUD's Analysis states that "(e)very application under the proposed rule will require preliminary underwriting."[8] This preliminary underwriting will have to be much more extensive than a typical pre-approval, since the GFE creates binding obligations with minimal or zero tolerance. Since total pricing of a loan package is driven by which loan sales program the borrower's loan is eligible for, the originator/broker may have inadequate information to price/underwrite the loan including factors such as PMI, which can vary substantially. Short of receiving a fee that covers at least the preliminary underwriting costs, the originators will be taking more risk and receiving less compensation for each new GFE. Thus, the economic incentive is for higher offered pricing.[9] Since originators will be making a firm commitment to borrowers they have not underwritten and they are not being compensated up front for any additional risk to protect themselves from losing money, the result will be a higher offered price under the assumption that the loan is an inferior one and would cost more to underwrite. This behavior is referred to as adverse selection and is explained in more detail later in this comment paper. Additionally, since many combinations of interest rates and points are driven by borrower credit and underwriting criteria that are only known after more due diligence of the borrower's application, above average borrowers will suffer from being offered GFEs that do not reflect their most advantageous pricing combinations available and this will result in reissuances of revised GFEs, a cost that lenders will pass through to borrowers.

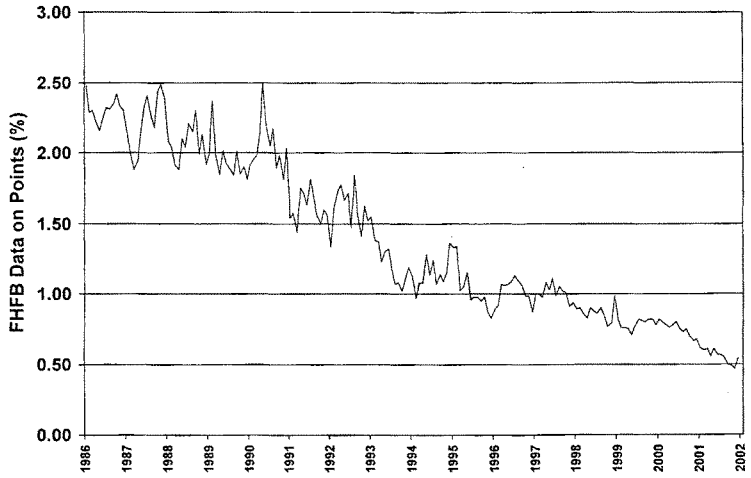
Calculating a YSP as pricing received by the broker that is above the contract principal of the loan may diminish the use of YSPs, but is likely to increase other direct origination fees for originators that capture this business. The new rule will require brokers to provide a breakout of

[8] See page 49 of July 2002 Economic Analysis.

[9] In finance theory, a strategy that produces a more positive outcome will dominate other strategies with negative outcome. In this case, the two strategies are to offer a GFE that attempts to reflect *exactly* what costs are, and run the risks of underestimating the costs, versus offering a higher cost than expected and face no downside risk if the costs are higher than expected (but not higher than offered in the GFE). The later strategy of offering a higher offered GFE is said to "stochastically dominate" from the originator/broker's perspective. This divergence of interests between the originator/broker (as agents) and borrower (as principal) is referred to as agency cost in finance literature.

certain payments they receive, so-called yield-spread premiums, when giving a GFE. Under this new arrangement, unfortunately, when given two identical mortgage origination options with two loans driven by identical secondary market-driven pricing, the borrower might mistakenly assume that an originator's GFE with an origination fee that includes the equivalent dollar cost of a YSP is more advantageous than a broker's GFE where the YSP is "credited to the borrower". Again this would be despite the two pricing packages being otherwise economically identical. Additionally, under the proposed rule, the APR estimate will reflect an inclusion of a "YSP" so brokers will be doubly penalized by the misimpression that the lender is giving away the borrower's money to a broker and that brokered loans have higher APRs. This creates a strong incentive for borrowers to decline broker offers and for lenders to substitute other origination channels for the use of brokers and consequently to increase their direct origination fees, returning to a market where "points" are higher. See Exhibit 1 for a graphic description of points charged to borrowers over a recent fifteen-year period as the use of mortgage brokers has increased.

Exhibit 1: Decline in Origination Points



Our analysis assumes that direct origination costs will increase significantly[10], and that HUD's estimates of consumer savings from increased YSPs "passed through to borrowers" may be significantly less than estimated, since the use of brokers (and YSP dollars available) will drastically diminish. See Exhibit 1, Scenario 1 for the effect of these alternative assumptions.

[10] We estimate an increase of 28 basis points in origination points. This is less than the 29 basis point standard deviation of points charged to borrowers on conventional loans according to data for the most recent 10 year period available (December 1991-2001) from the Federal Housing Finance Board's Mortgage Interest Rate Survey (MIRS).

Another important consumer consequence of higher points is that the down payment required would be much higher. For a 97% LTV loan, the borrower only needs to save 3% of the house price to make the purchase. If the loan now comes with two points, the time required to save the down payment would almost be doubled. This could seriously hurt the home affordability for households with limited wealth.

Exhibit 2, Scenario 1 Analysis

GFE COSTS AND BENEFITS UNDER ALTERNATIVE SCENARIOS
figures in millions

HUD Estimate	
Pricing Effects	
YSPs passed through to borrowers	$3,750
originators direct fees passed to borrowers (based on 5% of $15B)	$750
Reduction in TSP fees (based on 10% of $18B)	$1,800
Total transfers to borrowers	$6,300
Efficiencies	
Borrower Time spent shopping for loans and TSPs (based on one hour reduced shopping time for originator; 15 minutes reduced shopping time for TSP)	$826
TSP reduced time spent with shoppers, etc	$350
Loan Originators' reduced time spent with Borrowers (based on 30 minutes less time with customers; plus driving out less efficient operators)	$1,280
Cost to originators (extra 10 minutes to handle forms)	($226)
Add: additional cost of hedging new, multiple GFEs	$0
Cost to originators to make third part arrangements (10 hours per year)	($39)
SUBTOTAL: Efficiencies for Borrowers	$826
SUBTOTAL: Efficiencies for Businesses	$1,365
TOTAL EFFICIENCIES	$2,191
Note: Total Transfers to Borrowers and Borrower Efficiencies	*$7,665*

Alternative Estimate	
Pricing Effects	
YSPs passed through to borrowers assuming half of YSPs disappear	$1,875
originators direct fees passed to borrowers (based on 5% of $20B)	$1,000
net additional direct fees to borrowwers	($4,000)
Reduction in TSP fees (based on 5% of $18B)	$900
Total transfers to borrowers	($225)
Borrower Time spent shopping for loans and TSPs (based on one hour increased shopping time for originator; 30 minutes increased shopping time for TSP)	($991)
TSP reduced time spent with shoppers, etc	$350
Loan Originators' reduced time spent with Borrowers (based on 60 minutes more time with customers; plus driving out less efficient operators)	($1,360)
Cost to originators (extra 60 minutes to handle forms)	($1,356)
Add: additional cost of hedging new, multiple GFEs based on 10 percent increase in notional, 50bps	($750)
Cost to originators to make third part arrangements (40 hours per year)	($156)
SUBTOTAL: Efficiencies for Borrowers	($991)
SUBTOTAL: Efficiencies for Businesses	($3,272)
TOTAL EFFICIENCIES	($4,263)
Note: Total Transfers to Borrowers and Borrower Efficiencies	*($3,497)*

The risk is clearly there that borrowers may be mislead into choosing originator loans with higher costs over brokered loans simply because they are put off by the characterization of the YSP as a "lender payment to the borrower", as well as by the APR double-counting. In the HUD economic analysis, the authors argue that "The borrower's awareness of the trade-off is likely to be enhanced under the new rule *if the borrower applies for a loan with even one broker.*"[11] (*emphasis* added). If however, the borrower never comes in to contact with a mortgage broker, because fewer of them will be in business should this new rule take effect, then the average borrower may be entirely unaware that a direct origination charge that is at least as high as, or higher than, what might have been a broker's "YSP", is now built into the package of origination prices and interest rates they are offered in a non-broker originator's new GFE. HUD concedes that "(t)he new GFE broker requirements that treat brokers and lenders differently may result in misinterpretations of the loan fees"[12]. What the analysis does not examine is that the total cost of origination is as likely to remain the same despite the proposed regulatory changes and the net effect of the new "YSP" treatment would simply be to transfer revenue from brokers back to originators with no benefit, and perhaps even with an increase in costs, to consumers in the long run.

In requiring a breakdown between a market interest rate and other origination costs, including so-called YSPs, the new GFE may make shopping for rates and origination fees points more confusing. There is no "par" market interest rate. Interest rates on mortgages vary for many reasons including the value of mortgage servicing rights, the credit quality of the borrower and what mortgage investors' expectations are regarding prepayments of mortgage debt. The matrix of interest rates, origination fees, and other origination costs (including so-called YSPs) varies daily and often more than once a day. Additionally, pricing (rates, points, YSPs) can vary geographically (by state and metropolitan area) and by lender. If an originator/broker provides an applicant with a pricing matrix, that pricing matrix may not be comparable to other lender's loan programs. One lender may have a preference for receiving origination fees and offering lower rates. As explained earlier, the tradeoff between rate and points is a difficult matter. The rules of thumb frequently used in the industry can foster misleading decisions. Presenting the entire pricing matrix (s) to a borrower without help from financial experts can simply cause confusion and frustration.

One of HUD's objectives is that consumers/borrowers "fully understand the trade-offs between reducing their closing costs and increasing the interest rate on the mortgage". The benefits of trade-off between closing costs (or discount points) and contract rates is a complex issue that depends on many factors including: the borrower's expected tenure in the home/mortgage, prepayment penalties and interest cost of financing closing costs versus cost of using borrower's cash reserves. It has been an academic research topic for the past ten years and the research is still on going. The new GFE as described will not accomplish this goal.

If the new GFE requires quoting a rate in combination with origination fees, plus "YSP", plus APR, there are dozens of combinations of pricing available. If the borrower "shops" this matrix of rate/points/YSP to other originators they may not offer a directly comparable matrix of quotes.

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[11] See page 45 of July 2002, Economic Analysis
[12] See page 33 of July 2002 Economic Analysis.

This increases borrowers' shopping costs and may actually make pricing less transparent to borrowers. Additionally, if a group of lenders acts to offer identical matrices of rate/points/YSP, this may create collusion in pricing in some markets.

Originator negotiations with TSPs (in anticipation of providing GFEs to borrowers) regarding other settlement services may lead to "worst case" offered pricing by many TSPs and originators. Since tolerance is either zero or 10% of the GFE amount, the new requirements may create a common practice of originators and TSPs setting offered GFE prices high enough to cover the increased risk and then informing the borrower that the ultimate price at settlement may be, or is likely to be, lower. Since the penalty only arises from exceeding the GFE tolerances, this proposed rule could create a situation where it becomes relatively common practice to set pricing higher and crediting to the borrower any realized lower prices at settlement. Thus, the borrower may end up receiving estimates of prices that have been driven up by a new regulatory regime and they still will not have a clearer idea of what will be their final settlement cost.

Let's assume that all originators/brokers will start out to charge the borrower a lower fee if the loan turns out to be of commensurately better quality (e.g., easier to underwrite, sell forwards and perform settlement services), and underwriting and settlement costs are lower than originally estimated. Under this assumption, the original cost quoted in the RESPA proposal under either GFE or even the GMPA is only a "maximum" price instead of the "best estimate" of the cost. The end result is likely to be that, initially, the most risk-taking originators will get most of the business, but these firms too may go out of business and leave the market to firms that set offered pricing higher. Increasing the ability to shop for the "maximum" cost may not be more meaningful to consumers than the ability to shop for the "most likely" cost.

B2.GMPA Alternative

The lack of an application fee and inclusion of an Interest Rate Guarantee create a very strong economic incentive for adverse selection, i.e., "worst-case" pricing. We would anticipate that with the adoption of GMPA, the use of brokers will decrease markedly or brokers would become part of lender-dominated business consortia, perhaps funding using warehouse lines from the lender in the packaging group. Thus, the dollar amount of so-called YSPs that are available to be "passed through to borrowers" in HUD's analysis of the GMPA would be considerably smaller. Exhibit 2, Scenario 1 estimates that the amount of YSP returned to borrowers will be half as much as in the HUD estimate because the market structure will almost eliminate the existence of YSPs and of brokered transactions.

Originators/brokers will not be able to charge a fee for offering a GMPA estimate, thus creating incentives to build up other costs of the total package. Combined with the lack of competition from brokers both from the new GFE rules and the creation of packagers, strong incentives exist for packagers to take loan origination and marketing in-house. We would anticipate that direct origination costs (origination points) would rise back from their recent 10 year average, to a level

of about one point. Thus the direct origination costs in the alternative analysis shown in Exhibit 2 Scenario 2 rise significantly.

The interest rate guarantee is non-feasible: there is no "par" market interest rate or index that is hedgeable. Since the GMPA is a binding application, lenders face the risk of having to fund more loan commitments. Additionally, since getting a GMPA estimate from a lender is intended to be a "free" service made available to borrowers, there will be a strong tendency for borrowers to have multiple applications outstanding. Even if a substantial number of the applications do not rate lock, lenders will face considerable funding and interest rate risk and will require compensation for this risk at some point in the transaction. This cost is another factor in our analysis' assumption that pricing for origination services will rise as per the previous paragraph.

Pricing offered from large packagers to smaller settlement service firms may reduce prices in the short run, but this may be a short-lived phenomena as smaller firms are driven out of business. In Exhibit 2 Scenarios 2 and 3, we present 2 cases: Scenario 2, where the formation of packagers reduces TSP costs in the short run as negotiations for packaging prices reduces costs to consumers, and Scenario 3, which shows a much smaller benefit to borrowers from reductions in service providers' prices. Even in Scenario 2, the analysis anticipates a smaller reduction in TSP costs than does the 20% reduction in the HUD Economic Analysis. It is more difficult to estimate the impact of price increase in the long run due to the less competitive market structure after the business consolidation into packagers. There exists a non-trivial probability that the long-term net effect could be a cost addition to consumers rather than a cost reduction.

Exhibit 2, Scenario 2 Analysis

GMPA COSTS AND BENEFITS UNDER ALTERNATIVE SCENARIOS
figures in millions

HUD Estimate		
Pricing Effects		
Transfers to Borrowers from Originators		$6,700
comprised of:		
YSP passethrough (new GFE plus 10%)	4500	
reduction in direct origination fees	2250	
Transfers to Borrowers from TSPs Reduction in TSP fees (based on 20% of $18B)		$3,600
Total Transfers to Borrowers		$10,300
Efficiencies		
Borrower Shopping Time for Originator based on one hour less shopping fime		$1,322
Borrower Shopping Time for TSPs		$330
Cost to Borrowers of Lower Quality and Fraud		$0
Loan Originators reduced time spent with Borrowers (based on one hour less time with customers)		$1,360
TSP reduced time talking with Borrowers (based on 15 minutes less time with customers)		$340
Effect on Less Efficient firms (based on 2% of origination fees) more efficient TSPs	 $600 $360	$960
Reduced Time seeking Vulnerable Borrowers		$600
Benefits of Average Cost Pricing		$150
Originator Cost of Hedging Interest Rate Guarantee		$0
SUBTOTAL: Efficiencies for Borrowers		$1,652
SUBTOTAL: Efficiencies for Businesses		$3,410
TOTAL EFFICIENCIES		$5,062
Note: Total Transfers to Borrowers and Borrower Efficiencies		$11,952

Alternative Estimate Estimate 1 (short run scenario)		
Pricing Effects		
Transfers to Borrowers from Originators		($1,300)
comprised of:		
YSPs passed through to borrowers (assuming half of YSPs disappear)	$2,250	
reduction in direct origination fees	$2,250	
net additional direct fees to borrowwers	($5,800)	
Transfers to Borrowers from TSPs Reduction in TSP fees (based on 10% of $18B)		$1,800
Total Transfers to Borrowers		$500
Efficiencies		
Borrower Shopping Time for Originator based on one hour MORE shopping time		($1,322)
Borrower Shopping Time for TSPs		$330
Cost to Borrowers of Lower Quality and Fraud		($667)
Loan Originators reduced time spent with Borrowers (based on one hour MORE time with customers)		($1,360)
TSP reduced time talking with Borrowers (based on 15 minutes less time with customers)		$340
Effect on Less Efficient firms (based on 2% of HUD origination fees) more efficient TSPs (5% savings)		$780
Reduced Time seeking Vulnerable Borrowers		$0
Benefits of Average Cost Pricing		$150
Originator Cost of Hedging Interest Rate Guarantee (assuming added 5 bps of basis risk)		($750)
SUBTOTAL: Efficiencies for Borrowers		($1,659)
SUBTOTAL: Efficiencies for Businesses		($840)
TOTAL EFFICIENCIES		($2,499)
Note: Total Transfers to Borrowers and Borrower Efficiencies		($1,159)

Exhibit 2, Scenario 3 Analysis

GMPA COSTS AND BENEFITS UNDER ALTERNATIVE SCENARIOS
figures in millions

HUD Estimate		
Pricing Effects		
Transfers to Borrowers from Originators		$6,700
comprised of:		
YSP passethrough (new GFE plus 10%)	4500	
reduction in direct origination fees	2250	
Transfers to Borrowers from TSPs		
Reduction in TSP fees		$3,600
(based on 20% of $18B)		
Total Transfers to Borrowers		$10,300
Efficiencies		
Borrower Shopping Time for Originator		$1,322
based on one hour less shopping fime		
Borrower Shopping Time for TSPs		$330
Cost to Borrowers of Worse Quality and Fraud		$0
Loan Originators' reduced time spent with Borrowers		$1,360
(based on one hour less time with customers)		
TSP reduced time talking with Borrowers		$340
(based on 15 minutes less time with customers)		
Effect on Less Efficient firms		$960
(based on 2% of origination fees)	$600	
more efficient TSPs	$360	
Reduced Time seeking Vulnerable Borrowers		$600
Benefits of Average Cost Pricing		$150
Originator Cost of Hedging Interest rate Guarantee		$0
SUBTOTAL: Efficiencies for Borrowers		$1,652
SUBTOTAL: Efficiencies for Businesses		$3,410
TOTAL EFFICIENCIES		$5,062
Note: Total Transfers to Borrowers and Borrower Efficiencies		*$11,952*

Alternative Estimate Estimate 2 (long run scenario)		
Pricing Effects		
Transfers to Borrowers from Originators		($1,300)
comprised of:		
YSPs passed through to borrowers	$2,250	
(assuming half of YSPs disappear)		
reduction in direct origination fees	$2,250	
net additional direct fees to borrowwers	($5,800)	
Transfers to Borrowers from TSPs		
Reduction in TSP fees		$900
(based on 5% of $18B)		
Total Transfers to Borrowers		($400)
Efficiencies		
Borrower Shopping Time for Originator		($1,322)
based on one hour MORE shopping time		
Borrower Shopping Time for TSPs		$330
Cost to Borrowers of Worse Quality and Fraud		($667)
Loan Originators' reduced time spent with Borrowers		($1,360)
(based on one hour MORE time with customers)		
TSP reduced time talking with Borrowers		$340
(based on 15 minutes less time with customers)		
Effect on Less Efficient firms		$300
(based on 1% of HUD origination fees)	$300	
more efficient TSPs (0% savings)	$0	
Reduced Time seeking Vulnerable Borrowers		$0
Benefits of Average Cost Pricing		$150
Originator Cost of Hedging Interest rate Guarantee		($750)
(assuming added 5 bps of basis risk)		
SUBTOTAL: Efficiencies for Borrowers		($1,659)
SUBTOTAL: Efficiencies for Businesses		($1,320)
TOTAL EFFICIENCIES		($2,979)
Note: Total Transfers to Borrowers and Borrower Efficiencies		*($2,059)*

C. HUD Analysis - Effect on Efficiency Due to Proposed Rules

C1.GFE Alternative

Counter to the incentives created by the new GFE, HUD assumes that borrowers and originators and TSPs spend less time per loan application. HUD's analysis assumes borrowers save 45 minutes each, while originator/brokers and TSPs are projected to save a combined 75 minutes per loan. This result does run counter to the economic incentives created by a regulatory requirement that requires loan offerors to provide a GFE with minimal tolerance for errors in pricing and an accurate categorization of all the myriad closing options to the borrower. The new GFE will require significantly more originator time as well as time from TSPs. HUD requires[13] that the originator or broker fully explain the option of paying higher interest rates (YSPs) or reducing the interest rate by paying discount points. Elsewhere we have discussed the complexity of the trade-off of yield for origination points, YSPs, and discount fees with respect to the contract interest rate. Additionally, the GFE must contain an APR calculation and an accurate estimation of the loan amount upon which the loan amount is calculated (this amount will vary to the extent that the borrower finances certain settlement costs or insurance.) It is utterly unreasonable to suspect that the time spent per loan by originators/brokers could be reduced. The alternative analyses in Exhibit 2 instead, assumes a one hour increase in originator/broker time spent to accommodate the effect of more time face to face with applicants and the effects of multiple application (across originators) by the same borrower, plus a half hour increase in TSP time spent per borrower to choose among several complex contracts offered by multiple lenders, both of which are very conservative estimates of the additional time requirements of the rule. Obviously, if it takes the originator/broker and third party service providers more time to work with clients, it will also require more consumer time.

HUD assumes a reduction in consumer time spent shopping; we predict an increase. Additionally, with the minimal cost to the consumer of obtaining a GFE[14], consumers are highly likely to shop more - an outcome the new rule wants to encourage. We would anticipate an increase in shopping costs as well as originator and TSP time spent per transaction. This is almost sure to happen whether or not the market share moves away from brokers and YSPs as a form of compensation and towards other originators or users of direct origination fees.

The GFE form, which will include a YSP estimate (if applicable), interest rate, origination fees, APR, mortgage insurance costs will require more calculation time. The increase in time required to fill out the forms is due to the increased number of items to be calculated as well as the zero and 10% tolerance, which will require a much more careful assessment of all of the aspects of the GFE. As noted in the B.1 discussion of the pricing effects of the new GFE, if the incentives created by the rule lead to a common practice of simply offering higher prices/costs and making downward adjustments at settlement, the effect of the new rule will be not only an increase in the amount of time required to create the new GFE, but also more time spent in doing paperwork at settlement, thus leading to even further inefficiencies in the origination and settlement service market, costs that consumers are likely to eventually bear. The alternative estimate shown in

[13] See I.B, "Shopping Benefits" of HUD's July 2002 Economic Analysis.
[14] HUD Proposed Rule states "HUD would prefer that originators not impose any charge for a GFE ... to further facilitate shopping" Page 49150, Federal Register, Monday, July 29, 2002.

Exhibit 2, Scenario 1 only shows the impact of more time spent on the new GFE form. No additional cost is included for higher paperwork costs at closing.

Costs to lenders of offering GFEs with minimal fee payments by the borrower will result in multiple "applications" outstanding, increasing hedging costs for originators. Due to the nature of the required disclosures in the new GFE, the redefinition of what constitutes an application, and the "redisclosure" requirements of the new GFE alternative, borrowers are likely to seek more GFE estimates - an outcome HUD wants - and there will thus be a significant increase in outstanding applications. The HUD economic analysis notes this is likely to happen[15] but assumes a zero cost by stating that there will be a reduction in the number of loans where loan applications are made but not closed. Loans fail to close for many reasons, including sales that do not occur due to inspection problems, seller's failure to get financing and unforeseen borrower financial problems. There is no reason to believe that the extent of these events will be changed by the new GFE requirements. However, it is quite likely that borrower may have two or three simultaneous applications (or more) where previously they had one. Originators will avoid the cost of having to hedge these additional applications and typically try to only hedge loans that are expected to "pull-through" the application pipeline. However, given the sheer size of the increase in notional dollars of loan applications, lenders will have a difficult time accurately hedging their exposure to what are firm commitments to extend credit. Such newly created hedge costs would eventually be transferred to and paid for by consumers. This impact could be even more severe because it could increase the riskiness of the market for "TBA" secondary mortgage market products and cause mortgage lender's funding costs to rise. The analysis in Exhibit 2 Scenario 1 assumes that originators will hedge an additional ten percent of the notional amount of loans in HUD's baseline case.[16]

The GFE may encourage consumer/borrower shopping for financing and settlement services but may to some extent hinder shopping and negotiation for the best combination of home price in combination with financing, settlement and closing costs. The requirement of offering the new GFE will sharply curtail the current practice of "pre-approval", where a borrower/potential buyer comes to a broker or originator to get an estimate or indicated price of how much financing they can afford. Armed with this "pre-approval" information, potential buyers look for homes within these financial parameters. A homebuyer's (and seller's) willingness to change the terms of a transaction is subject to changes in the bargaining and pre-closing process. Under the proposed GFE rule, the originator must have a specific loan in mind when giving a potential buyer/borrower a GFE, including a specific down payment amount, loan amount, etc. The use of the new GFE may thus give buyers/borrowers a misleading impression of the amount of room for negotiation in a real estate transaction to share the burden of settlement costs and direct closing costs between the buyer, the seller, the originator/broker, and even the realtor. Ordinarily, a mortgage broker might explain to a potential buyer the way to negotiate for the best

[15] HUD's Economic Analysis states, "It is simply unknown how many additional GFEs the average borrower would get under the new rule." page 49 of July 2002 document.

[16] Based on a $1.5 trillion of loan production, or hedging an additional $150 billion of notional value of loan applications at a cost of 50 basis points.

price of the home in tandem with obtaining the best financing and settlement services, but under the new GFE regime brokers and originators will have stronger incentives against doing so. Thus, while the revisions to RESPA *might* help borrowers shop more effectively for financing and settlement services, the new rules may actually hinder buyer's bargaining power in buying the house in the first place, and the cost of the house is a much more significant expense than the cost of the financing or settlement services.

C2.GMPA Alternative

Counter to the incentives created by the new GFE, HUD assumes that borrowers and originators spend less time per loan application. However, borrowers, and originators are likely to spend more time in the shopping process. HUD's analysis assumes borrowers save one hour each, while originator/brokers are also expected to save one hour of time per borrower. This result runs counter to the economic incentives created by the GMPA alternative, which provides a free 'shoppable' package to the borrower. If the borrower is to compare what is supposed to be a straight-forward quote of terms then the borrower would seek the best terms. This equates to more borrower shopping time at various originators or other packagers and consequently means more time spent by originators in dealing with borrowers and providing them with GMPA. While the increase in borrower shopping time may be a good thing - *if* it leads to pricing decreases - there will certainly be more, not less, of it. The alternative analyses in Exhibit 2 Scenarios 2 and 3 instead, assume a one hour increase in originator/broker time spent, plus a one hour increase in borrower shopping time, both of which are very conservative estimates of the additional time requirements of the rule.

The effect on less-efficient firms may be overstated. Implicit in HUD's expectation of efficiency gains is that competition among smaller firms to be included in a settlement service package will drive down not only the prices they charge but will drive inefficient firms out of business. Since it is difficult to discern the difference between inefficiency and the ability to offer satisfactory services at a negotiated price, it is not clear how extensive economies of scale and scope will be under a GMPA market environment. Perhaps there may be some double counting of efficiencies between HUD's estimates of reduced TSP fees and efficiencies from the elimination of "inefficient" firms. This problem is closely related to how much TSPs will be willing or able to reduce their prices. Even if large lenders are able to attempt to offer "bulk purchasing," can the cost of small-scale services such as appraisals and home inspections be reduced significantly? The economic analysis shown in Exhibit 2, Scenarios 2 and 3 show a declining effect from the elimination of "less efficient firms". Again, many small settlement service providers are tiny businesses and the revenues are comparable to salaries received by employees of larger firms, i.e., they offer little or no economic profit to the small firm. It is unlikely that pricing can be squeezed out of these firms for an extended period of time until larger market participants with stronger negotiating power replace them within package providers and TSP fees go back up under a less competitive market structure.

Our analysis makes no provision for a $600 million efficiency savings for industry members from not "seeking out vulnerable borrowers for abusive loans"[17] as a result of using the GMPA. While any activity that results in abusive loans is reprehensible, such acts are very much the exception to standard practices. The notion that firms spend $600 million seeking out vulnerable borrowers is an assumption that we did not have time to empirically verify, so it is not included in our alternative estimates of the effects of GMPA.

D. HUD Analysis - Effect on Market Dynamics Due to Proposed Rules

D1.GFE Alternative[18]

As mentioned elsewhere, the mischaracterization of YSP as "lender payment to borrower" will cause market disruption and migration of retail loan initiation from brokers to originators or cause brokers to become originators. If brokers lose an important share of their revenues they will exit the business. In general, originators such as mortgage bankers and depository banking institutions have a higher cost structure and require higher fees to cover both their costs and the capital that they hold. As several industry analyses show, there are few economies of scale in loan production.[19] In fact, loan production cost through brokers is typically lower than through originator's other channels, with the exception of very small channels such as on-line loan acquisition. A migration towards larger originators will result in a more concentrated industry, but less so than under the GMPA alternative. But in either case, the opportunity for small businesses to enter this industry will be limited.

The GFE will raise direct origination costs, possibly making consumer refinancing more difficult. One effect of the secular decline in origination fees (points) over the last 10 - 15 years has been a reduction in barriers to refinancing by borrowers. The ability of borrowers to refinance has enabled borrowers to reap the benefits of the declining interest rate environment of the past two decades. Both consumers, mortgage brokers and mortgage bankers who specialize in origination have benefited from the waves of refinancing, as have certain small businesses such as appraisers that offer services to facilitate a refinance. The cost of refinancing is largely a

[17] See page 82 of the July 2002 Economic Analysis.

[18] In addition to the measurable pricing and efficiency problems that we discuss related to the GFE, there are a host of regulatory matters that need to be addressed and we defer comments to the those in NAMB's Comment Letter to HUD. Issues such as brokers not being currently required by law to calculate APRs, complications of pricing PMI within an APR; pricing upfront FHA premiums into an APR, etc. Additionally, APRs and other calculations will vary if the loan amount on which APR is based varies - if the borrower finances certain charges into the loan amount rather than into the contract rate, etc. All these factors add to originator/broker costs and will increase offered pricing and create inefficiencies.

[19] See, for example, Wholesale Access, 2001

financial cost (reinvestment risk) borne by portfolio lenders and holders of mortgage-backed securities. If the imposition of the new GFE creates obstacles to refinancing transactions, this result will reduce potential future economic benefits for consumers and small businesses to the benefit of large lenders and investors. We do not attempt to quantify the potential dimensions of this effect.

D2.GMPA Alternative

Similar to the case with the new GFE, if lenders must offer GMPAs at no cost to borrowers then multiple loan "applications" will exist with the same borrowers, adding considerable costs to originators to hedge this increased exposure. In the case of the GMPA, originators face two new sources of risk: a higher outstanding volume of loan applications outstand, which has been discussed earlier, plus a requirement for use of a quoted "interest rate index". Since there is no single index to hedge, originators will be exposed to basis risk, the risk that a common mortgage interest rate index that they attempt to hedge against will have different sensitivities to market volatility that the actual loans they have an outstanding commitment to fund. Our analysis estimates that this risk will create a cost to originators of five basis points of all loans funded. This cost alone may more than offset any consumer benefit from the GMPA alternative.[20]

With packaging of lending and settlement services, there are incentives that create conflicts of interest that could reduce quality and raise costs to consumers. Packaging may include combining firms that work together exclusively or may even be commercial affiliates of one another. Although packaging is more likely than not to be driven by lenders/originators, the emphasis will be on production volume, perhaps at the expense of quality. It is unfortunately not uncommon in the real estate industry for some market participants and settlement service providers to act counter to the consumer interest. The analysis in Exhibit 2 Scenarios 2 and 3 show an estimate of the costs to consumers of additional problems in a volume of $1.67 trillion[21] of home sales at a rate of four hundredths of one percent, or 0.04% of dollar sales volume. However, this is simply an estimate, as we were unable to more accurately estimate the size of the total agency cost without more time for more detailed research. The 0.04% is only given to illustrate the potential significance of this effect.

[20] See Schnare, A., 2002 at REALTORS.org for similar conclusion.
[21] Based on $1.5 trillion of loans at an average LTV of 90%, giving a total purchase amount of $1.6667 trillion.

E. HUD Analysis - Effect on Small Businesses

E1. GFE Alternative

The HUD Economic Analysis assumes that $3.5 billion of the $6.3 billion in transfers to borrowers - 55 percent -come from small originators/brokers and small settlement service providers. The alternative economic analysis presented in Exhibit 2 Scenario 1 assumes that transfers to borrowers are likely to be much smaller than the HUD estimation but that the new GFE alternative will create substantial costs for businesses, approximately $4.5 billion more than the HUD economic analysis. On balance, the analysis in Exhibit 2, Scenario 1 shows that businesses pass through almost the entire $4 billion of the additional costs created by this proposed rule back to consumers, plus additional consumer costs. This appears to be a relatively benign result for originators and TSPs, except that this economic outcome results from a massive shift of business towards larger lenders and larger firms in general. Thus, of the net increase of roughly $4 billion of new borrower costs, perhaps $6 billion will go to larger lenders and -$2 billion will go to brokers and other small lenders and TSPs. Based on the current market structure, a broker that does not fund loans and has minimal overhead can be a viable participant in the mortgage finance market. Under the GFE, revenue sources for brokers such as application fees, earned YSPs and other revenue will dry up, resulting in a likely decline of well over one half of revenue for small brokers. As business revenue migrates to other originators, or if brokers become funders using their own warehouse credit lines, the market structure will move towards a higher cost and more capital-intensive structure. A pure broker needs relatively little or no capital to operate. A broker or small financial institution that borrows using warehouse lines or other borrowing from financial institutions requires significant amounts of capital. Holding more capital requires more revenues and earning.

Lastly, the proposed rule allows offerors of new GFEs to negotiate "discounts" with third-party settlement service providers, so long as these specific discounts are passed through to the borrower. While the shift in business towards larger lenders may create pricing power for large lenders to negotiate discounts with some settlement service providers, there is no evidence that the newly dominant large lenders will not simply raise their own direct origination costs. Thus, while the itemized cost of that particular settlement service might be lower as a result of the negotiation, there is no guarantee that the *overall* consumer costs in the GFE will decline. We would anticipate that small originators/brokers and small TSPs lose more than 60 percent of their revenue (versus 55 percent in the HUD analysis) arising both from a loss in market share and lower revenue sources, and reduced prices. Small TSPs are least likely to benefit from HUD's estimated efficiency for reductions in time spent with shoppers, since many very small firms may not be able to participate in negotiated transaction with large lenders.

E.2 GMPA Alternative

The HUD Economic Analysis assumes that, under GMPA, $5.9 billion of the $10.3 billion in transfers to borrowers - 57 percent -come from small originators/brokers and small settlement service providers, with a somewhat larger share of this transfer coming from small TSPs than

under the GFE alternative. The alternative economic analysis presented in Exhibit 2, Scenario 2 and 3 does not make the same assumptions regarding the extent of cost savings to consumers. HUD's analysis concedes that "(t)here may be no substantial economies of scale of settlement services",[22] yet the analysis assumes a non-trivial twenty percent ($3.6 billion) reduction in TSP costs to consumers. The alternative analysis in Exhibit 2, Scenario 2 and 3 assumes that large packagers may be able to aggressively force down some settlement service costs in the near term, (a 10 percent reduction in costs) but that effect will wear off as a more concentrated or collusive market emerges. (Scenario 3 assumes only a 5 percent reduction in TSP costs to consumers). In the long run, even these benefits might disappear and even reverse.

While our analysis concludes that the creation of a system of packaging such as GMPA will eventually be a wash economically for business, the business dynamics will change, with packagers (usually major bank-affiliated lenders) capturing an increasing share of the revenues, at the expense of smaller lenders/brokers and small TSPs. Thus, small businesses could see a reduction of 60 percent or more of revenue. Even more so than under the GFE alternative, the GMPA will have a disproportionate effect on small businesses. Plus packaging of settlement services could actually create less competition in the long run to the advantage of larger institutions. Scenario 3 in Exhibit 2 shows such a long term effect, with more concentration, with transfers to borrowers from TSPs gradually shrinking, and further efficiencies and transfers to borrower that are net negative to consumers on both the cost and efficiency side. A market dominated by a concentration of packagers will drive many small businesses out of business and eventually reduce benefits to consumers.

[22] See page 74 of Economic Analysis, July 2002.

III. Concluding Remarks

In enacting a rule that is so sweeping in scope as to affect virtually every mortgage transaction in the US, great care should be taken to ensure that the measure does not actually leave consumers with fewer choices and paying higher costs to firms that are able to use size alone to reduce competition. Both the GFE and GMPA alternatives have, to varying degrees, the potential for unintended consequences that leave consumers, on balance, worse off. Another note of caution is that HUD assumes that the costs and benefits of introducing both the GFE and GMPA alternatives may average out if both approaches are adopted to an equal extent. Economic theory, however, gives many examples where the whole is worth more (or less) than the sum of its parts. Thus, combining the new GFE alternative simultaneously with GMPA could create costs and inefficiencies for originators, brokers, small business and consumers that could be much higher than if each alternative is looked at in isolation.

HUD should be very certain about the effects of this proposal before implementing it, since the downside for both consumers and small businesses is potentially quite large, perhaps even catastrophic for some smaller businesses. The existing HUD analysis needs a stronger empirical basis and the analysis needs to consider what financial incentives the rule(s) will create with respect to market structure, competition, and conduct. If consumers have fewer loan choices, at worse prices, the effect on the mortgage and housing markets could be quite negative.[23]

[23] See US Senate Banking Committee, Prepared Statement of Mr. David Olsen, January, 8, 2002, anticipating as much as a one third reduction in loan transaction if rules prevent the mortgage broker market from functioning properly.

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Attachment 5

National Association of Mortgage Brokers Testimony

"Supporting Statement for

Paperwork Reduction Act Submissions"

U.S. Department of Housing and Urban Development

August 2001

Attachment 4

Supporting Statement for Paperwork Reduction Act Submissions

Real Estate Settlement Procedures Act Disclosures
OMB Control No. 2502-0265
(Forms HUD-1 and HUD-1A)

A. Justification

1. The Department is proposing a rule to simplify and improve the process of obtaining a home mortgage. The proposed rule will affect the current information collection, which consists of third party disclosures needed to inform homebuyers about the settlement process. Currently, certain disclosures are required by the Real Estate Settlement Procedures Act (RESPA) of 1974 amended by Section 461 of the Housing and Urban-Rural Recovery Act of 1983 (HURRA), and other various amendments. The statute is found at 12 U.S.C. 2601 et seq. and the implementing regulations at 24 CFR 3500. Required disclosures include: the Good Faith Estimate, Special Information Booklet, RESPA-Section 6 Model Disclosure and Acknowledgement of Probable Transfer of Loan Servicing, and the HUD-1 Settlement Statement. Other disclosures may be required under certain circumstances and include: the Initial Escrow Account Statement, Annual Escrow Account Statement, Affiliated Business Disclosure, and Escrow Account Disbursement Disclosure. The proposed rule would require a new format for the Good Faith Estimate. The rule would require a new disclosure, the "Guaranteed Mortgage Package Agreement," in lieu of the Good Faith Estimate, to be eligible for certain exemptions from Section 8 of RESPA. This exemption would exclude the requirement to give an Affiliated Business Disclosure in certain circumstances.

   Further explanations of RESPA, including statutory and regulatory documentation, is available through HUD's web page at **http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm**

   Real Estate Settlement Procedures Act (Regulation X);
   Escrow Accounting Procedures
   Final Rule
   Federal Register Vol. 60 No.31 Feb. 15, 1995

   Real Estate Settlement Procedures Act (Regulation X);
   Escrow Accounting Procedures: Correcting Amendment and Clarifications
   Final Rule
   Federal Register Vol. 60 No.89 May 9, 1995

   Real Estate Settlement Procedures Act;
   Streamlining Final Rule
   Final Rule
   Federal Register Vol. 61 No.59 Mar. 26, 1996

   Amendments to Regulation X, Real Estate Settlement Procedures Act;
   Withdrawal of Employer-Employee and Computer Loan Origination Systems (CLOS) Exemptions
   Final Rule
   Federal Register Vol. 61 No.222 Nov. 15, 1996

   Amendments to Real Estate Settlement Procedures Act;
   Exemption for Employer Payments to Employees Who Make Like-Provider Referrals and Other Amendments
   Proposed Rule
   Federal Register Vol. 62 No. 90 May 9, 1997

   Amendments to Real Estate Settlement Procedures Act Regulation (Regulation X);
   Escrow Accounting Procedures
   Final Rule

Federal Register Vol. 63 No. 13 Jan. 21, 1998

Real Estate Settlement Procedures Act (RESPA);
Regarding Lender Payments to Mortgage Brokers
Statement of Policy 1999-1
Federal Register Mar. 1, 1999

- HUD-1/HUD-1A - Uniform Settlement Statement. Buyers and sellers receive a statement of actual charges and disbursements pursuant to the settlement (see Section 4(a) of RESPA).

- Affiliated Business Arrangement Disclosure (formerly Controlled Business Arrangement). This disclosure is required when a settlement service provider refers a borrower to an affiliated provider. Section 461 of the Housing and Urban-Rural Recovery Act of 1983 added an exemption under Section 8 of RESPA for affiliated business arrangements (AfBAs) as long as certain requirements were met. The implementing regulations at 24 CFR 3500.15, require that a disclosure be given when a settlement service provider refers a borrower to another settlement service provider, when an AfBA exists. Proposed revisions to these regulations were published in the Federal Register on June 7, 1996 and August 12, 1996. The Department published final regulations on November 15, 1996 (effective January 14, 1997), which implement Section 2103c of the Act. The proposed rule exempts this requirement under certain circumstances.

- Special Information Booklet. Homebuyers receive this disclosure regarding the nature and costs of real estate settlement services (see Section 5(d) of RESPA).

- Good Faith Estimate (GFE). Lenders must give borrowers an estimate of the settlement costs that the borrower is likely to incur in connection with settlement (see Section 5 (c) of RESPA). The proposed rule requires a new format for the GFE that would make shopping easier. It also would require that the estimate be firmer by establishing a tolerance in variance on the HUD-1, from what was estimated on the GFE.

- Guaranteed Mortgage Package Agreement (GMPA). The proposed rule would require this disclosure in lieu of the GFE when a Guaranteed Mortgage Package, including a guaranteed settlement service cost and an interest rate guarantee is offered consumers.

- Escrow Disclosures. An initial escrow account statement is provided to borrowers at the settlement of a Federally related mortgage loan, and an annual statement is provided to borrowers showing the previous year's activities in the escrow account. The lender may ask the borrower to voluntarily contribute additional funds if the charge will substantially rise in the second year; a disclosure must be signed by the borrower. Section 924 of the Cranston Gonzalez Affordable Housing Act of 1990 (P. L. 101-625, approved November 28, 1990), amended Section 10 of the Real Estate Settlement Procedures Act of 1974 (RESPA, U.S.C. 2609 (c)). Regulations allowing voluntary collection of additional funds were published January 21, 1998, FR-3236.

- Servicing Disclosures. Lender must give the borrower a disclosure at application that the servicing of the mortgage loan may be transferred and another notice when the loan is transferred (Section 941 of the Cranston Gonzalez National Affordable Housing Act, P.L. 101-625 amended Section 6 of RESPA). RESPA was amended in 1996 to allow a streamlined disclosure, however, the Department has not finalized regulations pursuant to allow this change.

2. These third party disclosures are required by statute and regulations. Settlement providers make these disclosures to homebuyers, and in some cases sellers; pursuant to transactions involving Federally related mortgages. Disclosures are not submitted to the Federal Government.

3. These third party disclosures may be submitted to consumers electronically. Additionally, many disclosures are computer generated. The HUD-1 and HUD-1A are available on the RESPA web site and private companies offer software programs which generate HUD-1s. Except for the HUD-1 and HUD-1A, settlement providers are free to develop forms that are tailored to their individual procedures and needs. Lenders/brokers may use a computer generated program to estimate costs reported on the GFE for specific settlement services. Approximately 20,000 lenders generate an estimated 11 million loan applications which would require a GFE. It is estimated that at least 50% of the GFEs are now generated by computer. Many servicers are using integrated computer systems for billing, recordkeeping, and generating escrow statements. Software manufacturers continue to market improved versions of these systems.

4. The only disclosure containing partial duplication is the annual escrow account statement. To reduce duplication, servicers may adapt HUD-required information to comply with IRS reporting requirements regarding escrow account items, such as taxes. Furthermore, the rule allows servicers to report a "short year" in the first annual statement so that HUD-required annual statements can be issued coincident with IRS forms. In open-end lines of credit, the GFE and HUD-1 are not required when certain truth-in-lending disclosures are given.

5. The collection of this information does not impact small businesses.

6. This information is not submitted to the Federal Government. These third-party disclosures are required by statute, 12 U.S.C. 2601 et. seq. and regulations. The burdens on respondents are the minimum necessary to comply with the statute, and to assist borrowers in comparison shopping for loans and tracking escrow funds.

7. Information is not reported to HUD. Respondents are required to keep records (HUD-1, HUD-1A, escrow disclosures) for five years. Information may be requested from providers as part of an investigation. There is a three-year statute of limitations for the Secretary to bring an action under Sections 6, 8 and 9. RESPA does not provide for a statute of limitations for escrow disclosures. The Inspector General recommended a five year record retention to limit the paperwork burden.

8. The Department is soliciting comments in regard to the information collection. The Department's Office of Policy Development and Research estimates that approximately 11 million loans are originated each year. The Department is taking this opportunity to request additional burden hours to take into consideration this increase over the previous estimate in 2502-0265.

9. There are no payments or gifts to respondents.

10. There are no assurances of confidentiality provided to respondents.

11. There is no information of a sensitive nature being requested.

12. Estimated Number of Respondents, Responses and Burden Hours Per Annum

Information Collection	Number of Respondents	Frequency of Response	Responses per Annum	Burden Hour per Response	Annual Burden Hours	Hourly Cost per Response	Annual Cost
Information Booklet/GFE or GMPA	20,000	550	11,000,000	.33	3,630,000	20.00	72,600,000
HUD-1 or HUD-1A	20,000	550	11,000,000	.25	2,750,000	30.00	82,500,000
AfBA	10,000	240	2,400,000	.10	240,000	20.00	4,800,000
Initial Escrow	2,000	4,290	8,580,000	.06	686,400	*0.00	0
Annual Escrow	2,000	17,500	35,000,000	.08	2,800,000	*20.00	56,000,000
Escrow Disbursement	2,000	500	1,000,000	.083	83,000	20.00	1,660,000
Servicing Disclosure	20,000	550	11,000,000	.033	363,000	10.00	3,363,000
Transfer Disclosure	20,000	2,500	50,000,000	.033	1,650,000	10.00	16,500,000
TOTALS			129,980,000		12,202,400		$237,423K

*Cost of initial escrow is included in the annual escrow cost of $20.00, which also includes staff time, mailing cost, and equipment.

Explanation of Burden:

Good Faith Estimate, Guaranteed Mortgage Package Agreement, Special Information Booklet

- It is estimated it will take 20 minutes to complete and explain the new GFE to borrowers, or to complete and explain the GMPA to borrowers. The burden hours for these disclosure are increased due to the new formats for disclosure and to take in consideration the increased estimate of 11 million transactions rather than the previous estimate of 5 million.

HUD-1/HUD-1A

- Approximately 11 million loans close per year. The Department estimates that the HUD-1 can be filled-in in a minimum of 15 minutes. There are software programs available to settlement agents which provide an interactive form, thus allowing the form to be easily completed.

Initial Escrow Account Statement

- Approximately 11 million loans close per year, 78 percent of which carry escrow accounts requiring an initial statement (according to a HUD study), 11 million loans x .78 = 8,580,000 responses.

Escrow Disbursement Statement

- The Department estimates that 1,000,000 borrowers will voluntarily contribute additional escrow funds into accounts due to anticipated increases the second year. Servicers may collect additional funds as long as borrowers agree to do so through a disclosure. The Department estimates this disclosure will (1,000,000 x .083) result in 83,000 burden hours.

Annual Escrow Account Statement

- Thirty-one million mortgages carry escrow accounts. It is estimated that 15 percent of these mortgages change servicers each year requiring a new annual escrow account statement. Thirty-one million escrowed mortgages plus 4.65 million (15 percent of 31 million) change servicers each year equals to approximately 35 million responses. Actual responses per respondent will vary according to the number of escrowed mortgages serviced by each respondent.

Initial Servicing Disclosure

- Approximately 11 million loans are closed per year which require a disclosure, 11 million loans x .033 = 363,000 burden hours.

Servicing/Transfer Disclosures

- The transferor and transferee may send this disclosure jointly. About 50 million transfers of servicing rights are affected every year, according to a knowledgeable official at the Mortgage Bankers Association. We estimate that approximately 10% of the 50 million transfers receive a single disclosure.

Affiliated Business Arrangement Disclosure

- A settlement service provider must provide the AfBA disclosure when a borrower is referred to an affiliated provider. The Regulatory Impact Analysis estimated that 4.5% of all home sales transactions will involve an affiliated relationship (1999 sales transactions 2,400,000 x .045 = 108,000). An additional 10% of all loan applications will require a AfBA disclosure (2.4 million x .10 = 240,000).

13. There are no additional costs to respondents. Although the GMPA is a new disclosure and the format for the GFE are changed, according to private companies who provide document packages to lenders and other settlement providers, updates to state and federal regulations are provided at no additional cost.

14. There are no costs to the government except for a small cost associated with keeping the Special Information Booklet and the HUD-1 or HUD-1A up-to-date. These are third party disclosures that are not reported to the government.

15. The proposed rule provides a new Good Faith Estimate (GFE) format and provides a new Guaranteed Mortgage Package agreement that under certain circumstances may be used in lieu of the GFE. Both formats include a disclosure of options the consumer has for paying settlement costs and for lowering the interest rate. It is anticipated that these new disclosures will require additional time to complete and to explain to the consumer. Additionally, the Department is taking this opportunity to make an adjustment to increase the previous estimate of 5 million loans a year to 11 million loans a year. The adjustment is based on public comment and information provided by the Office of Policy, Development and Research. Therefore, the previous submission of 6,500,000 hours are increased to 12,202,400. Of this increase, 2,530,000 hours are attributed to a program change and 3,172,400 hours are due to an adjustment of increased loan volume.

16. The results of the information collection will not be published.

17. HUD is seeking approval to not display the expiration date on the forms HUD-1 and HUD-1A because of the very large volume that is generated. The forms are not only required by RESPA but are used for virtually all one-to-four family residential transactions and have become a standard instrument for settlement procedures throughout the industry.

18. There are no other exceptions to the certification statement identified in item 19 of the OMB 83-I than what is stated in item 17 above.

B. Collections of Information Employing Statistical Methods

The collection of information does not employ statistical methods.

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Statement of

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2003 President
National Association of REALTORS®

Before the
Committee on Small Business
U.S. House of Representatives
Hearing on HUD's RESPA Reform Proposal
March 11, 2003

Good afternoon Chairman Manzullo and members of the Committee. My Name is Cathy Whatley and I am the broker-owner of Buck & Buck Inc., a residential real estate brokerage firm in Jacksonville, Florida. I am also the 2003 President of the National Association of REALTORS®.

On behalf of the National Association of REALTORS® (NAR), I appreciate the opportunity to appear before this committee to present our thoughts on HUD's proposed rule to reform the Real Estate Settlement Procedures Act (RESPA). NAR is America's largest trade association, representing more than 860,000 members involved in all aspects of the residential and commercial real estate industries. While our membership is large, the typical real estate brokerage is small, operating just a single office, serving a local market. Sixty-seven percent of residential brokerages have a sales force of five or fewer agents. REALTORS® work in every community across the country. When it comes to the home purchase transaction, we hold the position closest to the consumer. From the very early stages of the home search to closing day, the REALTOR® is involved and acts as an advisor in the process. It is because of this very important role that we feel we can offer valuable insight into how these proposed changes may impact the consumer as well as the small business community.

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

NAR has long supported efforts to improve RESPA and the home mortgage transaction experience for consumers. We admire Secretary Martinez's dedication to this initiative and we appreciate and agree with the stated goals of reform as set forth by the Department: 1) to simplify and improve the process of obtaining home mortgages, and 2) to reduce settlement costs for consumers. However, we feel the proposal before us will not achieve those goals and has the potential to result in significant negative consequences.

As you know, the HUD proposal overhauls the current process for disclosing the costs necessary to obtain a mortgage. It replaces the current Good Faith Estimate (GFE) disclosure requirements with two new options, 1) an Enhanced Good Faith Estimate, and 2) the Guaranteed Mortgage Package (GMP).

The following is a summary of our overall reaction to the proposal.

- HUD proposes two new disclosure methods, the Guaranteed Mortgage Package (GMP) and the Enhanced Good Faith Estimate (GFE). We believe the goals of reform can be achieved by improving the current Good Faith Estimate (GFE). While the proposal before us has serious flaws, we support the concept and recommend that further analysis and development of this concept be conducted. It makes more sense to build on a model that we know rather than one that is untested relative to consumer and/or industry benefit.

- The Guaranteed Mortgage Package (GMP) represents a radical departure from today's rules. There is not enough evidence of consumer and industry benefit to move forward with this at this time. Additional data collection, research and analysis need to be conducted to provide evidence of significant benefits. There are risks inherent in this proposal and until more is known about the likely impacts, HUD should postpone advancing this kind of significant regulatory change.

- Congress should address many of the changes to RESPA in this proposal. To propose a repeal of Section 8 or to require providers to fix their fees requires oversight by the body that created RESPA.

HUD's Economic Analysis and the Regulatory Flexibility Act

In its economic analysis, HUD assumes that both the GFE and GMP proposal will yield substantial benefits to consumers. These benefits are largely due to cost transfers that HUD assumes will result from the new process. However, they come to these conclusions without the

benefit of analyzing the underlying cost structure of the industry or the profit margins that exist today. For example, HUD forecasts a consumer savings in third party services of ten percent. We have to question these findings given the lack of national data on the distribution, the composition, and even the average level of closing costs. What we do know is that under the GMP method, third parties could be forced to offer deep discounts if they want to be included in lender packages. However, the Section 8 safe harbor removes the current requirements that these discounts be passed along to the consumer. The lender will now be free to charge the consumer whatever they want.

As you know, the Regulatory Flexibility Act requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Since HUD's GMP proposal provides lenders with the very strong incentive of a Section 8 safe harbor for the packaging of settlement services, it is likely the market will move in this direction. This proposal thus poses a serious threat to the settlement service industries that may already be offering a form of bundling or one stop shopping to their customers. These companies will not be able to compete with the large lenders who will now be offered a huge incentive to package.

HUD assumes a savings of $1.8 billion dollars in third party settlement costs. NAR believes HUD should conduct additional analysis to more fully quantify and qualify this benefit relative to the loss in the marketplace of third party settlement providers. An abundance of providers creates a healthy and competitive market where the consumer has choices and can base their choices on both price and quality. To create incentives that merely encourage consolidation without regard for the quality of services being provided by the small businesses in today's competitive environment should be reviewed more closely.

Industry and Consumer Reaction

It became increasingly clear at a recent congressional hearing on this issue, that both industry and consumer groups are splintered on the proposal. It appears HUD is facing a new challenge, to accommodate all of the conflicting recommendations without introducing an entirely new set of issues or unintended consequences. This underscores our belief that this proposal is so broad and complex that it deserves additional analysis to truly assess the benefits and/or negative consequences.

As you know, the Small Business Administration (SBA) Office of Advocacy submitted comments to HUD. They encouraged HUD to issue a revised initial regulatory flexibility analysis (IFRA) that takes into consideration the comments of affected small entities and develops regulatory alternatives to achieve HUD's objectives while minimizing the impact on small business. They are of the opinion that further economic analysis prepared by HUD, in a

revised IRFA, would improve the Final Rule. This is consistent with our belief that additional analysis is needed before moving forward with this proposal.

REALTOR® Impact: Real estate brokers cannot package under the GMP

While HUD maintains that anyone can package, the requirements of the packaging make it impossible for anyone other than a lender to package, i.e. the packager must also guarantee an interest rate. The only participants in the marketplace that can offer a guaranteed interest rate are lenders. Further, by granting a Section 8 safe harbor, lenders are placed in a preferred position to control the entire settlement service industry.

In addition to effectively prohibiting real estate brokers and others from participating in this new business, it will also disrupt the existing business models real estate brokerages have carefully developed through the years in full compliance with RESPA and other state and local laws. Many real estate brokerages have expanded their business beyond the basic home buying and selling transaction to providing other real estate related goods and services. By expanding their services they can establish and maintain a long-term relationship with their customers and build consumer loyalty. In an increasingly competitive marketplace, the value of retained customers is tremendous. Twenty seven percent of NAR member firms with 1-20 agents provide ancillary services, such as mortgage, title insurance, home warranties, etc.

These businesses are subject to current RESPA restrictions that prohibit compensated referral activity. Quality of service is what induces a consumer to use these services or an agent to refer their clients to them. These models will be at risk under the GMP approach where large lenders will have the benefit of a Section 8 safe harbor. These lenders will seek providers willing to discount their services enough to be included in a lender package. Quality providers such as those affiliated with real estate brokerages will simply not be able to remain in the business.

Other Settlement Providers at Risk

Industry groups representing mortgage brokers and title agents continue to raise concerns about the adverse affects of the proposal on their members, which are largely small businesses. To the extent this proposal removes these players from the industry, the real estate brokerage community suffers as well. The real estate transaction is dependent on a healthy competitive environment for settlement services. Today, a real estate agent has unlimited choices of service providers to recommend to clients whether it be a mortgage broker, a closing agent or a home inspector. These choices in the marketplace ensure a smooth transaction for the homebuyer, the goal of every REALTOR®. To enact rules that can result in the removal of these choices will directly impact the kind of service a real estate professional can provide to their clients. This in turn will impact the consumer who relies on the expert advice of their agent to guide them

through this complex transaction. HUD's analysis suggests that if a significant portion of the settlement service industry goes away, it will result in benefits to the consumer in the form of lowers costs. We believe there is much more at stake here that HUD should consider before moving forward.

Impact on Consumers

While HUD projects cost savings of $10.3 billion under their GMP proposal, they either dismiss or ignore some of the risks that are inherent in the GMP proposal. In an economic analysis written by Ann Schnare, PhD., The Downside Risks of HUD's Guaranteed Mortgage Package, (copy attached and submitted for the record) some of the potential negative outcomes of granting a Section 8 exemption are identified. The paper challenges HUD's assumptions about the market reaction to the GMP and identifies the key uncertainties associated with it.

Consumer impact will be felt in many ways, a loss of transparency in the process, an increase in the cost of the transaction, and a loss of quality services. Borrowers will shop for a loan based on an interest rate and a "black box" of settlement costs, making it impossible to comparison shop. The safe harbor from Section 8 will permit a lender to mark up third party services and keep the entire markup as profit, rather than pass along any discount to the consumer. Also, as pressure mounts on settlement providers such as appraisers, title companies, pest inspectors to drastically cut their prices to ensure inclusion in a lender package, quality of service could deteriorate. These potential consequences of the GMP should be more carefully considered.

Other Alternatives Should be Considered by HUD

We strongly believe there are serious flaws in the GMP proposal and believe they should instead pursue changes to the GFE that will provide some certainty about costs and simplify the process. However, if HUD is committed to moving forward with a Guaranteed Packaging rule as outlined in their proposal, we recommend a restructuring of the GMP. If the intent is to promote competition among non-lender packagers, a mechanism must be designed that will truly allow anyone to package independent of the loan. If designed correctly, it may offer opportunities for non-lender packagers, such as real estate brokers, title companies and others to provide alternative choices for the consumer, which do not exist under this proposal.

To date it appears the only alternative that would meet this objective is to split HUD's GMP into two independent guaranteed packages:

1) Lender Service Package: This package would include the lender services and perhaps the appraisal and credit report (800 series services on the HUD-1), and

2) Closing package: This package would include all of the other services such as title, inspections, surveys, government fees, etc. (1100, 1200, 1300 series services on the HUD-1).

Under the two-package system, a lender could offer a lender package along with a guaranteed interest rate. Anyone, including non-lenders, such as real estate professionals could offer the closing package. The conditions for receiving the Section 8 safe harbor would have to be carefully defined. Some minimal requirements would include:

- A lender could not require a borrower who is obtaining the lender's loan and lender package to also purchase the lender-closing package. In other words, the lender cannot tie their loan to a particular closing package.

- The services within the packages, both the lender and closing cost packages, would be itemized. Upon request of the borrower, the service providers should also be disclosed.

- Lenders should provide copies of all reports to borrowers, i.e. credit report, appraisal, etc. Lenders should also disclose to borrowers the type of appraisal used by the lender, i.e. Automated Valuation Model (AVM), a drive-by, or a full appraisal.

- HUD should move toward adopting and requiring uniform service fee descriptions so borrowers can make apples to apples comparisons.

Under this proposal, large lenders will still have a competitive advantage with the Section 8 exemption. However, it is anticipated the lender tying prohibition of the closing package will provide a non-lender some opportunity to compete in this market by offering these services directly to the consumer. The details of such a proposal requires further development and analysis to ensure it creates adequate opportunity for other market players to compete. Further, if HUD pursues this disclosure track, then it would be appropriate to delay implementation of the Enhanced Good Faith Estimate.

Conclusion

This proposal is extremely complex and represents a radical change in the way a borrower will obtain a mortgage. If the GMP provision is enacted, it will dramatically alter the lending and settlement services industries. Additional analysis as directed by the SBA should be conducted before moving forward with this proposal to more fully ascertain the impact. A reform effort focused on incremental changes such as improving the GFE is a more attractive option for satisfying HUD's stated goals for reform. By simplifying the GFE and clarifying that volume

discounts are not violations of RESPA, HUD has created the necessary environment for packaging to occur.

I thank you for this opportunity to present the views of the Association and will be happy to work with you and your staff to more fully develop some options to reform.

Testimony before the
U.S. House of Representatives
Committee on Small Business

Regarding

HUD's Proposed RESPA Reform
and the Economic Effects on Small Business

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Testimony before the
U.S. House of Representatives - Committee on Small Business
RESPA Reform and the Economic Effects on Small Business
March 11, 2003

Good afternoon Chairman Manzullo, Ranking Member Velazquez, and Distinguished Members of the Committee. I am Terry Clemans, Executive Director of the National Credit Reporting Association (NCRA) in Bloomingdale, Illinois and I would like to thank you for inviting me to testify today in the hearing regarding the Department of Housing and Urban Development's (HUD) recently proposed rule on the Real Estate Settlement Procedures Act (RESPA) Reform and its Economic Effects on Small Business.

NCRA is a non-profit trade association that represents the Consumer Reporting Industry and specifically "Mortgage Credit Reporting Agencies". There are approximately 300 businesses in the United States that specialize in Mortgage Credit Reports.[1] NCRA's more than 125 members, alone, provide in excess of 15,000,000 credit reports per year and specializing in the "Three Bureau Merged" and "Residential Mortgage Credit Reports" (RMCR)[2] as required by HUD, Fannie Mae and Freddie Mac for mortgage loan underwriting. Our typical member is a classic small business with approximately eight employees and annual revenues of about $1,000,000. Our members are highly specialized agents in the credit reporting industry that provide industry-specific mortgage credit services. Their responsibility is to assure the accuracy of credit files used for the most critical purchase of an average American consumer's financial life...the purchase of a home.

While we commend Secretary Martinez and HUD for addressing problematic issues regarding the current mortgage settlement solutions process, we have grave concerns regarding HUD's adherence to the Regulatory Flexibility Act (5 USC §601 et seq, the "RFA") and the proposed RESPA Reform. Our concern focuses specifically on the proposed Guaranteed Mortgage Package (GMP) as it relates specifically to the credit reporting industry and the enormous potential risk this plan represents to consumers.

Issues with HUD's Consideration of the Regulatory Flexibility Act

As the Committee knows, HUD must comply with a number of procedural steps in order to finalize a new rule or amend a current rule affecting the American people. It is the position of NCRA that HUD has adopted a proposal that will not properly safeguard consumer interests and has failed to abide by procedural requirements to produce a fair and appropriate regulation.

[1] Compiled from lists of credit reporting partners published on the web sites of Fannie Mae, Freddie Mac, Ellie Mae's ePASS and Calyx's Point Preferred Partners.

[2] A "Three Bureau Merged" report is a single report consolidating the raw data contained in all three of the national repositories...Equifax, Trans Union, and Experian. A Residential Mortgage Credit Report is an enhanced Three Bureau Merged report in which, for one standard price, all of the data has been validated, verified, updated, changed, or corrected by a Mortgage Credit Reporting Agency.

The Regulatory Flexibility Act was enacted by Congress to require federal agencies to consider the effects of their regulatory actions on small businesses and other small entities and to minimize any undue disproportionate burden. Subsequent to the publication of the Proposed Rule, on August 13, 2002, the President signed Executive Order 13272, strengthening the Small Business Administration's Office of Advocacy's ability to bolster agency compliance with the RFA. Executive Order 13272, "Proper Consideration of Small Entities in Agency Rulemaking," underscores agencies' obligations to consider the impact on small entities when writing new rules and regulations. Additionally, the Order requires that Advocacy teach agencies how to solicit and consider the views of small entities throughout the rulemaking process.

The SBA's Office of Chief Counsel for Advocacy reported in its Annual Report on Implementation of the Regulatory Flexibility Act for Fiscal Year 2002 (February, 2002):

> "The RFA requires each federal agency to review its proposed and final rules in order to determine if the rules will have a "significant economic impact on a substantial number of small entities." If a proposed rule is expected to have such an effect, an initial regulatory flexibility analysis (IRFA) must be prepared and published in the *Federal Register* for public comment. If the analysis is lengthy, the agency may publish a summary and make the analysis available upon request. This initial analysis must describe the impact of the proposed rule on small entities. The initial analysis must also contain a comparative analysis of alternatives to the proposed rule that would minimize the impact on small entities and document their comparative effectiveness in achieving the regulatory purpose."

Pursuant to the RFA, HUD purportedly performed an Initial Economic Analysis and attached a portion of it to the Proposed Rule[3]. On August 13, 2002 HUD published a notice[4] stating that it had not only made a copy of the Economic Analysis available for public inspection, but had also posted a copy of it on its website. While we have been told that the Economic Analysis was available for some time, a comprehensive search of the site reveals that it is no longer available. Indeed, there is no mention whatsoever of the Economic Analysis anywhere on the website.

Due to the difficult accessibility of this research we suggest that this Committee seriously consider amending the RFA to require all agencies to publish the entire Initial Economic Analysis on their websites, in an easily accessible manner, along with any proposed rules. This would allow full accessibility on the part of small businesses and consumers so that more complete comments may be made to agencies when proposals for rules are published. Without the readily available information utilized by agencies in the adoption of proposals, the public is unable to provide the input contemplated by the statutes and regulations governing the creation and amendment of regulatory plans by federal agencies.

A major part of the Proposed Rule would set up a new process for originating mortgages called the Guaranteed Mortgage Package Agreement. This process would allow a lender to offer a guaranteed mortgage package (mortgage, third party settlement services and closing costs) for a set price. Independent credit reporting agencies issuing reports for mortgage purposes, almost all small businesses as mentioned earlier, do not have the bargaining power to enter into volume-based discounts with third party settlement service providers, as do the few large entities in the industry. Under the Proposed Rule, NCRA estimates well over 90% of the mortgage credit reporting agencies, currently providing the vital

[3] 67 Federal Register pages 49170—49174 (July 29, 2002)

[4] 67 Federal Register page 53958 (August 13, 2002)

services needed to reach the record mortgage volumes of the past year, would not be able to compete with these larger entities and will be forced out of business.

In reviewing the Initial Economic Analysis as attached to the Proposed Rule, it is clear that HUD totally ignored the small business components of this industry. Mortgage credit reports are only mentioned as being part of settlement services, and nowhere is there an analysis of the importance of credit history information to both consumers and lenders in the process of the granting of mortgages. HUD's own estimates project a $3.5 to $5.9 billion loss in revenues if this proposal is implemented to small businesses. Since we have not been able to verify these numbers in the Economic Analysis, we are unable to ascertain if these numbers include the potential elimination of a few hundred small businesses in the mortgage credit reporting industry. Therefore, it appears that the estimates may be very low.

In a letter dated October 28, 2002, the SBA's Office of Advocacy reviewed HUD's compliance with the RFA in regard to the Proposed Rule and wrote to HUD that:

> "HUD's analysis included the overall cost of compliance for the proposal in its analysis. A revised IRFA would allow for HUD to compute the compliance cost per small entity. This would enable HUD to identify and analyze significant regulatory alternatives to minimize the potential burdens on small businesses subject to the rule. In addition, this information would assist small entities in understanding the nature of the impact of the rule on their businesses."

NCRA believes that HUD must undertake a broader and more realistic review of the economic impact that the rule will have on the mortgage credit reporting industry, and many other small businesses in the settlement services industry, as mandated by the Regulatory Flexibility Act.

NCRA further believes that this Committee should thoroughly review the RFA and its requirements in conjunction with the many opportunities afforded by internet technology to allow small businesses and consumers to have adequate knowledge regarding the factors behind rule proposals so that they in turn will have the ability to influence the regulations under which they must do business.

It seems ironic that HUD would overlook such a significant assessment regarding so many small businesses with such a negative financial impact when they claim to be pro-small business. Their policy in the operation of their own Procurement Opportunity Program and in their Small Business Policy Statement dictates:

> "It is the policy of the Department of Housing and Urban Development to ensure non-discrimination in Federal procurement opportunities for small businesses and especially those small businesses owned by the disadvantaged (SDB), women (SWOB), service disabled veterans (SDVB), and those located in Historically Underutilized Business Zones (HUBZone), or part of the 8(a) Business Development Program (8(a)). It is HUD policy to take affirmative steps to ensure inclusion of these businesses in HUD contracting. The Department recognizes that these businesses are of vital importance to job growth and economic strength of the country and that they have faced historic exclusion and under utilization in Federal procurement. A successful and strong business community is an integral component of the Department's overall mission of job creation, community empowerment and economic revitalization".[5]

[5] HUD Website - http://www.hud.gov/offices/osdbu/policy/statemnt.cfm

The ideals behind the proposed RESPA reform do not agree with the ideals of HUD's commitment to small business as described in the HUD policy on small business and their claim in understanding the importance of small business to the overall economic growth of our nation. The small businesses of the mortgage credit reporting industry are highly populated with firms that are owned by women, with more than 20 percent of NCRA's membership in this category. It is especially ironic that this comes at a time when our nation's economic state is so fragile and the success of the housing industry has been a mainstay in avoiding further economic problems.

Issues with HUD's Guaranteed Mortgage Package

The concept for system improvement and the intentions behind the GMP are sound and propose potential improvements to a current settlement solutions environment that is riddled with problems. The closing costs presented on the Good Faith Estimate (GFE) and the actual closing costs on the Settlement Statement (HUD-1) are, frequently, very different. Additional charges, not included on the GFE, that many times show up on the HUD-1 due to "additional services" required to close the loan, can be extremely costly and difficult to comprehend for the average consumer. In the midst of legitimate additional services required, the current situation provides opportunity for some unscrupulous lenders to include spurious charges for services that are difficult to identify and serve only to improve the lenders' profit margins.

NCRA understands the benefit to consumers of obtaining a guaranteed closing cost that would allow them a true "apples to apples" comparison of both interest rates and closing costs between lenders when shopping for the best deal on their home financing. Having one price quoted for all settlement services needed for the mortgage transaction could be a great benefit to the consumer; however, it also opens new areas for consumer overcharges and provides considerable financial risk to the consumer with credit reporting as part of the package.

The credit report is truly unique to the overall mortgage services package as it is one of the most important documents in the mortgage process to both the consumer and the lender. The credit report starts the entire loan process and its contents will influence the transaction beyond the closing and well into the secondary securities market. It alone can kill the loan and will dictate if all the other mortgage services, or the real "settlement" services are even needed. It also is the most important factor in determining how much the consumer will pay for interest and origination fees for the loan, by far the greatest cost to the consumer, many times exceeding the principal cost of the home.

NCRA's position is that the credit report should definitely not be included in the GMP for the following reasons:

1. If not properly performed, this service could cause serious financial harm to both the consumer and the lender.
2. It is one of the least expensive line items in the services related to the mortgage process.
3. It is the very first item obtained by a lender and is used to determine if the consumer qualifies for a loan, at what interest rate they will pay, and if any of the other services for settlement may even be needed.
4. The credit report is a pre-qualification and approval service, not a settlement service.

These Traits Make the Credit Report Different from All Other Services

As previously noted, the credit report is different from all other settlement services for a number of reasons. The most basic and distinctive difference is that it is required to ***pre-qualify and approve*** a

mortgage loan and is the very first step in the process. It is also unique in that its value is realized regardless of the outcome of the actual loan. The lender receives the value of the credit report even when determining if the consumer does not qualify for a loan. All other services are required to actually ***close*** the mortgage loan and are only ordered after the credit report has been evaluated. It is this very basic difference that has created a two-step process that is the standard in the mortgage industry. This standard was developed based on reasons addressed later in this document and, in our opinion, should not be changed in a new environment. Loan approval and loan closing should be maintained as separate processes, each with their own responsibilities, checks and balances for the protection of the consumer and the lender alike.

In HUD's proposal of the GMP, the credit report and selected other services are eligible to be excluded from the GMP, however, an exclusion option of the credit report does not protect the consumer and should not be a choice for the lender. Allowing the lender or a settlement service "bundler" or "packager" to decide whether or not the credit report is part of the GMP provides far too much influence regarding the consumer's credit evaluation and the type of credit services needed to properly evaluate the consumer. A serious conflict of interest exists if the lender has the ability to steer the type of credit services offered to the consumer due to the influence of the credit report on the consumer's interest rate and fees. This conflict is especially prevalent when a lender owns a Credit Reporting Agency.[6] For this reason the credit report should be required by HUD as a separate transaction, outside of all other settlement services, in either the revised GFE or the GMP proposals.

How GMP Savings Can be Quickly Lost

The savings that this proposed program is intended to bring consumers is minute compared to the cost of interest over-charges that could be in store for a consumer if the credit report is not completely accurate. It could, in many cases quickly cost consumers more in over-charges of interest rates than the total cost of all the settlement services needed to close the loan combined[7]. Accuracy in credit reporting has been greatly debated recently due to the December 2002 release of "Credit Score Accuracy and Implications for Consumers," published by NCRA and the Consumer Federation of America (CFA). A projected 38 percent of the applicants reviewed in one phase of the study were at risk of being incorrectly categorized into a higher cost loan due to characteristics found in their credit reports.[8] Other independent studies have been conducted with different findings regarding credit file accuracy. Results vary significantly with

[6] Several lenders have purchased or created Credit Reporting companies that engage in the credit evaluation of loans of which they have an interest. The most notable is LandSafe Real Estate Closing Services. LandSafe, Inc. was created in 1994 as a subsidiary of Countrywide Credit Industries, Inc., one of the nation's largest mortgage banking operations. As such, LandSafe is part of the publicly owned Countrywide® organization, whose stock is traded on the New York Stock Exchange (NYSE) under the ticker symbol CCR.

[7] Interest on a loan with an "A-" designation, the designation for sub prime loans just below prime cutoff, can be up to 2.25 percent higher than prime loans. On a 30 year, $100,000 mortgage, a borrower who is incorrectly placed into a 10 percent "A-" loan would pay a difference of $161.15 per month or $58,017.56 in interest payments over the life of the loan. This represents $215,925.77 in interest, compared to $157,908.41 if that borrower obtained a 7.75 percent prime loan. Thus, the consumer experiences a potential overcharge greater than half the cost of the principal amount of the actual loan, and has an unnecessary monthly expense equal to or less than the one time cost of the higher level credit report services that could have prevented the situation.

[8] In Phase One of the CFA/NCRA study, a sample of 1704 credit reports were randomly selected, producing 1545 files that could be reviewed for the three target criteria to signify problems in the potential effectiveness of automated three repository merged credit reports (159 reports (one out of ten files) had less than or more than one credit score per repository due to "mixed" credit files or a lack of a credit score from the repository). 38 percent of all files met one of the categories below and 20 percent fell into the categories of greatest sub prime risk by meeting criteria two and/or three below.
The high score and the low score on the file varied by 50 points or more,
The high score and the low score on the file varied by 30 points or more, and the file's middle score was between 575 and 630, or
The file had a high score above 620 and a low score below 620
Considering the files with multiple scores from a single repository or missing credit scores, the percentage of consumers with a questionable effectiveness of three repository merged reports increases by 10 percent.

some research showing error rates as low as two percent;[9] however, research done by the Federal Reserve[10] found some considerable credit data issues that could significantly impact a consumer's credit score.[11] Some of these findings in the Federal Reserve presentation seem to correlate closely to findings in the CFA/NCRA study and have serious implications for some consumers[12].

Despite these system shortcomings, NCRA believes the three credit repositories do an admirable job of accurately maintaining the files of almost 200 million consumers considering the circumstances in which they must operate. The credit repositories handle billions of pieces of data each month provided to them by a vast assortment of credit granting entities. Each credit grantor has their own set of errors or incomplete data that is being passed along to the credit repository as factual information. There are further challenges when unscrupulous consumers try to beat the credit system by changing their name, assuming someone else's identity, or disputing accurate derogatory information for financial gain. These situations create an environment in which the credit repository files will never be without errors. As our report shows, for the vast majority of Americans the system contains complete and accurate files, especially considering all the factors influencing the process.

While the system works well at a macro level, if you are one of the individuals in the high-risk group, the fact that most credit reports are complete and accurate and most loans are approved at the right rate is not important to you. With 38 percent of the population found to be in the high-risk category, this "micro" segment of the population is far too large for HUD to disregard without much greater investigation. NCRA strongly requests this committee to instruct HUD to conduct its own analysis and provide data to prove that consumers will not be harmed prior to implementing a program like the GMP, whereby credit

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[9] A 1992 study conducted by Arthur Anderson, commissioned by the Associated Credit Bureaus (now known as Consumer Data Industry Association) studied the behavior of 15,703 consumers who were denied credit based on a credit grantor's scoring system. From this sample, 1,223 consumers (7.8%) requested their credit report from the issuing credit repository, and 304 consumers (1.9% of the total sample) disputed the information on the report. Of these, 36 disputes (11.8% of those who disputed, or 2% of the total sample) resulted in reversals of the original credit denial.

[10] From a presentation titled "Credit Performance: Does situational data like the Economy Matter"? Robert S. Avery and Paul S. Calem, Federal Reserve Board, Presented at the Credit Risk Modeling and Decisioning Conference, May 29, 2002 sponsored by the Federal Reserve Bank of Philadelphia and the Wharton School. Views expressed are those of the authors and do not necessarily represent those of the Board of Governors of the Federal Reserve System or its staff.

[11] The Federal Reserve presentation outlined that of the 250,000 files it used in their research from "detailed account-level" data selected from a national credit repository in June of 1999 that:
-35% of the tradelines are not currently reported and not reported as closed
-13% of these are missing current balance
-30% of these are missing current payment status (though 5/6 of these have 0 balance)
-2.5% of these show current payment status of a minor delinquency with a positive balance. These represent 57% of all accounts which are "currently" minor delinquent
-Many of these are closed-end accounts past due
-Appears accounts often are not closed when they are transferred, paid or sent off to collection
Particularly acute problems with mortgages. 80% of individuals with 2 or more open mortgages showed that one mortgage was opened within 2 months of the last reporting of the other mortgage for approximately the same amount. Often one is listed as past due. Hard to distinguish between sale of servicing and a new loan.
Big problem with major derogatories. Hard to follow accounts when sent to collection departments or agency. Cannot tell if one or two accounts. Sporadic reporting of chargeoffs and payoffs.
Collection agency accounts also a big problem.
-30% of individuals show some collection account.
-88% are small (under $500).
-Source of creditor not coded. We parsed name of creditor to estimate type. Estimate 52% are medical; 24% are utilities; only 5% are for normal "tradeline type" loans (some of these are double counted).
-Payoff information sparse and often not linked to the original account. Inconsistency in reporting multiple small charges or single consolidated amount.
Credit limit missing in 34% of open revolving accounts currently reported.
Account ownership status missing for many non-primary account holders. Cannot tell if authorized user, cosigner, or co-applicant.

[12] Both the CFA/NCRA study and the Federal Reserve presentation noted problematic issues with collections, mortgage accounts and missing credit limits on revolving accounts. The most often cited reasons or factors provided with the credit score explaining why the consumer did receive a higher score relates directly to problematic findings in the reports.

reports will be produced by the cheapest provider. The adage "you get what you pay for" should not be forgotten when dealing with services that have such large impacts for some Americans.

Consumers have already seen a previously intended savings in the mortgage credit reporting industry fall short with the transition from the RMCR to the Three Bureau Merged report. When Fannie Mae, Freddie Mac and HUD endorsed this change, their intentions were to reduce the time and cost involved in a full investigation and to enable the implementation of "automated underwriting systems" that could approve a loan in minutes based upon risk-based scores generated by using the raw data contained in a consumer's credit report. While these systems have provided such benefits to the GSE's, lenders, and many consumers, the CFA/NCRA study points out that roughly 8,000,000 consumers are potentially at risk of being denied a loan or steered into sub-prime interest rates in a fully automated environment. At the very least, these consumers are paying far more in supplemental reports and "re-scoring" charges than the original RMCR would have cost.

Additional Services are Needed to Correct the Problem in the Mortgage Marketplace

Within today's fast-paced mortgage system that utilizes automated underwriting technology to make lending decisions in less than a minute, the credit report contains the greatest potential to prompt a legitimate need for additional services that can elevate the cost exponentially based on the specific contents of the consumer's credit history. No other settlement service has common and legitimate price swings of 100 to 1000 percent that are identified and ordered with the consumer instructions,[13] unlike many of the "add on" charges that have been know to find their way onto the HUD1 that the GMP is designed to stop. Additional credit reporting services are easily understood by consumers because they pertain to the completeness and accuracy of their financial obligations as detailed in the credit report. The average consumer usually knows if their credit card payments have been made on time or if an account was sent to a collection agency and if they have paid it.

NCRA believes that if a consumer is going to be charged anything above prime rate the lender should provide a copy of the credit report used to the consumer so they can review the credit data with the lender and understand the reasons for the increase in rate and/or the need for additions or corrections to the credit report. NCRA strongly believes that the consumer should be empowered with the information to make informed decisions about their options under the Fair Credit Reporting Act to dispute and correct these items themselves without an additional charge or, to work via the lender and hire professional assistance from the credit reporting agency to have the work done for them on an expedited basis. The consumer's first hand knowledge of their credit obligations provides a safeguard from abuse when they are provided the information to make informed decisions that is not found in most settlement services that are less well known by the average consumer.

In previous Congressional testimony on the proposed RESPA Reform[14] and in the official comments sent to HUD during the comment period that closed October 28, 2002 there are positions from the lending industry requesting to hide, from the consumer, information contained in the credit report or in some

[13] Prices for mortgage credit reports vary widely, even within the same type of service. A sample price range as researched by the NCRA found these results: Three (3) Repository Merged Report $10–$25; Residential Mortgage Credit Report $ 50-$100; Credit Re-scoring Services $50-$600. Individual service options also vary in price; such as lender verifications or updates $10-$50, due to the fees charged by many lenders for the data to be obtained, or supplements and non-traditional credit verifications, such as landlord verifications, $7-$25. Supplements and lender verifications are a vital step in making necessary additions, alterations or corrections to a credit report based on closing conditions from the lender. In some cases there may be multiple supplements required for each borrower on a loan.

[14] Testimony of the Community Bankers Association on the RESPA Reform before the US House of Representatives Committee on Financial Services, Subcommittee on Housing and Community Opportunity Feb. 25, 2003 Sec. IX E. "The requirement to provide copies of the certain documents (e.g. pest inspections; appraisal; credit report; and lenders title) to consumer on request is unnecessary."

cases even the type of report used for the loan.[15] We urge the committee to advise HUD to carefully look at this position and completely question the reasoning behind it. We are unable to detect any benefit to consumers and question the incentives for non-disclosure when there are issues of accuracy in this score-driven risk-based process.

Areas of Potential Consumer Abuse Involving Credit Reporting Services in the GMP

Lender Operational Cost Abuse

There are two areas of the GMP process that will allow lenders to potentially harm consumers by providing an opportunity for lenders to shift their internal operational costs that are not related to a consumer-specific loan, directly to that consumer in the mortgage origination process. This has been a problem historically with some services, despite RESPA regulations that prohibit this practice. With the "Safe Harbor" of RESPA Section 8 created by the GMP, the credit report could become a fertile ground for abuse. We have already seen this questionable practice in credit reporting and similar services needed for portfolio servicing, with the RESPA violations documented by HUD. The following two examples illustrate the abuse that HUD should be attempting to prevent:

1. Lenders have historically tried to lower or include the costs of pre-qualifying mortgage applicants into the costs of the settlement services billed directly to the consumer. Over the years, there have been many questions to HUD regarding the legality of this activity with respect to RESPA's interpretation of whether or not a pre-qualification credit report is something of value that should not be used as an enticement for other settlement services business[16]. This question would have a new twist in the proposed GMP, as it would now be cleared of any Section 8 scrutiny for all pre-qualification credit report costs to be billed to the consumers in the GMP.

2. In November 2001, HUD Secretary Martinez announced settlements of more than $2 million from illegal mortgage fees.[17] The two largest settlements in this November 2001 announcement were related to shifting of lender costs directly to consumers via this process. These RESPA settlements (between HUD and The First American Corp. and Transamerica Corp.) found that flood services had been provided from both companies to certain lenders at a greatly discounted cost or at no cost for portfolio review flood services, in exchange for referrals of future business of flood certifications required for new loan originations. These flood certifications at origination are paid for by the consumer. While the companies charged admitted no wrongdoing, HUD reached a settlement with these two companies at $1.2 million from First American and $613,000 from Transamerica.

The credit report is also used heavily in loan portfolio servicing, providing lenders new opportunities to shift significant operational expenses directly to the consumer under the proposed GMP with a waiver of the RESPA Section 8 regulations that currently forbid these practices. The credit report, due to its use in portfolio reviews (note the aforementioned flood services) and widespread use in all other areas of personal lending and loan servicing, is a greater potential target for abuse than any other mortgage related

[15] Commentary to HUD's proposed RESPA Reform Docket No. FR-4727-P-01 from Consumer Mortgage Coalition Oct. 28, 2002 Section 18 Disclosure of Anticipated ordering of credit report, Pest Inspection, Appraisal, or Lenders Title Insurance "HUD should not require packagers to reveal which credit verification procedures they use, because in many cases these are proprietary underwriting tools."

[16] It has been so commonplace in the industry that the leading independent credit-reporting agency in the county, First American Credco, has a policy statement online to discourage lenders from requesting them. http://www.credco.com/HTML%20files/RESPA.htm

[17] HUD News Release No. 01-118, November 2, 2001 – HUD Moves to Protect Families From Illegal Mortgage Fees – Pay $2 Million.

service. Lenders have a big appetite for credit reports. From pre-qualification and underwriting of all types of loans (both mortgage and personal) to the servicing reviews of all types of loan portfolios, the inclusion of the credit report in the GMP, with no fear of RESPA Section 8 violation, leaves consumers open to charges for all types of credit services that are not related to their actual loan transaction.

Incorrect Credit Service Reduces the Consumer's Ability to Obtain Properly Priced Loans

The credit report as part of the GMP could significantly reduce the consumer's ability to obtain properly priced mortgage financing, causing the consumer to have a huge increase in the overall cost of the loan. While there are several types of credit reports with drastic price differences (see footnote 13), the standard three bureau merged report is generally considered to be sufficient for much of the population. As mentioned earlier, however, previous studies question its effectiveness for more than one-third of all mortgage originations.

The CFA/NCRA study[18] compared and contrasted the credit scores between the three credit repositories for a sample of 502,000 three-bureau merge credit reports. Three phases of research, with various depths of investigation, were conducted on two subsets of this sample. This review compared the variance in scores from each of the three credit repositories when their files were accessed simultaneously for a mortgage loan, as a proxy for the consistency of the data on each of the consumer's reports. It reveals that the random mortgage applicant had an average (mean) range between the high and low credit score of 41 points. Chart 1 (see Charts) shows the point range of all files evaluated.

Applications near or at the fringe of prime to sub-prime interest rates (typically about 620) were further examined in detail. It should be noted that the files with lower scores showed a gradually increasing variance in the credit score range. The Regression line in Chart 2 (see Charts) shows this trend. As consumers fall into the below 620 score range, they would most likely be charged a higher "sub prime" interest rate or denied a loan. At this point, many files cross into an area of score discrepancy of nearly 50 points between the high and low credit scores from each of the three repositories. With the risk-based pricing models currently in use in the mortgage marketplace, the incorrect evaluation of the consumer's credit history can cause a significant increase in housing finance costs. From the in-depth investigations done in phase one of the study, it was observed that a single collection could have a 100-point effect on a consumer with an otherwise solid credit history. This research also conservatively estimated that more than two percent of all borrowers are likely being pushed into sub prime mortgages due to errors observed on the files reviewed.

More thorough credit research of the nature to meet the demands of the automated underwriting systems comes at a price (see footnote 13) that may not be encouraged in a GMP driven marketplace with credit as part of the package. HUD's emphasis is clearly focused on lowering the consumer's cost related to home finance services with no consideration given to true credit evaluation needs of the individual consumer. In the proposed rule, discussions state "competition is the substitute for regulation."[19] In an environment with credit as part of the GMP, will the lender want to order the additional services required and risk having to pay for them out of his/her own pocket? How often may they order these services, at their own expense when the results may produce a lower interest rate and a less profitable loan? Or will it be

[18] While the Consumer Federation of America and the National Credit Reporting Association, Inc. jointly collaborated on the study, *Credit Score Accuracy and Implications for Consumers*, the views and opinions expressed in this paper are exclusively those of the National Credit Reporting Association, Inc.

[19] Federal Register, 24 CFR Part 3500, July 29, 2002, Department of Housing and Urban Development - Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers; Proposed Rule, Page 49173 Item 2-C.

required that these services are thrown in by the credit-reporting agency in an "all inclusive" price to the lowest bidder? Either way compromises service and quality.

While there is no guarantee a credit report that gets re-scored will produce higher scores, common changes of just one or two errors can produce results of 40 to 100 points in a consumer's file. Some extreme cases have been documented in which consumer scores have increased by 200 points. One highly publicized example illustrated that "within five days, Phillips's FICO scores jumped 200 points -- taking her from a 580 to a 780, and from a high-risk mortgage applicant to an A-plus cream puff."[20]

RMCR's and Non-traditional credit access may also be more difficult to obtain under the GMP as these report options are very labor intensive and are higher priced as mentioned previously, (see footnote 13). When a consumer's file is found to have questionable data or is in need of some type of additional service (verification of past landlords or other creditors not found on the file of any of the repositories) there should be no barriers to impede this additional service as it could be a major difference in the approval of loans on the fringe. Another irony is that the RMCR and Non-traditional credit services are used extensively in HUD's FHA and VA programs.

It appears contradictory that with the stakes of accuracy as high as the above estimates, we would want a system that would endorse the use of the least expensive products for this critical service without any assurance that consumers are getting the proper service required for their specific needs. With the vast differences in the credit data within each repository (see Chart 2) and the potential downside to consumers for incomplete or inaccurate data being used on their loan, the question is raised: Is the credit report the area where HUD really wants to look for savings?

With the critical importance of accuracy and the potential consumer impact, we wish to restate the following question: Should the lender be encouraged to seek the cheapest possible solution for credit reporting services, when a bi-product of that encouragement may actually benefit the lender by overstating risks and obtaining higher interest rates than the consumer's true credit history represents?

Competition in the Credit Reporting Market

Credit reports as part of the GMP would cripple the mortgage credit reporting industry as we currently know it by eliminating almost all competition that is not owned by one of the three major credit repositories, a title company, or a lender.

Over the past decade, the credit reporting industry has undertaken rapid changes to keep up with the requirements of the changing technology of the mortgage industry. With these changes, we have seen almost complete elimination of some segments of the industry. In the mortgage credit-reporting marketplace, it was estimated that there were more than 1500 credit reporting agencies serving the mortgage industry ten years ago. Today there are less than 300 credit reporting agencies listed as available to do business in the mortgage industry.[21]

Another area of contraction lies within the affiliates of the three major credit repositories. Less than twenty years ago, there were five credit repositories building a national database.[22] Ten years later there

[20] The Washington Post, Ken Harney, The Nations Housing, 7/14/01 Bad FICO Mark? Rescore your credit page H01.

[21] Original numbers from NAICRA (now NCRA) 1992 membership marketing archives. Current numbers complied from lists of credit reporting partners published on the web sites of Fannie Mae, Freddie Mac, Ellie Mae's ePASS and Calyx's Point Preferred Partners.

[22] Trans Union, TRW (now Experian), Equifax, Chilton, and Pinger Systems.

were three and each had a vast network of affiliates providing consumers access to local service. All three of the repositories are in the process of buying back these affiliates, with one of them nearly finished, creating fewer sources from which to purchase credit files for resale. Many of these affiliates were also providers of mortgage credit reporting services and have been part of the industry loss explained above.

While the reduction in the past ten years is due to many reasons, if the GMP is approved with credit as an allowable package service, very few companies will be able to compete. The three major credit repositories own the files in their systems and will be able to provide their reports to lenders at a much lower cost than anyone else in the industry in exchange for the GMP business. Because of this file ownership and a monopolistic advantage the repositories maintain over the rest of the industry due to requirements by Fannie Mae, Freddie Mac, and HUD for Three Bureau Merged reports, they can do this at a significantly lower cost than any other credit reporting entity that has to purchase the credit files from each one of these essential facilities. While this would create a short-term reduction of overall profit for the repositories, once the majority of the competition had been eliminated, it is doubtful that prices would stay at a level competitive enough to warrant the further reduction in the industry. Just by the nature of the makeup of the entire industry, some anti-competitive questions could be raised.

The question of service vs. product has made it difficult to enforce antitrust activity in credit reporting, allowing pricing situations to go unchecked by the governmental agencies designated to enforce competitive practices. Considering these circumstances, and the importance of a healthy and competitive credit reporting industry, is it wise for HUD to pass regulation that could assist the exploitation of antitrust loopholes?

Despite argument to the contrary in the Proposed Rule[23] that characterizes the credit reporting industry as being "national in nature and characterized by economies of scale," credit reporting is also localized in nature (similar to appraisal) for very good reason. Many lenders know the value of the customer service that the smaller, more local credit reporting agencies can provide to this unique marketplace. Thanks to a handful of aggressive software companies that provide these specialized companies with the latest technology available, these smaller firms can offer a unique mix of technology, personalized service to consumers, and the flexibility required to close the tough loans with services sometimes not even offered by the largest companies.[24] Losing the ability to obtain this type of service could create a major problem for many consumers.

The companies likely to survive in an environment that has credit included in the GMP, aside from the major credit repository owned companies, include those firms that are owned by title companies (e.g., Credco, of the First America Corp.) or directly by lenders (e.g., LandSafe, of Countrywide Credit Industries) that could include credit reports as a loss leader for marketing of their own additional, more profitable settlement services or the actual loans themselves. This is a practice currently engaged in, despite seemingly clear RESPA issues, by some wholesale mortgage lenders as a potential inducement to

[23] Federal Register, 24 CFR Part 3500, July 29, 2002, Department of Housing and Urban Development - Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers; Proposed Rule, Page 49173 & 49174 Item 2-G.

[24] Factual Data Corp, a large publicly traded credit reporting agency and one of five companies that is a direct provider to both Fannie Mae and Freddie Mac's automated underwriting systems, temporarily stopped offering RMCR's as part of their services. Upon returning them to their service portfolio, the prices were significantly increased as reported to NCRA by several of their customers.

It should also be noted that in conversations with HUD officials in April 2002, NCRA was told that certain larger credit reporting agencies report difficulty in the ability to obtain payment histories from landlords. Unautomated and non-traditional credit sources, the kind requiring high levels of manual research, are the areas in which the smaller, localized credit reporting firm's service levels excel. These types of services can also be crucial to documenting the true credit risk of those consumers on the border of prime/sub prime interest rates.

obtaining the funding rights to the loan from mortgage brokers.[25] The credit report is far too important and far too incomplete for a significant portion of the population to be reduced to a "loss leader" type product with an incentive to push it through the system at the lowest possible cost.

If these predictions of severe industry restriction hold true, what value could be provided to consumers by a further reduction of the credit reporting industry? When has less competition actually been good for the consumer? In times of peak refinance volumes such as those we have experienced in the past two years, would five to ten companies be capable of handling all of the volume or would we return to the days when consumer complaints about credit reporting agencies were labeled "Public enemy #1 at the FTC"?[26]

Conclusion

The National Credit Reporting Association, Inc. (NCRA) conditionally supports the pursuit of the GMP concept as a means to bring greater efficiencies to the consumer in the acquisition of settlement services. However, we only support it specifically for settlement services needed to close a loan, not to approve a loan. Therefore, NCRA supports the GMP as long as the credit report is required to be an additional service to the GMP, not included in it.

The credit report is required as the first step in the process of loan approval and has far too great an impact on the consumer, to be included in a package of services that are not even needed until after the credit report has been secured and processed. The enticement for the cheapest possible solution to credit reporting services may, at first glance, seem attractive; however, it is as full of pitfalls as the original problem HUD is trying to fix. The ability to pass along some of the lender's non-related operational costs provides the opportunity for more abuses to the system in new ways. Giving the lender the ability to decide whether or not to include credit as part of the GMP does not provide consumers with the protection they deserve to make sure they obtain the type of credit review needed for their specific credit circumstances.

Finally, further reduction in the number of credit reporting companies in business could prove very harmful, long term, for the entire competitive balance of the credit reporting industry. The three major repositories, being essential facilities to the rest of the industry's ability to exist, would have a monopolistic advantage over everyone else in the industry. Including the GMP "safe harbor" from RESPA Section 8, HUD would be empowering them with the ability to use questionable business practices to virtually eliminate all competition except that of companies that could provide credit reports as loss leaders for other services.

Considering that the credit report, depending on the type needed, is already one of the lowest cost services in the mortgage settlement services process, and that it is also the only service with a direct impact on the price of the most expensive part in the mortgage process -- the interest rate of the actual loan, should it be encouraged to be completed "on a shoestring"? It seems far too risky to allow the credit report to be the lenders' choice for inclusion in the GMP with an incentive for them to obtain it at the lowest possible price, regardless of the impact on the consumer. This is especially true when factoring in that 38 percent of the mortgage applications reviewed in the CFA/NCRA study were found to be at high risk for credit report problems due to extreme circumstances on their credit reports. The proposed "savings" associated

[25] Countrywide Credit Industries website, https://www.cwhc.com/Partner/StaticPopup.asp?DocumentName=Credit_Bureau_Update From their own credit reporting agency and through their Countrywide Wholesale Business Channel ® Countywide Credit Industries recently began offering free credit rescoring services to their mortgage broker customers. This seems to be a questionable practice under HUD RESPA Regulation X.

[26] 1993 US PIRG report *"Credit Bureaus: Public Enemy # 1 At the FTC"* found that credit reporting agencies were the number one consumer complaint to that agency each year between 1989 and 1992.

with the credit report as part of the GMP could cost a significant portion of our population, many of whom are in the position to least afford it, more in higher interest charges in a matter of only a few days or weeks, than could ever be saved by this proposal. HUD's quest to save a few dollars from one of the least expensive items in the entire mortgage process could for some, keep the American dream of home ownership only a dream. **

CHARTS

Chart 1

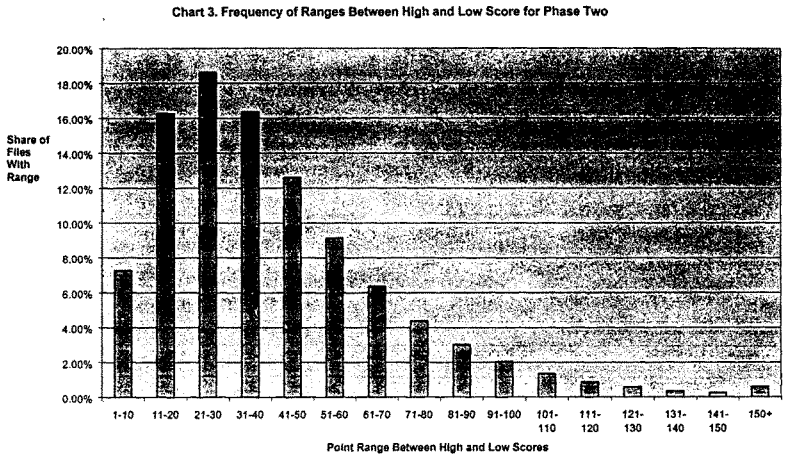
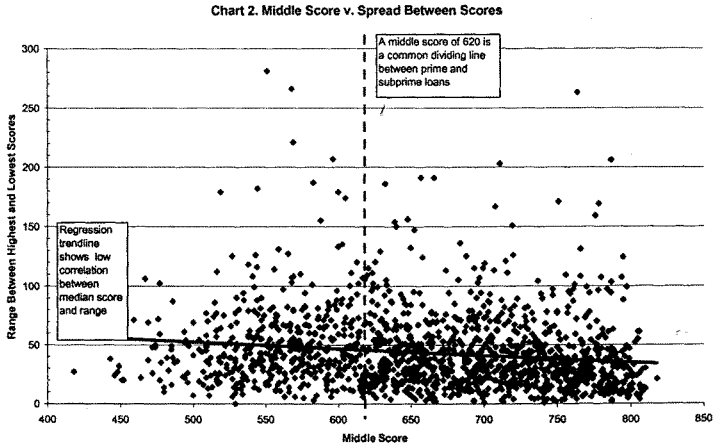


Chart 2



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October 16, 2002

Rules Docket Clerk,
Office of General Counsel, Room 10276
U.S. Dept. of Housing and Urban Development
451 Seventh St. S.W.
Washington, D.C. 20410

RE: **Docket No. FR- 4727 – P – 01**

Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers

The Colorado Mortgage Lenders Association (CMLA) was founded in 1956 as the representative voice of mortgage lending in Colorado. Over the past 46 years, our members have accounted for the vast majority of mortgage funding in our state. CMLA represents over 6,000 individuals through 291 corporate memberships. Our members include the largest national mortgage bankers, independent local mortgage brokers, and a wide variety of affiliates who provide services to mortgage originators.

Relative to the proposed RESPA rule changes, we offer our analysis from the perspective of a unique hybrid within the real estate finance industry. Due to our diverse membership and our responsibility to represent all members equally, our position cannot be skewed to favor one segment of our industry. Our purpose is not to advocate a favorable outcome for one type of mortgage originator at the cost of others. Rather, we advocate a level playing field for all mortgage originators and service providers. Thus, we offer this analysis as, quite possibly, the one true non-partisan critique of the proposed changes.

We applaud your efforts to simplify the real estate settlement process, address concerns relating to predatory lending, and satisfy disputes over yield spread premiums and other class action suits. We believe that providing understandable information to the consumer is at the heart of any legislative process which may be designed to streamline the mortgage loan system and to eliminate improper consumer practices. CMLA supports any regulation that promotes consumer choice and empowerment, requires meaningful disclosure, and that would enhance consumer ability to shop effectively for mortgage lending services.

GENERAL COMMENTS

The CMLA challenges one basic assumption made by HUD in submitting the proposed rule: that more disclosure is better. Without a comprehensive approach to reform Truth in Lending ("TILA"), RESPA, and HOEPA, additional disclosures will be counterproductive. Consumers need better information, not more information.

The Secretary has acknowledged that "[m]any of the current system's problems derive from the complexity of the process...." The CMLA agrees, but believes that a piecemeal approach to regulatory reform will do nothing to simplify the process. As reflected below, the proposed rule immediately raises questions regarding the interrelationship with TILA and HOEPA as well as FHA guidelines. Attempted simplification of one part of the mortgage regulatory scheme seems to ignore that interrelationship which creates more "unintended barriers" for both consumers and mortgage professionals.

Similarly, the Secretary has pledged greater enforcement of these revisions. Again, the CMLA believes that this ignores the regulatory framework which exists and which governs this industry. Promulgation of additional rules, without enforcing the existing rules creates uncertainty regarding the ultimate financial and 'business' effect the rules may have. The CMLA believes that HUD should first enforce existing laws prior to promulgating new regulations.

I. THE CMLA ENDORSES THREE PARTS OF THE PROPOSED RULE:

A. Description of the Loan Originator's Function

The CMLA believes that most loan originators provide this explanation to their borrowers and therefore this part of the proposed rule merely reinforces a best practice. The CMLA urges the Secretary to ensure that this does not create an agency or fiduciary relationship. In Colorado as in most states the relationship between borrower and lender is one of debtor and creditor baring additional circumstances.

B. Explanation of the Option of Paying Settlement Costs through the Use of Lender Payments Based on Higher Interest Rate

As with the explanation of the Loan Originator's role, the CMLA believes that most originators explain the interrelationship between interest rates and the amount of cash the borrower may pay to close a loan. Since this again reinforces a best practice, the CMLA supports this portion of the proposed rule.

C. Improved Good Faith Estimate

a. Information on Interest Rate and Costs

As consumers are better informed, they have the ability to shop based upon rates and costs. Providing this information in the Good Faith Estimate ("GFE") will give the borrower the necessary information to shop. The GFE should not, however, provide an alternative mechanism for "locking-in" an interest rate. As a result the disclaimer regarding the potential rate change is an indispensable portion of this change.

b. Simplification and Consolidation of Major Categories on the Good Faith Estimate

This is a classic example of HUD recognizing that more information sometimes isn't better. Consolidation of major categories on the GFE provides the consumer with better information to use should the consumer choose to shop. CMLA is concerned, however, that without a comprehensive approach to reform of the total regulatory framework, HUD will now be creating conflicts with TILA disclosures and with the HUD-1.

II. THE CMLA HAS FIVE AREAS OF CONCERN ABOUT THE PROPOSED RULE.

In addition to the general concerns set forth above, the CMLA believes that the specifics of this rule appear to promote or provide an advantage for larger and medium sized companies at the expense of smaller mortgage lenders and originators. We would encourage HUD to further analyze the impact this rule would have on smaller companies to ensure that this rule provides no competitive advantage to larger companies. If this cannot be demonstrated the CMLA would urge HUD to dispense with this regulatory proposal to allow a more comprehensive proposal.

HUD's Economic Analysis and Initial Regulatory Flexibility Analysis concludes that While $5.9 Billion of the total impact of $10.3 billion will be absorbed from small originators, "firms suffering losers [sic] under packaging are originators and third party providers who are currently charging high prices for their services." CMLA disputes this finding. Further HUD's comment that small lenders may not be placed at a disadvantage under packaging because of the "bulk" buying power of large lenders is flawed. First, HUD concludes this because "there is no evidence of this effect today where large lenders can purchase services such as appraisals on a "bulk" basis." This reasoning is suspect since prior to and unless this proposed rule goes into effect, there has been no motivation to create "bulk" transactions since there is no benefit to the lender.

Small lenders are not the only potential casualties of this proposed rule. The large national appraisal firms and title underwriters will reap the benefits of packaging to the detriment of smaller companies. The smaller companies currently provide nearly 65% of these services because of their service and products will suffer not because of any impermissible activities, but rather the arbitrariness of this rule. The CMLA believes that artificial advantages created by regulation ultimately cost the consumer more than the prices a free economy establishes through competition.

A. Disclosure of Loan Originator Compensation

The CMLA represents a diverse membership and believes fundamentally that HUD must strive to provide a level economic 'playing field'. This aspect of the proposed rule provides unfair disclosure of broker income. While the CMLA recognizes that current regulations provide for disclosure of this information, the proposed regulation we believe tries to take a 'commodity' approach to this information. The basis for this rule appears to be the belief that all loans are fundamentally the same and disclosure of this information will "improve consumer shopping for mortgages, which will result in better mortgage products at lower prices for consumers."[1]

If this rule disproportionably impacts small originators, as the CMLA believes it will, then those originators who have the ability to address loans that do not fall within the commodity category will cease to operate. As a result, the rule may have its desired result, but it will be only on those loans which fall within given, predictable categories. Ultimately, those consumers who rely on mortgage loan professionals to guide them to alternative loan products which more precisely fit their circumstances, will be forced to accept the commodity product or will ultimately be excluded from the mortgage market.

Additionally, the proposed regulation continues to prohibit a lender from increasing the cost of settlement services to the borrower, unless the settlement services are part of a Guaranteed Mortgage Package. While the ability to increase is not the specific objection, it is again creating an advantage for those larger companies that are situated to take advantage of the Guaranteed Mortgage Package.

Finally, the focus appears to be on the fact that a loan "originator can profit by failing to reduce other charges by the full amount of a yield spread premium or

[1] Economic Analysis and Initial Regulatory Flexibility Analysis, Chapter 5, I, A.

by overcharging for discount points."[2] The proposed regulation treads dangerously close to controlling pricing by loan originators and therefore regulating income on each loan originated. The CMLA believes that this continues to reflect a commodity approach to mortgage lending which is at odds with many loans originated throughout the country.

B. Tolerances of the Good Faith Estimate

The CMLA's concerns in this area relate back to CMLA's fundamental position that comprehensive reform is required in the mortgage industry, not piecemeal reform, and that fewer regulations, which are actually enforced, not more, will ultimately benefit the consumer. Currently disclosures have some relationship to each other, with the GFE mirroring the HUD-1 presented at closing and each having a relationship to the Truth-in-Lending disclosure required under Regulation Z. By changing only the GFE and not engaging in wholesale reform, HUD ignores this relationship.

In connection with this proposal, HUD has created tolerances for various disclosed fees. These tolerances, which in many cases are zero, have no specific consequences attached to them except the borrower's ability to walk away from the transaction and recoup their money. This creates a scenario where consumers will close on loans where settlement fees exceed the disclosure tolerances contained in the proposed rule. After the fact, class action lawyers who have targeted this industry to provide a source of income for themselves will bring suit against the lenders seeking to rescind the loan transactions and have the monies paid to the lenders credited back against the original loan amounts. While this was consciously allowed as a remedy under the Truth in Lending Act, to have this occur as an unintended consequence would cost the industry millions and inure only to the benefit of the class action attorneys.

Further, the CMLA is unsure of the connection drawn by HUD in the statement in the summary that "[c]oncurrently with finalization of this rule, HUD also will establish procedures for closely scrutinizing loan originators that fail to meet these new GFE requirements for possible Section 8 violations." This appears to reflect a belief that any violation of the tolerances is based on a Section 8 violation rather than a change of circumstances or an additional charge unrelated to any potential Section 8 violation. Unfortunately no distinction will be drawn by class action attorneys who sue for violation of the tolerances.

Finally, with added regulation and disclosure requirements comes added cost. The CMLA believes that if tolerances are exceeded, the more regulations

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[2] Economic Analysis and Initial Regulatory Flexibility Analysis, Chapter 3, III, B.

with which the lenders and originators are required to comply, the more costly the loan. Logically, the more costly the loan, the more consumers you price out of the loan market.

C. Identification of Shoppable and Required Services

In order to make decisions regarding the credit-worthiness of a borrower and therefore commit to making a loan at a given rate and cost, lenders engage third-parties to provide them with certain information. While the CMLA believes that providing a description of these services is appropriate, and is already accomplished in the current GFE and HUD-1, to allow borrowers to participate in the process compromises the lending process. History has revealed that fraud is most prevalent in those situations were the process of obtaining third-party information has been compromised. Recent cases involving 'row' houses in Baltimore is a classic example of this problem.

D. Guaranteed Mortgage Packages

In the summary of this proposed rule, HUD states, "today's RESPA rules hold back efficiency and competition by acting as a barrier to the packaging of settlement services." As we have set forth above, and as previously recognized by HUD, more regulation and rules will not solve this problem, but rather, as it has in the past, will further stymie competition and hurt the consumer. We have also previously highlighted the belief that this will cause a disadvantage for the smaller lender, ultimately reducing competition and causing less choice and higher prices for the consumer.

While the Guaranteed Mortgage Package appears to simplify reporting of the fees and costs of originating a mortgage loan and provides a safe harbor from Section 8 violations, the regulation does not address any apparent conflicts with state and local lending ordinances. Again we believe this will be an area class action attorneys will exploit. While HUD may take the view that more stringent requirements benefit the consumer, most local laws tend to require disclosures which are consistent with current federal disclosure requirements. To comply with these requirements lenders will be required to provide two different disclosures which will have different information which will increase confusion and cost for consumers. Additionally, the rule may well be in conflict with state and local real estate ordinances.

What is ironic about this proposal is the fact that the activities which HUD has denounced appear to have gained favor through the Guaranteed Mortgage Package. Current regulations prohibit referral fees based in large part on the fact that a consumer was not given an opportunity to 'choose' a mortgage lender based on the merits, including the cost of the loan. Now it appears that 'steering'

a borrower to a lender will be permissible and even encouraged so long as there is a Guaranteed Mortgage Package. With the dual ability to provide the 'new' GFE rather than a Guaranteed Mortgage Package, the borrower is forced to shop only among those entities that provide packages. This process creates an advantage for the larger lenders.

Smaller mortgage originators and lenders play a vital role in the mortgage market. The free marketplace has allowed companies, both large and small to find opportunities to succeed. Creating artificial advantages for segments of the industry, even unintentionally, will ultimately cost the consumer both financially and in terms of choice. The CMLA strongly urges HUD to reevaluate the conclusions it reached in its Financial Analysis.

III. THE CMLA REQUESTS CLARIFICATION ON ISSUES.

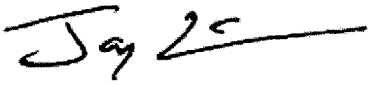
The CMLA believes that the need for comprehensive reform is highlighted by the issues that need further clarification. The CMLA is unclear as to whether the yield spread premium disclosure now creates origination fees that will trigger HOEPA guidelines, or possibly violate FHA's lending guidelines. Further, assuming that an annual percentage calculation is required under the new GFE; does that calculation track the requirements of TILA? Previously the HUD-1 has been used to provide a GFE. Given the fact that the GFE guidelines will be changed, does HUD anticipate redrafting the HUD-1 to comply with the new GFE? Will there be a new HUD-1 which will mirror a Guaranteed Mortgage Package? Finally, in a sales transaction, the title insurer is generally selected by the seller, a stranger to the loan transaction. How will the lender or originator control this cost and why should this be a risk to the lender if tolerances are exceeded?

CONCLUDING COMMENTS

The CMLA believes that comprehensive reform of all regulations relating to mortgage origination is appropriate. The approach the Secretary has taken appears to be more reactive to try and address a problem which is being publicized by certain consumer groups. This type of piecemeal approach to regulatory reform will result in higher costs, additional disclosures which confuse rather than clarify information for consumers and unintended consequences which will ultimately limit competition and consumer choice. Free marketplace activity with reasonable, comprehensive regulation will continue to provide more Americans with an opportunity for home ownership.

The CMLA welcomes the opportunity to clarify any of the comments set forth herein.

Very truly yours,



Jay Wilson,
Chairman of the Board

Cherry Creek Mortgage Company
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October 25, 2002

Rules Docket Clerk
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Department of Housing & Urban Development
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Washington, DC 20410 – 0500

Comments of
Cherry Creek Mortgage Company

Docket No. FR-427-P-01
RIN 2502 – AH85

Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the process of Obtaining Mortgages to Reduce Settlement Costs to Consumers

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Cherry Creek Mortgage Company is one of the largest mortgage lenders in the state of Colorado, possibly the largest home-owned lender in the state and according to recently published national rankings, one of the one hundred largest mortgage lenders in the nation.

Our company has grown to this size in less than 15 years. On one recent day, we closed more loans than in the entire first year of the company's existence. We expect to continue to grow in the future and consider providing loans to home purchasers and owners to be a noble calling.

In addition, we'd like to state for the record that, having reviewed the Executive Summary of the proposed rule, we believe that we will not be affected in any material adverse way. About 90% of our loans will be exempted from some of the proposed rules since we are primarily a mortgage *banker*, rather than a *broker* company. As for the remainder of our loans and those provisions which will affect our entire production, we have sufficient resources of staff and expertise to promptly and fully comply with the new rules.

Comments of Cherry Creek Mortgage Company

We nonetheless consider **this proposal to be seriously flawed**. In its main effect, it gives **new advantage to large and medium sized companies, including our own, at the expense of small mortgage brokers.** We see no valid public policy reason to disadvantage our small company colleagues nor do we believe the proposal will aid homebuyers or refinancers, nor make the overall market stronger or more efficient. We base this conclusion on the following considerations:

1. The proposal seeks to place a limitation on fees charged by mortgage lenders and, thereby, "reduce settlement costs for consumers."

   As a threshold point of consideration, we are aware of **no statutory provision which gives HUD the right to control or limit the price charged by mortgage lenders**. Therefore the attempt to do so seems certain to invite litigation and the probability that regulations purporting to require fee limitations would be struck down by the courts.

2. Moreover, **it is far from clear that HUD has or could readily obtain the necessary expertise to act wisely in this area even if it had the legal authority to do so**. One need look no further than the first page of the Executive Summary to discover that "today's RESPA rules hold back efficiency and competition by acting as a barrier to the packaging of settlement services."

   In other words, **an earlier HUD regulation has had a perverse effect. Why would we not suppose that a new regulation might turn out the same way?**

   It seems pretty clear that, in general, as regulatory burdens increase, costs increase. Such costs usually get passed on to consumers. Although we could easily cite numerous examples of this phenomenon, there seems little point in doing so. By now, it is obvious to almost everyone that **the most creative, friendliest and most efficient markets are precisely those that have the least regulation.**

   A case can be made for regulation of industries and markets in which there is little or no competition. But the mortgage lending industry is about the most competitive industry on earth. So there's little likelihood that new regulations will reduce overall costs and every reason to assume that existing and **proposed regulations will increase overall costs and that, ultimately, such costs will be passed on to consumers, as has been observed on many occasions, in many industries, including the mortgage lending industry.**

   At the very least, before imposing new regulations, there should be some objective showing that existing regulations have done more good than harm.

3. The estimated savings to consumers appear to be extremely unrealistic. For example, the report suggests that half of the estimated $7.5 billion in YSP's paid to brokers would be "recaptured" by borrowers – that is, $ 3.75 billion would flow

to borrowers in the form of reduced borrowing costs rather than to mortgage brokers as compensation for their services.

Is this idea of squeezing broker profits workable? Is it fair? Having stated our doubts of whether doing so is within the competence or legal authority of the HUD, we now ask the department to consider what fraction of total mortgage broker profits the sum of $3.75 billion would turn out to be?

It is possible that someone knows the total profits of all mortgage brokers in America. We do not. But we estimate brokerage industry profits as follows: A typical year of mortgage origination (that is a year in which refinancings are much less than during the current year) might produce a national total of $1.3 trillion in closed loan volume. *Brokers* may originate half that amount or $650 billion. Industry sources tell us that a typical broker might make a profit of 10- 20 basis points on origination volume, producing **total broker profits of $650 million - $1.3 billion**.

So, if the department's economic analysis is correct, this proposal would wipe out more than the entire profits of all mortgage brokers in America. Where is the realism – let alone the justice – of such an idea?

But, of course, the department's analysis is *not* correct. If the rule is adopted, brokers will continue to retain all or almost all of the YSP's or find other ways to increase revenue. Failing to do so, brokers will throw in the towel, and withdraw their services and capital from the industry – much to their own detriment and, more important, a punitive loss to borrowers who now benefit from the vigorous competition provided by mortgage brokers.

Perhaps this is why the National Association of Mortgage Brokers estimates that adoption of the pending proposal will result in "**40 percent of mortgage brokers being driven out of business.**"

4. The proposal continues existing **prohibitions against GFE fees being "marked up"** by mortgage lenders. Such price controls are quite rare in American industry. We have no such prohibition on marking up the prices of houses, furniture, computers, clothing, etc. In fact, very few of the goods and services in our national economy are regulated in this way. Why? Because **such regulation is widely perceived as unfair and basically unworkable.**

   Either the price limitation will be greater than what competition will permit, in which case the limitation is ineffective. Or the price will be less than the market requires in which event mortgage lenders will circumvent price controls in one of several ways.

   We encourage HUD to delete this provision from the existing and proposed regulations. **The free market will do a much better, fairer and more efficient**

job of providing settlement services than any regulation, certainly better than the current and proposed regulation, which is more of a nuisance than anything else.

Getting rid of this provision would be an opportunity for HUD to demonstrate faith in the free market which would be consistent with the basic free enterprise themes espoused by President Bush. Continuing the status quo will merely indicate that HUD still embraces a form of regulation that has been largely repudiated in this country and abroad.

We note with interest that the proposal supposes that packaging settlement services may be a desirable and cost effective alternative. This is probably true. And, in fact, **such "packaging" might have already occurred if not prohibited by regulation...** another example of how the regulations have constrained free markets from doing their job. But again, why should this choice be at the sufferance of a regulation? Why not just repeal the existing prohibitions and let the market sort out what consumers want and what will be most efficient?

Most of us would think it absurd to forbid automobile manufacturers from packaging or marking-up accessories like radios, spare tires, etc. It just wouldn't make any sense to say that a furniture store couldn't bundle or "package" sofas with lounge chairs, etc. Instinctively, we know such regulations would be counter-productive. The mortgage lending market is not different in this respect.

5. Despite the Department's avowed distaste for marking-up various settlement services, a GMPA "safe harbor" is provided so that otherwise covered lenders are exempt from charges of "illegal referral fees, kickbacks and unearned fees." Although certainly not intended by the Department, we cannot help but wonder if this exemption opens the door to precisely the kind of **kickbacks to real estate agents that the Department has long condemned.**

   In any event, the "packaging" required to achieve "safe harbor" status includes at least one service, which is generally not under control of the mortgage lender -- title insurance. So, in many cases, the **"safe harbor" will be effectively nullified.** In our experience, mortgage lenders rarely control or even influence selection of a title insurer in a purchase transaction. Sometimes, in fact, the title insurer has been pre-selected before the lender is even aware of a proposed transaction.

   If adopted, the main effect of this provision will be to reduce, not increase competition. At present, thousands of appraisers, for example, compete for business. Under the new GMPA "safe harbor" provision, they will have to be part of a "package" which means they'll have to be tied in with one of a handful of large title insurance companies and will **no longer be able to effectively compete on an independent basis.**

Comments of Cherry Creek Mortgage Company

6. We also note that the proposal requires a new series of disclosures by mortgage brokers. For reasons previously pointed out, our company would be little affected by this provision. And, to a minor extent, we would actually be helped because we would be largely exempt, as a mortgage *banker*, from provisions that would be extra paperwork and administration for our competitors who are mortgage *brokers*.

   But **the fact that we might be helped does not make this good public policy.**

   The whole idea is rooted in a wrong and somewhat insulting notion that consumers are too dumb to know that the broker "does not represent all wholesale lenders so there may be a cheaper loan somewhere else." As a matter of fact, we find most borrowers are well informed about such matters and the competitive environment is such **that a requirement of this type really isn't needed.**

   Again the comparison with other industries is useful. Are we making a mistake in the vast majority of industries which are thriving without such regulations? Not many consumers would think so. Nor do we.

   The loan process is already burdened with numerous such disclosures, all presumably intended to inform and aid the consumer. In practice, however, the main effect is to make loan documentation files thicker and more costly, slow down the process and raise the price to borrowers. Rarely, if ever, does this form of notification have any substantively beneficial result for the borrowers who are so overwhelmed with paperwork before and during the closing process that they routinely ignore it all and sign whatever the title company closer puts in front of them.

7. Finally, although it is contrary to our company's interest to say so, we want to emphasize that **the whole idea of requiring brokers to disclose their fees is unfair to mortgage *brokers*.** Companies like ours – mortgage *bankers* – are not required to make disclosures of this type. Nor should they be. But it is hard to understand the justice of a regulatory regime that has different requirements for different competitors.

   It is especially perplexing that the Department would wish to perpetuate this form of regulation to the advantage of large, national lenders and the disadvantage of smaller lenders. **The playing field is already heavily tilted toward the Big Guys. Why make matters worse?**

Like existing regulations, this proposal purports to help consumers. Actually, it is just one more in a **long series of regulations that have caused mortgage files to grow in thickness and rise in cost over the last twenty years or so. Homebuyers would be better off without most of them.**

Comments of Cherry Creek Mortgage Company

It would be a great service to the nation if HUD would set an example of repealing many of the regulations, which impose a drag on the nation's economy. In any event, the current proposal should be withdrawn or amended to address the foregoing concerns.

We appreciate the opportunity to comment and, in the event the HUD personnel should wish to talk to some people who are engaged in the business of making residential loans, we will be happy to discuss these matters with department representatives.

Sincerely,

William L. Armstrong
Chairman