# FULL COMMITTEE HEARING ON RESPA AND ITS IMPACT ON SMALL BUSINESS

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# CONTENTS

## OPENING STATEMENTS


| | Page |
|---|---|
| Velázquez, Hon. Nydia M. | 1 |
| Chabot, Hon. Steve | 2 |
| Lipinski, Hon. Dan | 3 |


## WITNESSES


PANEL I:

| | |
|---|---|
| Jackson, Ms. Ivy, Director of the Office of RESPA and Interstate Land Sales, U.S. Department of Housing and Urban Development | 4 |

PANEL II:

| | |
|---|---|
| Kermott, Mr. Gary L., Vice Chairman, First American Title Insurance Company, Executive Vice President, The First American Corporation, On behalf of the American Land Title Association | 20 |
| Cockey, Mr. Adam D., Senior Vice President, Prudential Carruthers Realtors, On behalf of the National Association of Realtors® | 21 |
| Kittle, Mr. David G., CMB, Chairman-Elect, Mortgage Bankers Association | 23 |
| Savitt, Mr. Marc, President-elect, The National Association of Mortgage Brokers | 25 |
| Gordon, Ms. Julia, Policy Counsel, Center for Responsible Lending | 27 |


## APPENDIX


Prepared Statements:

| | |
|---|---|
| Velázquez, Hon. Nydia M. | 35 |
| Chabot, Hon. Steve | 37 |
| Altmire, Hon. Jason | 38 |
| Jackson, Ms. Ivy, Director of the Office of RESPA and Interstate Land Sales, U.S. Department of Housing and Urban Development | 39 |
| Kermott, Mr. Gary L., Vice Chairman, First American Title Insurance Company, Executive Vice President, The First American Corporation, On behalf of the American Land Title Association | 53 |
| Cockey, Mr. Adam D., Senior Vice President, Prudential Carruthers Realtors, On behalf of the National Association of Realtors® | 81 |
| Kittle, Mr. David G., CMB, Chairman-Elect, Mortgage Bankers Association | 89 |
| Savitt, Mr. Marc, President-elect, The National Association of Mortgage Brokers | 144 |
| Gordon, Ms. Julia, Policy Counsel, Center for Responsible Lending | 158 |

Statements for the Record:

| | |
|---|---|
| Attorneys' Title Guaranty Fund, Inc. | 172 |
| Independent Community Bankers of America | 175 |
| National Association of Federal Credit Unions | 180 |

# FULL COMMITTEE HEARING ON RESPA AND ITS IMPACT ON SMALL BUSINESS

**Thursday, May 22, 2008**

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
*Washington, DC.*

The Committee met, pursuant to call, at 10:07 a.m., in Room 1539, Longworth House Office Building, Hon. Nydia M. Velázquez [Chair of the Committee] Presiding.

Present: Representatives Velázquez, Cuellar, Lipinski, Altmire, Clarke, Johnson, Chabot, Bartlett, and Fallin.

## OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

Chairwoman VELÁZQUEZ. Good morning. I call this hearing to order.

Today, we will examine the Department of Housing and Urban Development's proposed rule on the Real Estate Settlement Procedures Act.

The recent housing crisis has revealed that predatory lending remains much a problem. It has also demonstrated the importance of providing quality information to home buyers. Over time, the closing process has become more complex, making these consumer disclosures even more critical.

The recent abuses we have seen in the mortgage market have, in part, been exacerbated by a lack of such protections. RESPA was initially established to provide these very safeguards, but clearly, they are not working in today's housing market. At its very foundation are the Good Faith Estimate and the HUD-1 forms, which provide home buyers with basic information concerning the costs of their purchases.

Unfortunately, HUD's recent proposal to update these forms as well as the settlement process is not the cure-all that home buyers need. The rule creates additional paperwork and complexity, potentially adding to the confusion of an already stressful purchase. This could lead to information overload and could ultimately result in more uncertainty for consumers. In addition to these problems, it will create chaos for small settlement service providers. These firms play a key role in the home-buying process, and they stand to incur billions of dollars in costs due to the implementation of the RESPA regulation.

Aside from the enormous costs posed to small businesses, it also creates an environment in which they are placed on an unlevel playing field. While HUD asserts that volume discounts will provide consumers with savings, we know better. It will lead to the

bundling of services and will reduce competition by forcing small firms out of business. As a result, consumers will ultimately face higher prices.

It is my expectation that Steven Preston, who President Bush recently nominated to be Secretary of HUD, will help address these problems. We know Mr. Preston well on this Committee, and I am hopeful that he will utilize his experience as head of the SBA to ensure that the RESPA rule does not unnecessarily burden small firms.

The changes the proposed rule makes to the settlement and closing costs have come at a challenging time in the housing market. It is important that we closely examine this modification so its recovery is not undermined. We also have the responsibility to protect home buyers by ensuring that they are given information about loan terms and closing fees in a clear, easy-to-understand manner. At today's hearing, we will begin to answer these questions and will make sure that we are not doing more harm than good to the home-buying process.

I look forward to today's testimony, and I thank all of the witnesses again for coming here to share their views.

I now yield to Ranking Member Chabot for his opening statement.

**OPENING STATEMENT OF MR. CHABOT**

Mr. CHABOT. I thank the chairwoman for yielding.

I want to thank her once again for holding this important hearing on the Department of Housing and Urban Development's proposed changes to rules implementing the Real Estate Settlement Procedures Act, or RESPA.

This is the committee's third hearing on HUD's plan to modify regulations governing the real estate settlement process. Although HUD has made significant strides since the Committee last examined this issue back in January of 2004, I remain concerned about the procedures used to assess the economic impact that the proposal will have on small businesses operating in the residential real estate market.

I certainly concur with the idea that the complex process associated with the purchase of a home can and should be simplified given the state of the housing market in certain areas of the country, including my home State of Ohio, and we just happened to have the Governor of Ohio in for a meeting this morning. The Ohio delegation did. There is no doubt that a more transparent process on the front end may ameliorate problems on the back end, thereby potentially reducing the number of foreclosures.

The effort to reduce confusion and to increase transparency in the real estate process should not be borne solely by small businesses. The Regulatory Flexibility Act, or RFA, requires Federal agencies to consider the impact of their proposed rules on small businesses and to determine whether there are any practical alternatives that would reduce the adverse effects on small business while still achieving the Agency's regulatory objectives.

In the case of the proposed RESPA rules, HUD must assess alternatives that increase transparency and that assist consumers but that do not necessarily pose undue burdens on small busi-

nesses that play a vital role in the operation of the residential real estate market. In particular, the Department's initial Regulatory Flexibility and Analysis and Regulatory Impact Study used data from 2002 and 2004. The data may be accurate, but they clearly do not reflect the current turbulence in the residence real estate market. An accurate analysis under the RFA requires an assessment of the regulation in the context of the current economy, not in the economy of 5 years ago.

I will be interested in hearing from HUD how it plans to update this data to reflect current economic conditions. I also will be interested in hearing from our other witnesses how changes in the marketplace affect their capacity to implement regulatory changes. I am also concerned that HUD did not perform a detailed assessment of the consequences of volume pricing on the future viability of small businesses. There is no doubt that volume discounts will benefit consumers and may provide marginal assistance in improving the residence real estate market. However, the long-term consequences of reduced competition may argue against making changes that will further shrink an already troubled sector of our small business economy.

Finally, I also would like to hear from our witnesses as to whether this is an appropriate time to commence this type of significant rulemaking change. The focus of the Department's resources should be on helping the ailing housing sector, not implementing new regulations that might divert some of these resources away from the more critical mission of restoring health to our housing sector. Once that is done, the Department could turn its attention to its modification of rules to implement RESPA.

I want to thank the witnesses for taking the time to come here to testify this morning.

I will conclude by just noting that I am also the ranking member of the Antitrust Task Force of the Judiciary Committee, and we are holding a hearing at 11:00 o'clock. All the five heads of the oil companies are being hauled in. They have been thrashed over in the Senate, and now they will be thrashed here in the House, and so I have to attend that particular thrashing. Mary Fallin from Oklahoma will be sitting in for me, and she will be here shortly.

I want to, again, thank the chairwoman for holding this hearing. I yield back.

Chairwoman VELÁZQUEZ. Thank you, Mr. Chabot.

I would like to recognize Mr. Lipinski for the purpose of making an opening statement.

**OPENING STATEMENT OF MR. LIPINSKI**

Mr. LIPINSKI. Thank you, Madam Chairwoman.

I would like to, first of all, thank Chairwoman Velázquez and Ranking Member Chabot for holding this hearing today and for their continued leadership on this and on other small business issues.

I also would like to thank all of our witnesses today for their participation and input on this issue that we all know, with all of the turmoil going on in the housing market today, is very critical.

As the housing foreclosure crisis worsens, I think all of us want to do all we can to help homeowners while taking action to prevent

future crises. However, we must not rush to solutions that will significantly increase costs to consumers, that will reduce choices, and that will shut out small businesses from providing settlement or mortgage origination services. Unfortunately, I am concerned that HUD's proposed rule may have some of these negative impacts. At a time when our economy is already suffering, we should not be sacrificing the jobs and economic growth created by small businesses while we make an effort to address the housing crisis.

I look forward to listening to testimony, and I am hopeful that we can find an alternative solution that helps consumers without burdening small businesses. I will also be submitting for the record testimony provided by Attorneys' Title Guaranty Fund, a lawyer's service that represents more than 3,500 law firms throughout the Midwest, many of which are small businesses. I urge my colleagues to take a look at this thoughtful testimony they have provided regarding this proposed rule.

Again, I thank the chairwoman and ranking member for holding this hearing. I yield back the balance of my time.

Chairwoman VELÁZQUEZ. Thank you.

Now I welcome Ms. Ivy Jackson, Director of the Office of RESPA and Interstate Land Sales in the U.S. Department of Housing and Urban Development. Her office is responsible for administering the Real Estate Settlement Procedures Act and the Interstate Land Sales Full Disclosure Act. Ms. Jackson has a Master's of Science in Consumer Economics from Auburn University.

Welcome.

**STATEMENT OF MS. IVY JACKSON, DIRECTOR OF THE OFFICE OF RESPA AND INTERSTATE LAND SALES, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

Ms. JACKSON. Chairwoman Velázquez, Ranking Member Chabot, on behalf of the Department, I appreciate the opportunity to discuss important issues related to the Real Estate Settlement Procedures Act, known as RESPA, and to highlight aspects of the proposed rule as part of HUD's RESPA reform.

Today, in the midst of a housing downturn when thousands of Americans are faced with the prospect of losing their homes through foreclosure, there is no doubt that the process of buying a house, itself, has been part of the problem. Many homeowners went to the settlement table, paid thousands of dollars in closing costs and entered into loans they did not fully understand. Consumers need to know: What type of loan are they getting? How much will it cost per month? What is included in their monthly payment? Will it go up? Today, consumers have no assurance that the loan terms and closing costs they are offered will be what they will be faced with at the settlement table.

RESPA was enacted to protect consumers during the home-buying process, requiring certain disclosures and prohibiting practices such as kickbacks and referral fees that increase the cost of settlement. RESPA requires the lender or mortgage broker to give a good faith estimate of charges the consumers will expect to pay to close the loan. The HUD-1 settlement statement itemizes the charges actually imposed.

RESPA covers millions of transactions each year involving virtually all loans by one-to-four family residential properties. It extends to providers settlement services such as appraisals, credit reporting, loan origination, and title and closing services.

The RESPA reform process has been thorough and inclusive. HUD has sought input from consumers, industry and Congress about how to update and improve the settlement process. In 2005, HUD held seven roundtable discussions with consumer and industry groups. Three roundtables conducted in Chicago, Fort Worth and Los Angeles were in conjunction with the Small Business Administration. HUD has thoroughly considered various options and opinions arising from these meetings in developing the current proposed rule, which includes a standardized GFE to improve the disclosure of loan terms and settlement costs, making it easier for consumers to shop, limitations on how much final settlement charges can vary from the estimated charges, and modification of the HUD-1, including a closing script, that will compare the final HUD-1 charges with the GFE and will describe to the consumer the terms of the loan he is receiving.

Finally, the proposal requires indirect fees paid to the mortgage broker by the lender and charged to the borrower through the interest rate to be applied to reduce the consumer's direct costs at closing.

HUD believes clear presentation of loan terms will improve borrower understanding of risky mortgage features, such as teaser rates, interest-only loans and balloon payments. Improved consumer shopping will lead to lower settlement costs of an estimated $500 to $700 per loan or over $8 billion annually. These savings, we believe, will come from competition and high-priced producers.

Since there is no evidence small businesses have been disproportionately charging high prices, there is no expectation of a disproportionate impact on small businesses.

Industry costs for the rule include one-time adjustment costs for training, software upgrades and legal advice related to the proposed GFE and HUD-1. These costs are estimated to be $570 million and $390 million from small business but at $5,000 to $6,000 per business. Recurring GFE costs include time processing the new forms and in calculating third-party charges to meet the tolerances. HUD-1 recurring costs include preparing the closing script and in reading it to the borrower. Total recurring costs are estimated to be $98 per loan. Even if all costs were passed on to the consumer, there would be a positive net effect of approximately $700 per loan. There are other economic effects that are important but difficult to quantify.

As a result of the proposed reform, consumers are less likely to engage in risky and uninformed borrowing, which could have positive impacts on the housing market, on the financial system and on the national economy. HUD would like to work with Congress to enact legislative changes to RESPA, such as requiring the delivery of the HUD-1 to the borrower 3 days prior to closing and providing for civil money penalties to bolster consumer protection and to ensure uniform enforcement.

Given the recent increase in home foreclosures, HUD remains committed to improving the complicated, unclear and costly home-

buying process. Under this proposal, home buyers would be presented for the first time ever with the standard form disclosing important aspects of the loan.

Thank you for the opportunity to appear here today. I look forward to your questions.

[The prepared statement of Ms. Jackson may be found in the Appendix on page 39.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Jackson.

Ms. Jackson, the RESPA rule requires settlement agents to explain the terms of a mortgage at closing. It seems to me that the lender is in the best position to explain these terms, not the settlement agent.

Do you anticipate that settlement agents will be able to answer most mortgage-related questions at closing?

Ms. JACKSON. We believe that they would. It is merely taking the information that we believe would be transmitted with closing instructions from the lender to the settlement agent and going over the documents. Many settlement agents go over these documents today. I have been lucky in all of my closings to have that done.

Chairwoman VELÁZQUEZ. Does that mean that HUD is putting the settlement agent in a position of speaking for the lender?

Ms. JACKSON. We are only asking that the—just as the information about the other loans and charges are transmitted from the lender to the title agent or to the closing agent to prepare the HUD-1, then this information would be transmitted to the disclosures on the script to be read to the borrower.

Chairwoman VELÁZQUEZ. If an agent tried to explain the mortgage and tried to answer questions that should be answered by the lender, doesn't that put an agent in the position of providing the unauthorized practice of law under many State laws?

Ms. JACKSON. Well, we have heard there is some concern out about that in different States, and that would certainly be something we would be looking at in the final rule into what would be appropriate for the closing agent to communicate to the borrower.

Chairwoman VELÁZQUEZ. So you are telling us that you are revisiting that issue?

Ms. JACKSON. Well, we certainly would be looking at it. This is, of course, a proposed rule. Anything is open to, you know, comment or to other ideas, certainly.

Chairwoman VELÁZQUEZ. I know HUD intended for the longer Good Faith Estimate format to provide more transparency to consumers. However, in some respects, the form decreases transparency. Unlike the existing format, the new GFE fails to itemize the fees.

Why did you or why did HUD reduce this level of detail in the new GFE?

Ms. JACKSON. We are trying to stop the proliferation of fees. I have had title agents or lenders call and say they have run out of lines on the HUD-1 and on the GFE. They had so many different types of fees that they were charging the borrower, and it is difficult to compare what one lender calls an ″admin fee″ and what the other calls a ″processing fee.″ Even in negotiating on your loan costs, you may find you get one of the charges—the processing

fee—off only to find, at closing, there is an admin fee for approximately the same amount of money. So we have tried to compress cost categories.

Chairwoman VELÁZQUEZ. Ms. Jackson, I understand all of that. I have the two forms here—the old format and the new one. This one is four pages. This one has all of the items. It itemizes all the fees so the borrower is able to look at it and see what he is paying for at closing. On this one, I think it is much easier for someone to hide some of the fees, don't you think?

Ms. JACKSON. Well, in the good faith estimate stage, we are trying to get the borrower to concentrate more on the bottom line of what his costs are going to be and the loan terms. Now, it is true that we have compressed certain categories on page 2 of the GFE. Of course, that is also open to comment. If there are specific items that others believe that should be required to be itemized, we will certainly take that into consideration.

Chairwoman VELÁZQUEZ. Ms. Jackson, the RESPA rules require settlement agents to determine whether certain charges estimated on the GFE exceed a 10 percent tolerance at closing. I know some members of the real estate industry are concerned that the rules do not give them enough guidance on what to do if the tolerance is exceeded.

Can you clarify to us what a settlement agent is supposed to do if the tolerance is exceeded?

Ms. JACKSON. We would just expect the settlement agent to highlight that to the borrower. If it is a refinance transaction and the borrower has the ability to rescind the transaction—

Chairwoman VELÁZQUEZ. I understand the concern from some of the people in real estate that you do not provide enough guidance.

Ms. JACKSON. Well, we would certainly take that into consideration in going forward.

Chairwoman VELÁZQUEZ. Let me ask you: Is a settlement agent supposed to stop a sale when the tolerance is exceeded by a mere $10 or $20?

Ms. JACKSON. No, that was not our intention. It was only to highlight it to the borrower. Also, because we intend to ask Congress to give us the authority to require that the HUD-1 be given to the borrower 3 days in advance, then we believe that the borrower would then have enough time to compare the GFE and the HUD-1 and to contact the lender and make a determination if there was a mistake or it would be the borrower's choice then what they would like to do with that.

Chairwoman VELÁZQUEZ. Okay. Mr. Chabot alluded in his opening statement to the fact of the regulatory flexibility analysis that HUD conducted for the RESPA rule, which was extensive. However, some firms in the real estate industry are concerned that it underestimated the economic effect on them given the fact that, when the regulatory flexibility analysis was conducted, the economic climate was totally different from what we are in today.

So what kind of outreach did you conduct with the small business community to determine the economic impact of the rule?

Ms. JACKSON. Well, we did hold the roundtables. That was, you know, back in 2005. We have been, you know, listening, talking to people. During this comment period, we have offered to meet with

any group or individual who would like to come in and talk with us about it. We will also be going back to see at the time of the final rule if there have been any changes in our figures that we would be updating that at that time.

Chairwoman VELÁZQUEZ. Let me ask you: Can you give us any example of where HUD makes changes to the rule based on feedback from small businesses?

Ms. JACKSON. Well, packaging is no longer a part of this rule. We certainly heard about that in the proposed rule in 2002. As you know, a former rule was withdrawn in 2004, and that has been part of this whole reform process.

Chairwoman VELÁZQUEZ. Is that one example or do you have more examples?

Ms. JACKSON. I would think that that is probably the, you know, major example.

Chairwoman VELÁZQUEZ. I have other questions. I will come back to you.

Now I will recognize the ranking member.

Mr. CHABOT. Thank you, Madam Chair.

Ms. Jackson, does the Department plan on updating the 2002 and 2004 data that it used to prepare the initial regulatory flexibility analysis?

Ms. JACKSON. Well, HUD used the latest census data available. So, if there is other data available by another source, then we would consider looking at it.

Mr. CHABOT. But that was data from back a number of years ago.

Ms. JACKSON. Right, it was.

Mr. CHABOT. Would you concede that the situation in the real estate industry has been pretty tumultuous in recent years? With the market's having tanked and just the home-building market and everything that is going on out there, wouldn't you agree that we have very different circumstances now than we did from the time of that data?

Ms. JACKSON. Well, circumstances in the market have certainly changed. I am not sure whether that would affect our cost analysis or not.

Mr. CHABOT. So, at this point, you do not have any plans on doing it. Would you be open to—

Ms. JACKSON. We would certainly be open to looking at more recent data—

Mr. CHABOT. Okay.

Ms. JACKSON. —and in looking at and in calculating what the costs would be.

Mr. CHABOT. Okay. Thank you.

Is HUD planning to hold any more public forums after the comment period closes?

Ms. JACKSON. At this time, we do not have plans to hold any.

Mr. CHABOT. Is that something else that might be considered if you determine there was reason to do that?

Ms. JACKSON. Well, we would be in the rulemaking process, and I am afraid I would have to check to make sure that that was something that would be appropriate during the comment period.

Mr. CHABOT. I am going to yield back at this time, Madam Chair.

Chairwoman VELÁZQUEZ. Ms. Clarke.

Ms. CLARKE. Thank you, Madam Chairwoman and Ranking Member Chabot, for holding this very important hearing.

The Real Estate Settlement Procedures Act is a vital tool in the American home-buying process. Most importantly, small businesses, such as title insurance companies and title agents, are important in the settlement and closing costs of residential mortgages. I believe that more transparent information could enhance consumer shopping and could discourage predatory, discriminatory and fraudulent lending processes.

So it is my hope that this concern is at the center of all that we understand the impact of HUD's proposed rule on small entities will address as this is a very important component of the subprime mortgage crisis and its predatory lending.

Ms. Jackson, I just have a couple of questions for you. First, can you explain to me how the proposed Good Faith Estimate is shorter or less complicated?

Ms. JACKSON. Well, borrowers would be able, if they wished, to just take the first page and to use that to compare costs and loan terms from different lenders since the loan terms are all on this first page, the important ones that we believe, like ″Is there a prepayment penalty?″ ″Can the interest rate go up?″ ″What is the beginning interest rate?″ Then at the bottom, there is a total of their costs.

Page 2, of course, then goes into more detail about the different types of costs and the different services that the borrower is paying for.

Pages 3 and 4 are merely more of an informational type for borrowers to explain to them what are some other charges that they may encounter in the home purchase and ownership. It also talks about whether the borrower would—if they do not have the money to bring $10,000 to closing, maybe through the trade-off table, they could see if there is a loan product that has a little bit higher interest rate where they would only have to bring $3,000 or $4,000 to close. So it is more of an educational tool for consumers, pages 3 and 4.

Ms. CLARKE. Would the Good Faith Estimate allow for an easy comparison to the HUD-1 settlement statement?

Ms. JACKSON. We have made some changes to the HUD-1 so that you can look back from the HUD-1 to the cost categories on the Good Faith Estimate. The closing script also—currently, we had proposed to have what we call a ″crosswalk″ where the fees on the GFE are listed and the fees on the HUD-1 so that the borrower can easily see if there is any difference.

Chairwoman VELÁZQUEZ. Would the gentlelady yield?

Do you think that, for the consumer, it is much easier and that they will be able to detect and to compare apples with oranges here?

Ms. JACKSON. Well, yes, because what we are trying to do is to come to, for example, a total of all lender fees so they can compare the lender fees of one loan to the lender fees of another. Like I said, borrowers become confused when the different fees have different names, whether it is an admin or a processing fee or a fee to sell

their loan in the secondary market or miscellaneous fees, those types of categories that we see.

Chairwoman VELÁZQUEZ. I will yield back, but I have to tell you, if I am in the process of reviewing this for my own sake, it will be quite difficult for me as a consumer to be able to compare the fees in this format, the HUD-1, with the Good Faith Estimate. My concern is we are doing this to protect consumers. Do you test these forms? What type of outreach do you do with consumers?

Ms. JACKSON. Yes, we did extensive different rounds of testing. I believe we had at least six rounds of testing beginning in 2002 through November 2007. We have been in Atlanta; Boston; Denver; Seattle; Tulsa; Los Angeles; Minneapolis; Austin, Texas; Portland, Oregon; Birmingham, Alabama.

Chairwoman VELÁZQUEZ. Okay. Okay. So you showed these two forms to them, to the consumers?

Ms. JACKSON. We showed them different forms. First, the company that was developing the form talked to the consumers and found out what they felt that they needed and developed the form, and then we did test something that was very similar to the HUD-1, and the consumers liked the form better that we have now.

Chairwoman VELÁZQUEZ. So you are telling me—and I will yield back and give you more time.

You are telling me that it is not much easier for some people to hide fees that are not itemized? Because they are not itemized here. It is not easier to hide those fees?

Ms. JACKSON. Well, it would be in the—they would see the totals of which category was higher than another category.

Chairwoman VELÁZQUEZ. I yield back. Thank you.

Ms. CLARKE. Thank you, Madam Chair. I just have one final question.

Ms. Jackson, as you know, hidden costs can act as a payment shock to a borrower, causing financial distress, which could possibly lead to rising foreclosure rates. Borrowers may have entered into high-cost loans as a result of discrimination.

Can you explain to me how this proposed rule will address this issue and, yet, not adversely affect small businesses?

Ms. JACKSON. Well, what we are trying to get borrowers to do is to shop. By holding lenders and brokers who are loan originators to a zero tolerance as we have proposed, then what they propose on the GFE is what the borrower would actually be charged at settlement. We have calls in my office every day from people who are at settlement who find out they need $900 more to close or that there was a fee that they did not anticipate. So what we are trying to do is, really, put the faith back into good faith estimate.

Ms. CLARKE. You spoke about the zero tolerance.

How was that enforced or how is oversight given to that?

Ms. JACKSON. Unfortunately, we do not have penalty provisions, civil money penalty authority, under RESPA. My staff is very pro consumer and has been able to call on behalf of consumers and, in most cases, get those fees reduced or taken off. Sometimes just HUD's calling gets their attention, and they offer to do that. We have returned hundreds of thousands of dollars to borrowers that way, but we do believe that we need civil money penalty authority

to make certain that we can enforce what is put on the GFE and then what is charged at the HUD-1 or closing stage.

Ms. CLARKE. Just in closing, Madam Chair, I think part of the run on the mortgage foreclosure piece has been a lack of real oversight and penalty. The practice has become sort of, I think, a way of doing business. Unfortunately, as a result of that, so many people have been adversely impacted.

So it is my hope that as you look at this and as you speak to the value of zero tolerance that some sort of provision is made to really enforce that so that we change that behavior and so that people do not see our sort of new paradigm of lending as a way of continuing a practice that has been really injurious to our economy.

I yield back. Thank you very much, Madam Chair.

Chairwoman VELÁZQUEZ. Sure.

Mr. Bartlett.

Mr. BARTLETT. Thank you very much.

Among other pursuits in a former life, I was a land developer and a home builder, so I have sat many times at the settlement table. I am not a big fan of regulation, but I am a huge fan of truth in advertising.

I gather what you are doing comes closer to truth in advertising than it does to regulation?

Ms. JACKSON. Well, we do believe that what borrowers are told on the phone or what is put on a Good Faith Estimate should be what they will receive at the closing table, and so we do want to see that. It has impacted—we do believe that borrowers have paid higher origination charges. HUD will soon come out with a study done with the Urban Institute where we believe, based on the study, that African Americans paid $315 to $532 more than non-minorities after controlling for other relevant factors and that Latinos paid $290 to $450 more than non minorities after controlling for all other factors. We believe that, in making the Good Faith Estimate actually be what the borrower will finally see, that they will have the confidence to shop and to obtain the best loan.

Mr. BARTLETT. When the real costs exceed by more than 10 percent the Good Faith Estimate, who pays that?

Ms. JACKSON. On the 10 percent—on the tolerance?

Mr. BARTLETT. You have gotten a Good Faith Estimate of what it was going to cost. You come to the settlement table, and it costs more than that. Your regulations say that if it, in fact, exceeds that by more than 10 percent somebody has to pay that difference. Who pays the difference?

Ms. JACKSON. If the borrower wants to go ahead and close through the transaction, then they would go ahead and pay the additional amount of money. We hoped by having the HUD-1 delivered 3 days in advance that there would be a dialogue between the borrower and the lender to either reduce the cost back under the 10 percent tolerance or less. We also, if given civil money penalties, would look to see whether there was a pattern or a practice with that lender or, perhaps, report that lender to Federal and State regulators also.

Mr. BARTLETT. But there is no leverage at the settlement table to get those costs reduced if they, in fact, exceed the Good Faith Estimate?

Ms. JACKSON. Well, I think some people probably have the leverage to do that, particularly on—

Mr. BARTLETT. But you do not? You do not have any leverage? Today, no one is compelled to make up the difference. The buyer either goes through with it or—

Ms. JACKSON. He does. He goes through and pays. We have looked at asking the rule about the possibility of a time limit to cure so that the lender, whether it is 15 days or 30 days or some other time frame, would go back to reimburse the borrower for the overcharges during that cure period. If they did not, if we were given penalty provisions, then we would start an action, an action against the lender.

Mr. BARTLETT. Do you think the borrowers who are now in distress did not go to the settlement table with their eyes wide open?

Ms. JACKSON. I think that some did not. I know that sometimes borrowers are brought—we had an example in our office where the documents were sent to the consumer's home to sign. It was, you know, in the evening. She signed them without really looking at them. She ended up with an $8,000 prepayment penalty and an adjustable rate interest that was a lot higher and additional charges, I believe, around $12,000. Now, we were able to use just our influence to get her out of that, but there are millions of borrowers who are ripped off every day.

Mr. BARTLETT. I would like to note in closing, Madam Chairman, of the many times I sat at the settlement table, I never read the documents because there were too darned many of them. As a result of regulations, there is a huge pile of documents. I paid a lawyer to sit at the table with me, and I trusted that he had read the documents and that he gave me good advice.

You cannot, Ms. Jackson, count on the consumer to read these documents. They are too technical. There are too darned many of them. There is a huge pile of them at the usual settlement. Somehow we have got to cut through this so that the buyer really knows what he is signing. I trusted the lawyer who sat with me at the table. I do not know who they trust. Is it their agents?

Ms. JACKSON. I do not know, sir. That is exactly what we are trying to do because there are so many documents, and different terms of the loan are in different places, and there is different information. So that is why on the first page we put what we thought was most important.

Mr. BARTLETT. Thank you very much, Madam Chairman.

Chairwoman VELÁZQUEZ. Mr. Cuellar.

Mr. CUELLAR. Thank you, Madam Chair.

Ms. Jackson, I am an attorney. In the past, I have done closings, so I think we know exactly what we are talking about. Even as an attorney, I think it is complicated. Even as an attorney, I think it is too much paperwork, and I do understand the reason you are trying to do this, but we have to be careful about the solution that we want to use to address the problem. I always believe that the solution should be better than what it was before.

In hearing from my Texas folks, they seem to have big concerns, and I do not know if you have seen that there is a huge amount of questions on this side. I am talking about this side of the table.

The first thing is I think your own estimates say that the cost of the real estate industry would be $570 million up front and then about $1.2 billion annually; is that correct? Is that what your estimates are?

Ms. JACKSON. Our estimates would be that it would be about that amount up front, the $585 million to $590 million, and we believe that works out to be about $5,000 to $6,000 per small business

Mr. CUELLAR. Okay. Who do you think the small business is going to transfer that cost to?

Ms. JACKSON. To the consumer.

Mr. CUELLAR. Okay.

Ms. JACKSON. However, we believe that there are substantial consumer savings. Even if you pass all of the costs on to the consumer, our estimate is that the consumer would still be saving around an average of $600 per loan transaction.

Mr. CUELLAR. So, if you transfer $5,000 and take another savings, you say, at the end it will save the consumer money?

Ms. JACKSON. Yes. We believe, in the end it would save the consumer money.

Mr. CUELLAR. Okay. You do know that there are so many folks who disagree with your opinion on this.

Ms. JACKSON. Yes.

Mr. CUELLAR. Okay. Second of all, paperwork. Some attorneys charge by page. No, I am just kidding. There is a lot of paperwork. I am a big believer—in Texas, I had legislation to reduce paperwork for all of the agencies. One is, if you can put it on one page instead of on 10 pages, let us try to reduce it. Nothing against attorneys—I am also an attorney—but if you can put it in plain English, put it in plain English.

Does this reduce paperwork or does this add paperwork to a process—and I know this process because I have done it in the past. Does this reduce or does this add to a process that already has a lot of paperwork?

Ms. JACKSON. Well, it does add more pieces of paper to the process, which does have a lot of paper now, but at the same time we believe that it is important information to keep borrowers from getting into the messes that they are in now. We believe that a lot of borrowers did not understand the loans that they were getting. So, if it takes another sheet of paper or, you know, another line of disclosure, then we believe that that is worth it.

Mr. CUELLAR. Is it possible to save money and save paperwork—well, is it possible to help the consumer by doing it in such a way that you actually save him money and actually reduce the paperwork or are you saying the only way we can help consumers is by adding more paperwork and by adding another $5,000 to the real estate industry that will be passed on to the consumer?

Ms. JACKSON. Well, we only control the Good Faith Estimate and the HUD-1 and a couple of other disclosures in the process. So we do not—you know, HUD does not necessarily have the control to reduce other paperwork that may be required by the State. Oftentimes, borrowers are asked to re-sign disclosures.

Mr. CUELLAR. So you are saying that you have the power to increase paperwork but not to reduce paperwork?

Ms. JACKSON. We have the power to control what is on the GFE and on the HUD-1 and on a few other disclosures but that anything else would be outside of our jurisdiction.

Mr. CUELLAR. I know my time is almost up. Let me just ask my last question.

I can understand the intent. I do not have a problem with that. I want to protect the folks whom you mentioned—the Hispanics, the blacks—anybody who might be taken advantage of, okay? I just want to see a solution that will make it easier and simpler for the folks we are trying to protect and not make it expensive. The last question that I want to ask is:

Did you all do a cost-benefit analysis to this? In other words, in order to help somebody, is it going to cost more to help that person? Does it cost more than the benefit we are trying to provide?

Ms. JACKSON. We do not believe so. We believe that it will cost—add—an additional approximately $98 per loan closing, but we believe that consumers will still reap substantial benefits in hundreds of dollars more.

Mr. CUELLAR. So we are adding to the costs to help the benefit to the consumer?

Ms. JACKSON. Well, we are adding to the—perhaps it will be more costly to explain a little more to the consumer what they are actually getting, but at the end of the day, then, you know, maybe they would not get a loan with a prepayment penalty where they cannot get out of that.

Mr. CUELLAR. I am with you, but my question is, if you can just answer this: In terms of paperwork and cost to the consumer, does the cost-benefit analysis mean we are adding more to the cost to benefit the consumer? Just a ″yes″ or ″no.″

Ms. JACKSON. Yes.

Mr. CUELLAR. Okay. Thank you.

Chairwoman VELÁZQUEZ. Mr. Johnson.

Mr. JOHNSON. Thank you.

I am coming in on the tail end of this discussion, so I must apologize. I hope I will not ask anything that has already been asked.

I will say that, you know, there is some cost in implementing these new regulations that have been proposed, but the regulations and the costs will be passed on to the consumer. Is that what I am hearing you say? It will be approximately how much per closing?

Ms. JACKSON. $98 per closing.

Mr. JOHNSON. $98 per closing.

But now the purpose of these new regulations is to enable the borrower to understand precisely the kind of loan product that is being offered in advance, prior to the borrower's coming to the closing table, correct?

Ms. JACKSON. Correct.

Mr. JOHNSON. Then once the borrower is at the closing table, the regulations, the proposed regulations, will result in the borrower's having a better understanding of the product that is being closed on their behalf, correct?

Ms. JACKSON. Correct.

Mr. JOHNSON. So it will tend to help people avoid getting locked into situations that they never intended, and it just comes up at

the closing, such as the fact that this mortgage has a balloon payment feature, correct?

Ms. JACKSON. Correct.

Mr. JOHNSON. Or it has got an adjustable rate and the rate can adjust every 6 months or every year or every 2 years or after 2 years or 3 years or 5 years have gone by, that kind of thing, correct?

Ms. JACKSON. That is absolutely correct, sir.

Mr. JOHNSON. And that is not a 30-year fixed rate mortgage. There is even a prepayment penalty. There is or is not a prepayment penalty.

Ms. JACKSON. That is correct.

Mr. JOHNSON. And your yield spread premium, which most people have no idea of what that means, they get an understanding of what the yield spread premium is and how much it is actually going to cost them, correct?

Ms. JACKSON. Yes.

Mr. JOHNSON. So these kinds of regulations would result in, probably, a savings as far as any equity that may be in a home that is being refinanced?

Ms. JACKSON. That is correct.

Mr. JOHNSON. And it probably even has the potential to cut down on some of the up-front costs on a new mortgage that the borrower would be expected to produce at the closing table?

Ms. JACKSON. That is what we expect, to the tune of about $600 per loan.

Mr. JOHNSON. So this $98 that it would cost the borrower would have to be weighed against the potential savings that would accrue to the borrower. Then a net result, in your humble estimation, would be what in terms of dollars to the borrower?

Ms. JACKSON. Well, we believe that the savings would be around—almost $700 to start. Then there could be additional savings for time efficiencies to the borrower. Then after subtracting the $98, we still believe that the consumer would have a net benefit of $600 to $700.

Mr. JOHNSON. What would that savings be derived from?

Ms. JACKSON. It would be derived from the fact that we believe that borrowers could take the first page and shop from lender to lender and have everything on the first page so that they could compare apples to apples so that you know that you are comparing loan features—if they are fixed rate to fixed rate, no prepayment penalty to no prepayment penalty—and derive the best loan for you. Then once you accept that loan, what you believe you will pay at the GFE stage is what you will actually see at settlement.

Mr. JOHNSON. Okay. All of this has been precipitated by the alarming increase in the number of home foreclosures that were brought on by people being steered into the subprime market who could have afforded a prime loan, but yet they ended up with a subprime loan unbeknownst to them?

Ms. JACKSON. That has certainly—we believe that the fact that they did not know what terms they were getting and that their costs were greatly increased has helped lead to the current crisis.

Mr. JOHNSON. All right. Thank you.

Chairwoman VELÁZQUEZ. Ms. Fallin, do you have any questions?

Ms. FALLIN. Thank you, Ms. Chairman.

Sorry I missed getting to hear some of your testimony, but we appreciate your coming today and helping us with this very important issue. I had something I wanted to ask you about on the volume price discounts. That is:

Does the HUD plan on assessing in its final regulatory flexibility analysis the viability of small business in the residential real estate settlement industry due to the implementation of the volume price discounts? What effect will it have on small businesses, and will it be able to compete?

Ms. JACKSON. Well, we do not really think that it would have an effect on small business.

First, volume-based discounting is allowed now under RESPA. What we have tried to do in the rule is to clarify to all of the different jurisdictions across the country that HUD interprets that it is not a violation of RESPA for volume-based discounts as long as any savings derived from it is passed on to the consumer. So, if there were some negotiation to lower appraisals or the cost of appraisals, as long as that savings was passed to the consumer, then we would not consider it to be a violation.

Ms. FALLIN. Well, do you think the same amount of small businesses will be able to compete for this program to be able to offer the discount?

Ms. JACKSON. We do think that small businesses will also be able to take advantage of volume-based discount.

Ms. FALLIN. All right. Thank you.

Thank you, Ms. Chair.

Chairwoman VELÁZQUEZ. Ms. Jackson, I understand that HUD requires for settlement agents to draw up a script and to read it aloud. My understanding is that HUD estimates that that requirement will add up to 45 minutes to the time it takes to close a transaction.

How did you arrive at this figure? How much will this new requirement cost small businesses in the real estate industry?

Ms. JACKSON. Well, we believe that, as we said, it would add, probably, I think it was, around $54 per loan for the recurring cost on the HUD-1.

Chairwoman VELÁZQUEZ. The 45 minutes will represent $54?

Ms. JACKSON. Well, it was 30 minutes. That was for the preparation of the script, then an additional 15 minutes would be—reading the script about 5 minutes, and we allowed about 10 minutes per question, and so we used a loaded salary figure of about $150,000 and came up with the $54 for the 45 minutes. Now that is assuming—we thought that that was the worst-case scenario, that that would be going from additional costs to a settlement agent who did not go over any documents with consumers at all now, who just basically said, ″Here, sign these documents.″ As we know, many settlement agents go through the documents with the consumer now, so we tried to come—we do not believe that it will be $54 per loan for all transactions, but we tried to use the worst-case scenario.

Chairwoman VELÁZQUEZ. So 45 minutes. That means that agents will be doing fewer closings because they have to go through this process. So how are they going to make up for the closings that

they will not be able to do given the fact that they are going to be spending 45 minutes?

Ms. JACKSON. Well, we do believe that these costs probably will be passed on to the consumer, but we do believe that the consumer will still save in the long run.

Chairwoman VELÁZQUEZ. You mentioned that it will represent $600 more per consumer.

Ms. JACKSON. Right. A net cost benefit after $98 of approximate costs for the new rule per loan was subtracted.

Chairwoman VELÁZQUEZ. RESPA, if done properly but without enforcement and oversight, will take us nowhere.

So how do you intend to have in place the type of oversight that will make it work?

Ms. JACKSON. Currently, we depend on other Federal banking regulators and State regulators. When they go in and do examinations, they check to see that RESPA is followed. If not, it is sometimes referred to us or sometimes they take action themselves. As I said—

Chairwoman VELÁZQUEZ. What happened? What happened? We have almost 3 million homeowners in this country who are going through foreclosure or who will be going through foreclosure. Where were the regulators? Were they sleeping at the switch?

Ms. JACKSON. Well, I cannot speak for all of the different regulators, but that is our concern. That is why we have asked for penalty provisions so that we can also enforce and try to make certain that borrowers, at the closing, do get the deal that they were promised. We want transparency in the transaction.

Chairwoman VELÁZQUEZ. And simplicity, too, because if there is transparency without simplicity, we might not achieve the goal for the consumer to know every fee that they are supposed to pay at closing.

I have to go back to these pages of this format. You know, when I compare it to the old one, you can match them up line by line, and you can find the fees on the settlement statement with the Good Faith Estimate. When I tried to do this here—believe me, I do not know what test you do with consumers to come up with the conclusion that this four-page format is better suited to achieve the goal of protecting consumers and to have transparency in the process.

Ms. JACKSON. Well, we are in the comment period, and we will be, you know, re-looking at all of the comments that come in, and we will be re testing.

Chairwoman VELÁZQUEZ. Well, for whatever it is worth, this almost Ph.D. candidate here will tell you that I just—I do not get it. I just—I do not get it. I do not get it. If I am going to close and have this—believe me, I went through this. I did not read it. My husband did. If I have to go in a room by myself, it is going to take me I do not know how long to compare the fees that are, one, on the good faith and on the settlement statement. So I do not get it. I hope that you will go back and revisit that just because it is four pages. Sometimes—like some of the members from the administration come and say that they do more with less. Maybe consumers will be able to get better with less in terms of the pages that you are putting together.

Ms. JACKSON. We do think that that first page is very important, though, that consumers know whether they have a prepayment penalty or whether their interest rate can go up.

Chairwoman VELÁZQUEZ. Okay. Does any other member have any more questions? Yes.

Ms. CLARKE. Madam Chair, I have one final question.

As it stands, the GFE would become a binding or a final quote, which would be difficult to provide without underwriting. Loan pricing depends on having information about borrower credit history and ability to pay. Also, loan originators need to assess borrower risk to generate a binding quote, especially high-risk borrowers, which takes time and money.

Wouldn't your proposed GFE disclosure requirements create some controversy?

Ms. JACKSON. Well, it has certainly created controversy. What we believe is that you do make certain assumptions. The GFE is generated after certain information is obtained from the borrower—a property address, their Social Security number—so that a credit report can be pulled. Then based on certain types of information, that is what the quote would be based on. If, once you get into the loan processing you find that the borrower went out and bought a new car or that something changed his financial picture—if you found a bankruptcy that did not show up in the filed credit report—well, those types of things, of course, would be a reason to change the loan product. So it is not that once you get the GFE and you find out something is different in the borrower's financial picture that you would have to go through with that quote.

Ms. CLARKE. So does the process begin again? I mean what happens to that borrower? Most of these borrowers are coming to the table, and they are not as sophisticated about their financial standing with respect to credit reports and things of that nature. If, in fact, you come upon a case like that, do they have an opportunity to revisit the GFE? What exactly happens at that point? What do you think would happen at that point? Because this is all theoretical at this point.

Ms. JACKSON. This is what we envision would happen, that if something comes up in the borrower's credit or in his financial situation that the lender did not know about at the time, then they would say that they could not offer that loan product. If they had another loan product that the borrower would fit, they would then issue a new GFE for that new loan product.

Ms. CLARKE. Thank you, Madam Chair. I yield back.

Chairwoman VELÁZQUEZ. Ms. Fallin, do you have any other questions?

Ms. FALLIN. Ms. Chairman, I have just one more question.

Do you have any suggestions on how we can protect the consumers and give them the information that they need to have full disclosure of all of the fees and costs to reduce the paperwork? Is there anything that we, as Congress, mandate, which I know there is a lot of stuff, that you see that might be unnecessary as far as the protection, the disclosure and the loan process itself, that we could consider doing away with?

I was looking at these forms also, like the chairwoman. By the way, she mentioned that she had her husband look at the forms

because she did not understand them. She is a very smart woman. She just has less time than her husband, so I just wanted to clarify that. Her husband is very smart, too. I just think she has less time to understand all this stuff.

In looking at the forms, when you can look side by side, it does appear to be easier to understand, and I have had many loans myself and kind of prefer that information, but I thought I would just ask if you have any recommendations for us as to how the government can help the government.

Ms. JACKSON. Well, not at this time. We will be glad to look at that and maybe get back to you, you know, and respond to that. The form is—you know, four pages is long, but like I said, the last two are more educational information for the borrower. We have, you know, struggled with that. Do we put the information in the settlement cost booklet? However, if we do that, then the information, such as the tradeoff table, is not loan-specific. So, you know, we are struggling with that. You know, we will certainly take your comments into consideration.

Ms. FALLIN. I always like to provide full disclosure to people when they are buying stuff, but sometimes we get too wordy and too complicated in our forms, and it confuses us more. I wonder sometimes if the government does not want to just confuse people.

Thank you.

Chairwoman VELÁZQUEZ. Ms. Jackson, you are excused. Thank you so much for being here today.

I will ask the second panel, please, to come forward.

Ms. Jackson, I would like also to know if there is a staff person who will remain in the hearing room.

Ms. JACKSON. Yes, there is.

Chairwoman VELÁZQUEZ. Can we have his or her name?

Ms. JACKSON. Andrew Faye.

Chairwoman VELÁZQUEZ. Thank you.

Sorry for the inconvenience of the room, but our Small Business Committee room is under renovation, so hopefully—this is the government, you understand. It can take one more month or maybe three or four, so who knows.

Anyway, I would like to welcome our first witness, Mr. Gary L. Kermott. Mr. Kermott is Vice Chairman of First American Title Insurance Company and also serves as Executive Vice President of the First American Corporation. He will be testifying on behalf of the American Land Title Association.

ALTA, founded in 1907 is the national trade association and voice of the abstract and title insurance industry. Nearly 3,000 title agents, abstractors and title insurance companies are active members and conduct business internationally in almost 100 countries worldwide.

Welcome. You will have 5 minutes to make your opening statement.

**STATEMENT OF MR. GARY L. KERMOTT, VICE CHAIRMAN, FIRST AMERICAN TITLE INSURANCE COMPANY, EXECUTIVE VICE PRESIDENT, THE FIRST AMERICAN CORPORATION, ON BEHALF OF THE AMERICAN LAND TITLE ASSOCIATION**

Mr. KERMOTT. Thank you, Chairwoman Velázquez, and thank you, members of the committee, for this opportunity to testify on HUD's proposal to amend RESPA.

As Madam Chairman mentioned, my name is Gary Kermott, and I am serving as the 2008 President of the American Land Title Association. As such, I am speaking on behalf of our nearly 3,000 title insurance companies, agents, abstractors, escrow officers and attorneys who search, examine, insure land titles, and perform real estate closings. A majority of our members are small businesses with between 2 and 16 employees.

Although we agree with HUD on its goals, we are concerned that the proposal will not achieve them and may, indeed, create problems that undermine HUD's efforts. In addition, the association believes the Department is attempting, by regulation, to convert a statutory disclosure regime into a new pricing regime that was not intended by Congress and is not authorized by the statute. We address that in our written statement.

My remarks today will focus on three areas of the rule that would be most harmful to our small business members and consumers: First, the closing script; second, how fees are disclosed and, third, volume discounts and tolerances.

First, the closing script: The closing script will lead to longer and postponed closings, to the loss of down payments and increased litigation while failing to provide any real benefit to consumers. Why? First, it is too late at closing for consumers to change the terms of their loan. The moving van is parked outside. Second, the settlement agent does not have the information or the knowledge to answer questions raised by the closing script. Third, the increased costs for longer closings will fall on the consumer. In some States, it will raise the issue, as mentioned earlier, of the unauthorized practice of law, but more importantly for our small business members, HUD fails to recognize that over 50 percent of closings occur at the end of the month. This increased time to complete, read and explain the closing script will definitely and disproportionately harm smaller settlement companies because they lack the resources to add personnel and physical space to accommodate these extended closings. The script should be completed and delivered by the lender earlier in the process so that the consumer understands their loan terms and has the opportunity to negotiate changes.

Title and closing fee disclosures: Although one of HUD's key objectives is to simplify and to improve consumer disclosures, how our fees are disclosed on the new forms is misleading and will discourage consumer shopping for services that are in their best interests. Why? Because the new GFE only discloses an aggregate figure for a range of services. That makes it more difficult for the consumer to shop for individual title or closing services at a lower price. They will not know what is included in the package. Similarly, by lumping together so many different charges into the category of Primary Title Services on the new HUD-1, the buyer and seller will not know how their funds were actually disbursed and

to which providers. This defeats a primary purpose of the HUD-1 as a record of the transaction. This will also hide what fees the seller may have negotiated or be required to pay under State law, practice or contract.

Volume discounts and tolerances: Volume discounts are anti-competitive and will harm small title insurance companies, small banks, mortgage brokers, appraisers, and other small settlement providers. The largest companies have the resources to either favor their own affiliated companies or to create a network of preferred providers that could offer services below cost. This will push small, independent providers out of business, resulting in less competition and higher prices. Our members do not believe HUD should dictate such changes. Because lender recommended services are subject to a 10 percent tolerance, the message to the borrower will be ″Go with me. You will get a better deal.″ By emphasizing these guaranteed prices to consumers, lenders would encourage a borrower selection of the recommended provider and end shopping. HUD even recognizes this in their economic analysis. Yet, there is no guarantee that these recommended service providers are the least expensive or the best. This is a disguised form of packaging that was uniformly rejected in 2002.

Based on these concerns, ALTA suggests that HUD limit its efforts to simplifying only the GFE and the HUD-1 so the comparisons can be more easily made between the documents. This would be a huge improvement for consumers without imposing extraordinary costs on small businesses.

Thank you.

[The prepared statement of Mr. Kermott may be found in the Appendix on page 53.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Kermott.

Our next witness is Mr. Adam D. Cockey. Mr. Cockey is the Senior Vice President of Prudential Carruthers Realtors, a real estate firm, with 25 offices located in the District of Columbia, Maryland and Virginia. He is here to testify on behalf of the National Association of Realtors. NAR was founded in 1908 in Chicago, Illinois. It is America's largest trade association with 1.2 million members.

Welcome.

**STATEMENT OF MR. ADAM D. COCKEY, JR., SENIOR VICE PRESIDENT, PRUDENTIAL CARRUTHERS REALTORS, ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS®**

Mr. COCKEY. Thank you, Madam Chair Velázquez and members of the committee. Thank you for holding these hearings and for giving the National Association of Realtors® the opportunity to share our 1.2 million members' concerns about HUD's proposed RESPA rule.

My name is Adam Cockey. I am the Senior Vice President for Prudential Carruthers, which is a full-service real estate firm, located in Washington, Maryland and Virginia. I started in the real estate profession 33 years ago, the same year Congress passed RESPA, so RESPA and I have sort of gone through this industry together.

RESPA reform is important to NAR members because it is an essential component of any home purchase. Real estate agents develop working relationships with clients and stay with them throughout the closing process. As a result, consumers look to their real estate professional to help them understand the process from beginning to end.

In 1974, the key congressional objectives of RESPA were to reduce settlement costs, to eliminate referral fees and kickbacks, and to require disclosure to consumers so that they could better understand the terms and costs of their transactions. One thing Congress made very clear when it passed this law was that RESPA was not designed to be a rate-setting statute. NAR believes that HUD's extensive changes to the Good Faith Estimate and to the HUD-1 disclosure forms fall short of the mark and need additional work.

HUD's changes, though well-intended, could have been much improved if HUD had tested some of these ideas with those who must implement them. We believe that the proposed rules err by, one, expanding the current two-page Good Faith Estimate to have four pages, by eliminating the disclosure of a number of settlement costs and by requiring a 45-minute closing script. This is not simplification. Despite the suggestion of its own design consultant, HUD did not reformat the GFE to more closely match the HUD-1. Marrying the two forms in a common sense solution would greatly have helped the consumer decide whether the terms of expenses that were disclosed to them at loan application are those that are governing the loan terms and costs at closing.

NAR also believes it is imperative that the consumer has information of all relevant costs. HUD's failure to include all of the standard costs in its revised GFE will give consumers less than full disclosure, which Congress intended. While Congress never intended RESPA to be a rate-setting statute, that is where HUD has chosen to focus. The proposal includes anti-kickback exemptions for volume discounts and tolerances for some costs that will tip the balance in favor of the largest lenders and will hurt small, independent settlement service providers.

The proposed rule permits lenders to offer borrowers a package of third-party settlement services. Clearly, the largest lenders will be most successful in exerting their sizable market strength on providers to create the lowest cost package of settlement services to the detriment of small businesses.

While the idea of creating a mechanism to reduce prices is appealing, HUD has ignored the impact that this will have on service quality. As we have seen in the current market mortgage crisis, quality loan products and appraisals do matter. If recent experience has not taught us anything, it is that cutting corners in this business only results in broken dreams. Now we are all paying for it.

Finally, HUD's proposed closing script will add far more costs than HUD anticipates and will provide little benefit. HUD estimates the closing script will add 45 minutes and little cost. It is hard to imagine closing attorneys will donate that extra three-quarters of an hour or that a closing agent will not need to be compensated for the reduced number of transactions that can be handled. In the end, buyers and sellers will pay the added cost. In my

practical experience, the information, including in the closing script, comes too late. Disclosure could be better achieved by a clearer Good Faith Estimate at the beginning of the process.

In conclusion, NAR strongly supports better disclosure of mortgage terms and settlement costs. HUD's RESPA reform proposal, however, should be reworked to focus on common sense disclosure while eliminating the volume discounts, closing script and tolerance provision. NAR believes that we need to put aside the political calendar and work on a practical and effective reform focused on simple disclosure. We have the ability to do RESPA reform right. We cannot afford just a good enough approach.

Thank you.

[The prepared statement of Mr. Cockey may be found in the Appendix on page 81.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Cockey.

Our next witness is Mr. David G. Kittle. Mr. Kittle is Chairman-Elect of the Mortgage Bankers Association and is President and Chief Executive of Principal Wholesale Lending, Inc., in Louisville, Kentucky. Mr. Kittle has been active in the mortgage banking industry since 1978. The Mortgage Bankers Association is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country.

Welcome.

**STATEMENT OF MR. DAVID G. KITTLE, CMB, CHAIRMAN-ELECT, MORTGAGE BANKERS ASSOCIATION**

Mr. KITTLE. Madam Chairwoman, thank you for the opportunity to appear before you as a mortgage banker and as a small businessman. I am pleased to discuss the changes HUD has proposed to the RESPA regulations.

Since HUD last issued a RESPA rule in 2004, the real estate market has experienced an unprecedented crisis, resulting in severe hardship for consumers and businesses alike. This crisis has many causes and victims. The causes range from economic conditions to real estate prices, to outsized investor and borrower appetites. The victims include borrowers—but more than that, future borrowers—communities and the economy at large. While MBA does not believe that the lack of transparency in the mortgage process is the main cause of borrower difficulties or that its improvement is the only solution, greater transparency could help stem abuses. The sheer volume and complexity of disclosures today allow abusers to hide in plain sight.

Long before the current market crisis, MBA supported simplification and greater financial literacy. MBA believes that the problems in the industry are a good reason to redouble efforts in both of these areas. Greater transparency would better empower consumers to make smart choices based on their own individual needs. It would also empower borrowers to compare their initial loan offers to the final cost of the loan, which would help protect against abuse. In today's market, people shop more effectively for a new flat screen TV than they do for a mortgage. We all need to do a

better job to encourage increased shopping by consumers and clearer loan information.

The forms that borrowers confront today include the truth in lending disclosures, which detail the cost of credit, and the Good Faith and HUD-1, both of which detail settlement costs. These forms are required under TILA and RESPA. Consumers need to get a clearer, simpler set of forms than these. So any changes to TILA forms, which are the Federal Reserve's responsibility, and to RESPA forms, which are HUD's, should happen together. Otherwise, additional costs associated with implementing new forms and procedures will fall on consumers and small businesses. In other words, reform should happen comprehensively rather than piecemeal.

HUD has issued its rule, and the Federal Reserve has announced that it will work on a new TILA rule. HUD and the Fed should work together on these forms. If they are unable to do that, at the very least, HUD should delay the implementation of its rules until the Fed implements its TILA changes. Most importantly, the disclosures must work together. It makes no sense to have TILA, GFE and HUD-1 forms that do not.

While we have many issues that are detailed in our testimony, actually improving transparency is the most important. The HUD-1 and the GFE should work hand in hand. If nothing else, failing to ensure that they do will be a missed opportunity that will result in continued confusion among consumers. While simplification of the mortgage process is a high priority for MBA, we do not believe improvements should unduly harm small businesses. We believe that small businesses operate effectively in all aspects of the mortgage process and should continue to do so.

The rule as proposed by HUD will have significant effects on both small and large businesses. The effects of the proposed rule would include onetime and ongoing costs of the new rule, including increased time and money spent in closing and possibly increased legal liability for everyone involved. My written statement goes on to further detail on these points.

The Mortgage Bankers Association supports efforts to make the mortgage process simpler, clearer and more transparent for consumers. Doing so will empower consumers and will help fight predatory lending. The RESPA rule released by HUD is not simplification. Consumers need a full reform of the disclosures they see, including RESPA and TILA, that help them quickly and effectively navigate the mortgage process. Public policy should help ensure that the problems we see in the market today do not happen again. Reforming the mortgage process is an important but difficult task, and it is imperative that we get this right.

One more quick point. I appreciate the 5 minutes you have given me today. Just imagine if I had to read the entire closing script that HUD proposes. It would have taken me nine times as long as this statement took me to read.

Thank you. I look forward to answering your questions.

[The prepared statement of Mr. Kittle may be found in the Appendix on page 89.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Kittle.

Our next witness is Mr. Marc Savitt. Mr. Savitt is the President-Elect to the National Association of Mortgage Brokers. The national association is the voice of the mortgage broker industry, representing the interests of mortgage brokers and home buyers since 1973.

Welcome, sir.

**STATEMENT OF MR. MARC SAVITT, PRESIDENT-ELECT, THE NATIONAL ASSOCIATION OF MORTGAGE BROKERS**

Mr. SAVITT. Good morning, Chairwoman Velázquez and members of the committee. Thank you for the opportunity to testify today.

Like most of my fellow NAMB members, I am a small business owner, living in the same community where I work. As a member of NAMB, I am required to adhere to a professional code of ethics and best lending practices. In addition to NAMB requirements, mortgage brokers are regulated in all 50 States and in the District of Columbia.

HUD's proposed rule will make bold changes in the marketplace and in my business. In light of the current market situation, rising home foreclosures, the credit crunch and recent proposed changes to the FHA program, NAMB questions the appropriateness of the timing and implementation of the proposed rule.

Today's mortgage market is significantly strained and continues to experience turmoil and change. At this time, NAMB believes HUD's efforts and the mortgage market in general may better be served by focusing on the market today and in providing support for consumers currently at risk of losing their homes to foreclosure. NAMB applauds HUD's RESPA reform efforts to date. However, we believe HUD should consider declaring the implementation of any new policies or procedures until the market is able to stabilize, to accommodate changes and to provide assistance to the high volume of borrowers currently in need of refinancing and/or foreclosure assistance through programs administered by HUD.

NAMB believes HUD should continue to move forward with the RESPA reform process, focusing specifically on measures in the proposed rule that seek to protect consumers from unnecessarily high settlement costs and abusive practices and enhance transparency of the loan origination process, taking into consideration comments and suggestions received during the critical review period.

NAMB has long advocated for high uniformed standards for all mortgage transactions as well as the creation of minimum standards for education, criminal background checks and the national registry for all originators. NAMB objects to components of the proposed rule that would not best serve the consumer either because they would impede competition, would treat direct competitors differently, would fail to reflect the most authoritative research or would not consider the most effective and least burdensome alternatives.

Despite changes in the market since 1992, such as automated underwriting systems, Web-enabled credit scoring, software programs, et cetera, which have blurred the lines between broker and lender transactions, the proposed rule continues to promote artificial distinctions between broker and lender transactions.

The proposed rule requires the disclosure of yield spread premiums, YSPs, only in broker transactions. In general, YSP represents the spread between the wholesale and retail rate of funds. This spread is not required to be disclosed in lender transactions. This artificial distinction places small business mortgage brokers at a competitive disadvantage by imposing asymmetrical disclosure obligations among the originators receiving the same competition.

Exhaustive studies of the mortgage disclosures by the Federal Trade Commission—the government's principal consumer protection agency—in 2004 and again in 2007 showed that additional disclosures of YSP created confusion, caused consumers to choose more expensive loans, led to a bias against broker transactions, and impeded competition, thus hurting consumers. Requiring brokers but not other originators to make such disclosures enables our competitors to steer consumers away from brokers even if brokers offer more favorable loans.

For these reasons, NAMB believes the FTC should conduct a thorough analysis and field testing of any proposed GFE forms to ensure the market remains competitive and that new disclosures do not lead to biases or fraudulent practices between the distribution channels. We are operating in a vastly different market where all originators act in the same capacity. Therefore, regulations must be based on function, not artificial distinctions based on license, classification. Even the MBA acknowledges this shift in the market towards an originate to distribute model. Due to this market change, it seems clear that HUD must broaden its definition of ″mortgage broker″ to capture everyone who originates to distribute.

Additionally, for two reasons, NAMB believes that HUD has failed to adequately comply with the Regulatory Flexibility Act when promulgating its proposed rule.

First, HUD's initial regulatory flexibility analysis relies upon outdated information when estimating the economic impact of the proposed rule on small entities, including mortgage brokers. Second, HUD's IRFA does not reflect sufficient comparative analysis of less burdensome alternatives to the proposed rule which would minimize the adverse impact on small entities.

NAMB looks forward to continuing to work with this committee as well as with respective regulators on accomplishing solutions that are effective in helping consumers without hurting small business.

Thank you. I would be happy to answer any questions.

[The prepared statement of Mr. Savitt may be found in the Appendix on page 144.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Savitt.

Our next witness is Ms. Julia Gordon. Ms. Gordon is the Policy Counsel for the Center for Responsible Lending. Ms. Gordon works with Congress, Federal agencies, civil rights and consumer groups, housing counsel and agencies, industry groups, and others to ensure fairness in lending, especially with respect to mortgages.

Welcome.

**STATEMENT OF MS. JULIA GORDON, POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING**

Ms. GORDON. Thank you.

Good morning, Chairwoman Velázquez, Congresswoman Fallin and other members of the subcommittee who I know to be there even though I cannot see them.

I am Policy Counsel at the Center for Responsible Lending, a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth. We are affiliated with a lender self-help which makes responsible, fixed-rate home mortgage loans to people with blemished and nontraditional credit.

As others on the committee and panel have noted, we do not consider inadequate disclosure to be the only or even the leading culprit in today's foreclosure crisis. Rather, the crisis was caused by lenders and brokers who are selling risky and unsustainable loans primarily in response to demand by the secondary market. Improved disclosures will not necessarily provide adequate protection to consumers who will be making one of the most important and complicated financial decisions they will ever make. It will take substantive laws to prevent discriminatory and predatory practices, to realign incentives and to restore health to the mortgage market.

That said, even within the context of RESPA, we see an opportunity to prevent some of the abuses that have led to the current crisis.

In our view, yield spread premiums have played a key role in causing the problems we see today. Under this practice, as it works in the subprime market, lenders pay brokers a premium for steering people into higher rate loans than those for which they qualify. Then often they pay those brokers an additional bonus for locking borrowers into those higher rates with prepayment penalties. RESPA has long prohibited compensation for services that simply deliver a loan with a higher interest rate, referring to such compensation as a ″kickback.″

Although it may seem that all yield spread premiums might constitute kickbacks, HUD has opined that, since consumers can use yield spread premiums to buy down up-front loan origination costs, they are delivering value, and they are not prohibited. That is how the practice often works in the prime market. Yet, in the subprime market, this trade-off rarely, if ever, occurs. The lion's share of subprime loans carries significant up-front fees, closing costs, discount points, prepayment penalties along with the yield spread premium. Consumers end up compensating the broker at both the front and back ends, essentially buying the rate down and then buying it right back up.

We would like to see HUD use its longstanding definition of a ″kickback″ to prohibit those yield spread premiums that are made in conjunction with up-front broker compensation or other rate-lowering payments. We believe this would help to reform the subprime market without impacting the prime market adversely.

In the changes to RESPA before us today in the disclosure related to the yield spread premiums, while we are glad to see HUD acknowledge the importance of the issue, we think that the proposed disclosure has as its core assumption the existence of this price trade-off that we do not believe exists. Moreover, the new

GFE characterizes this as a credit when in fact this results in an increase in cost. So, in any reworking of this GFE, we would like to see that more clear and accurately disclosed.

We understand that brokers are concerned that they are not be being treated even-handedly, and I have great sympathy for Mr. Savitt's position on that. However, CRL's recent research shows a vast disparity between the cost of subprime loans originated by independent brokers versus retail lenders. We see that the cost over the life of the loan can be as much as $43,000 for every $100,000 borrowed. Even, you know, in the shorter time period, such as 5 years or 4 years, you know, it is close to $5,000.

In our written testimony, we talk about some other aspects of today's RESPA reforms, but just to mention a few, we do believe any change to the GFE must ensure that the GFE includes the APR, which enables consumers to make an apples-to-apples comparison, and because most consumers shop mainly on total monthly payment rather than on comparing settlement costs, the GFE should include that number again.

Finally, we strongly support HUD's request that Congress enhance RESPA's civil penalties and equitable relief. We further request that Congress add a private right of action for all elements of RESPA, particularly the GFE and HUD-1. In our work, we have often seen GFEs misused to lure people into abusive loans, and the lack of a private right of action means that such misuse often carries no consequences. If it is not enforceable, even the most perfectly designed disclosure form will not assist consumers.

Thank you so much for the opportunity to testify, and I look forward to your questions.

[The prepared statement of Ms. Gordon may be found in the Appendix on page 158.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Gordon.

We are going to proceed with questions. We are going to have three votes. We will see. We will recess and then come back here, but I am going to start with Mr. Kermott.

You heard me questioning Ms. Jackson regarding the burden that the rule puts the title agents in, in explaining loan terms at closings. I am asking you if you feel it is appropriate for the title agent to be responding to questions about loan documents or should that be the lender's responsibility.

Mr. KERMOTT. It should absolutely be the lender's responsibility. The way the rule is written now, there are many problems with the closing script in explaining the loan terms and so forth. First, it is too late in the process, as I mentioned in my opening remarks. They are at the closing table. What is the borrower to do if there is a discrepancy between what they thought the terms of the loan were and what they actually are?

Chairwoman VELÁZQUEZ. Well, if I heard Ms. Jackson well, I believe that she mentioned that she is going to revisit this issue.

Mr. KERMOTT. I hope she does revisit it because it should be provided by the lender earlier in the process.

With regard to the time it takes a settlement agent to prepare the closing script, to read this closing script and to respond to questions, HUD estimates it would take 45 minutes. We have done a

survey of our members, and that is a minimum. Most would expect it would take at least an hour to an hour and a half in additional time on top of what it already takes to perform a closing. So that is an added expense and added time tacked on to particularly our small business members.

There is a UPL issue that we mentioned earlier, the unauthorized practice of law. In many States, a lay closing agent is precluded from explaining the terms of the loan because of unauthorized practice of law statutes. With regard to the economic analysis that HUD has done, it would cost our industry $2.5 billion in providing the closing script.

Chairwoman VELÁZQUEZ. Mr. Cockey, I would like to ask you: Can you explain if HUD's estimate of 45 minutes is accurate or will it take even longer?

Mr. COCKEY. In our estimate, it will take longer.

Part of what I do every day is I run a title service for our company, and I have for the last 15 years been involved in it. There is not a settlement service person here who is going to be able to get through that process in 35 or 45 minutes.

Chairwoman VELÁZQUEZ. Okay. Mr. Kittle, it is crucial that borrowers be able to easily compare the Good Faith Estimate with the HUD-1 form, and you heard me asking Ms. Jackson about the two forms.

Can you discuss the discrepancies between the new forms and how this may create confusion for borrowers?

Mr. KITTLE. I can, Madam Chairwoman.

As somebody who owns a small business, a small mortgage company, and still meets regularly with customers to take the loan application—I still meet them face-to-face—this is an example of—it is not because of financial privacy, an actual FHA file. It is because, from application to closing, this is about how big a file is. Going from a one-page GFE to a four-page only adds to that, first of all.

We have proposed and have sent to HUD—the Mortgage Bankers Association—a new HUD-1 that actually matches the GFE together line for line. That way, the borrower does not have to look at a four-page GFE with references to go and try and look it up, which only delays the loan application and adds turmoil to the whole process.

So we are against the reading of the document that we are talking about, and we are against the four-page GFE. It does not add simplification.

Chairwoman VELÁZQUEZ. Ms. Gordon, do you have any comments regarding the two forms?

Ms. GORDON. We agree that we are a little bit mystified, if the effort was to make the GFE and HUD-1 easier to compare, why they are not more similar.

Chairwoman VELÁZQUEZ. Mr. Savitt, I understand that your industry is concerned about the RESPA rule's requiring yield spread premiums to be disclosed on the new GFE form.

Is there a different way to get at the issue of transparency?

Mr. SAVITT. Well, first of all, mortgage brokers have been completely transparent in the disclosure of all of their compensation since 1992. Under a HUD mandate at that time, we were required

to disclose, obviously, all of our up-front fees and any type of indirect compensation, which of course we call YSP, and others who receive it call it other things. I do not know how we can be any more transparent in what we are doing now. Every dime that we make is completely disclosed to the consumer at time of application and also again at time of settlement.

Chairwoman VELÁZQUEZ. I am going to recognize Ms. Fallin because she has some commitments, and will not be able to come back, but I will be coming back, and I hope the other two members will be able to come back.

Go ahead.

Ms. FALLIN. Thank you, Madam Chair. I will make it quick, and maybe Ms. Clarke can get some questions in, too, if we can do some quick answers here because we are short on time.

Mr. JOHNSON. And perhaps Mr. Johnson also.

Ms. FALLIN. Mr. Johnson, too.

Mr. JOHNSON. Thank you.

Ms. FALLIN. Yes, sir. You bet.

Mr. JOHNSON. All right. I feel like Ms. Gordon over there in the corner.

Ms. FALLIN. Nobody is paying attention to you.

Mr. JOHNSON. Right.

Ms. FALLIN. If I could ask Mr. Kermott: Do you think that the new regulations will hurt small business lenders?

Mr. KERMOTT. Yes.

Ms. FALLIN. All right. I think, Mr. Cockey, you talked about the failure to disclose all closing costs.

Can you explain what some of those costs are that are not being disclosed?

Mr. COCKEY. Well, they are some of the settlement costs that they will really kind of be bundling. To me—

Ms. FALLIN. They are all bundled together?

Mr. COCKEY. Right. That is not the way to approach it. If we are trying to give full disclosure to the consumer, we are just hiding or have the opportunity that things can be hidden.

Ms. FALLIN. All right.

Mr. COCKEY. To me, that is what we are trying to fight against.

Ms. FALLIN. Mr. Kittle, you mentioned something about our needing to change the form so consumers can shop prices and different services that are available and different lenders. I think it might have been you. It may have been somebody else.

Mr. Savitt?

Mr. SAVITT. No, I do not believe—

Ms. FALLIN. Is there any way that we can help consumers be able to compare prices?

Mr. SAVITT. Yes, absolutely.

Just like the MBA, NAMB turned in to HUD an example of a Good Faith Estimate which was very close to your Good Faith Estimate. It was a mirror image of the settlement statement which we think would be the most effective for consumers to better understand the transaction. There is nothing easier when you go to closing than to have on the Good Faith Estimate the same numbers match up identically as they do with the HUD-1 settlement statement. So, therefore, a consumer can compare line by line all the

way across, and if there is a difference they would be able to easily spot it.

Mr. KITTLE. We totally agree with that line for line.

Ms. FALLIN. That is what I am trying to get at. Okay.

Mr. KITTLE. Absolutely.

Ms. FALLIN. Thank you.

Madam Chairman, I will quit here so they can ask their questions. Thank you.

Chairwoman VELÁZQUEZ. Ms. Clarke.

Ms. CLARKE. Thank you, Madam Chair.

My question is to Ms. Gordon. I know you are there.

Can you tell this committee how the inadequate disclosure of incentives for brokers and lenders, also known as the yield spread premiums, adversely impacts the secondary market but, most importantly, the consumers?

Ms. GORDON. Well, the reason they adversely affect the secondary market is because what has happened is borrowers have been sold loans that are unaffordable. They are steered into loans at higher rates than those for which they would qualify based just on their credit scores and income, and then they are locked into those rates with prepayment penalties.

If you look at a subprime rate sheet, you will see the additional compensation that the broker receives from the creditor for putting somebody into a higher rate loan than that for which they qualify and then for also adding a prepayment penalty to that loan. Now, the consumers do not ever see these rate sheets. You know, you do not get to see that. So, for the most part, consumers have no idea that this practice occurs.

To the extent that there is disclosure of fees to borrowers, our experience with vast numbers of consumers is they had no idea how this system was working and how they were compensating their brokers.

Now, I have no doubt that there are excellent brokers out there who fully explain this to their customers, but a lot of the problems that we are seeing in the subprime market come from the fact that that largely did not happen, and this was a significant problem, especially in the African American and Latino communities.

Ms. CLARKE. Ms. Gordon, you believe that YSPs are kickbacks between brokers and lenders.

What do you recommend today on how to strengthen the disclosure to YSPs, especially to subprime mortgages?

Ms. GORDON. I think that you could probably write the disclosure form in an easier-to-understand way. We go into more details on that in our comments to HUD, but I think the important thing is, unless the yield spread premium is really a trade-off for closing costs, it should not be permissible. After that, all that is happening is somebody is being compensated for bumping up a rate, and that specifically is what is prohibited by RESPA.

Ms. CLARKE. I am sure you have some comments on that, Mr. Savitt. Would you like to respond as well?

Mr. SAVITT. Absolutely. Thank you for recognizing me.

First of all, as I mentioned to the chairwoman, yield spread premiums are an indirect compensation that are completely disclosed by mortgage brokers twice—once on the Good Faith Estimate at

time of application and the second at the settlement. Yield spread premiums are a very useful tool that consumers have been taking advantage of for many years. When consumers shop for a loan, the first question they ask is ″What is your interest rate?″ They compare lenders, brokers, other originators. Usually, the question of closing costs does not come into it until they actually, you know, drill down a little further, but the first question is they are comparing interest rate to interest rate.

If a lender offers an interest rate, for example—and most consumers want usually a 30-year fixed rate with zero points. So, if I am at 6 percent for zero points and a lender or a bank is 6 percent at zero points, obviously the bank is receiving the same type of compensation. It is just that they do not have that requirement that we do to disclose it. Brokers are fully transparent.

As far as subprime loans go and brokers taking advantage and the yield spread premium costing consumers more money, there was a study done a few years ago by Georgetown University. NAMB had nothing to do with that study whatsoever. They came to us after the fact and stated that by using a mortgage broker a consumer would save 1.13 percent on their annual percentage rate by using a broker over other types of originators. Also, there was a GAO study that was commissioned by Chairman Frank of the House Financial Services Committee on what caused the crisis that we are having today, the foreclosure crisis. That study not only vindicated mortgage brokers, but it also—because, of course, you know we were getting the blame for everything in the beginning, but it also did not mention yield spread premiums at all, let alone as the root or the cause of this.

The final thing I would like to say is I get very frustrated for several reasons when I hear that a yield spread premium is a kickback. Number one, usually if you are getting a bribe or a kickback, you do not disclose it to the consumer. State housing agencies—one of the States that I am licensed in is West Virginia. The State housing agency, the West Virginia Housing Development Fund, has a bond program. As you know, it is a below-market interest rate that tries to help consumers—first-time home buyers—get into a home for less money out of their pocket. I have been dealing with them for over 20 years. In the beginning, they used to charge up front 1.5—or they would charge the consumer 1.5 points up front. That would go to the broker. Everyone now—all of the lender-broker compensation and anyone who is a participating member of that State housing agency—is paid by either a yield spread premium or a service release fee.

Ms. CLARKE. Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Johnson.

Mr. JOHNSON. Thank you. I just have one question.

Has HUD reached out in an efficient way to you all in their composing of this new rule? If not, what could they do to improve the process?

Mr. COCKEY. It is my feeling that they think they have reached out, and they have listened, but I am not sure that they have been able to hear the messages that have been given. We have certainly had the opportunity to present information and thoughts and process, but I am not convinced that they have really heard—I listened

to Ms. Jackson this morning, and it is almost like they were talking about something that was another industry, that they really had no practical knowledge of what we do as practitioners from the real estate side on a day-to-day basis and how we move our clients through the process of getting a mortgage, of having the settlement services done and standing beside them. It just boggled my mind to listen to some of the comments. I was much more interested in what the committee has said because I thought you asked excellent questions and seemed to have a greater grasp on some of the things that were happening than HUD had.

Mr. KITTLE. I would agree with that, Mr. Johnson. The MBA has a great working relationship with HUD. We visit with them and talk with them and meet with them often, but I am not sure they hear. We are the professionals. We do it every day, and we present to them simplification—again, a GFE and a HUD-1, two pages total that match. Yet they come up with a four-page GFE that does not match with references. So at the end of the day I am not sure that they are hearing what the industry is having to say.

Mr. SAVITT. In the roundtables that Ms. Jackson spoke about during her testimony, HUD said they were looking for a consensus from industry and that they were going to also consult with Congress before they came out with a proposed rule. The roundtable that I attended was in Fort Worth. I believe there were about 35 or 40 people there from all over the industry. You had consumers. You had closing agents, bankers, brokers, title companies. Everybody was there.

There was a real estate agent who mentioned that the Good Faith Estimate, the four-page Good Faith Estimate, was so confusing that as a realtor for 30 years she could not understand it. HUD received her consensus, but as far as I am concerned, they really did not take any of that information into consideration because they basically came up with the same rule that they had last time minus packaging.

Mr. JOHNSON. Mr. Kermott, you are going to do—

Chairwoman VELÁZQUEZ. Mr. Johnson, you can see Ms. Gordon would like to make some comments.

Mr. JOHNSON. Okay.

Ms. GORDON. I just want to add that, a couple of years ago, the Center for Responsible Lending joined with the National Association of Realtors in developing a kind of consensus GFE. You know, HUD took that from us, but it was not what the final product was.

Mr. KERMOTT. As was mentioned earlier, HUD had the roundtable discussions in 2005. Our membership was invited to participate in that. I would just like to echo what my fellow panel members have said.

We emphasize simplifying the GFE and in getting it consistent with the HUD-1. If HUD would do that, it would make the transaction simpler and more efficient without adding what they are proposing here, which would add costs and complexity to the transaction.

Chairwoman VELÁZQUEZ. The time has expired. I just would like to ask a question to Ms. Gordon and to, maybe, any other member of the panel who might wish to comment.

What kind of reforms do we need that the RESPA rules do not address?

Ms. GORDON. A private right of action. I mean it would be great to have the perfect GFE, the most simple, clear GFE that lines up perfectly with the HUD-1, but if the GFE is only enforceable by regulatory agencies, we know that for the most part there will continue to be a lot of inaccurate and, in many cases, blatantly misleading or lying GFEs. Without the enforcement that comes from having a private right of action, I mean I think we could truly design the perfect form, and it would not matter.

Chairwoman VELÁZQUEZ. Does any member of the panel wish to speak? So you do not feel that we need any other thing—

Mr. KITTLE. Well, I will take one stab at it.

We issued a paper on Monday, 33 pages, of which you have a copy, that gives a clear, definitive line between mortgage bankers and mortgage brokers. We think that will help transparency. Mortgage brokers are my clients, but at the end of the day, its clear, distinct difference is we lend and they do not, and we are required to report for HMDA and things like that, and they are not. So there are clear, distinct differences we can do.

Chairwoman VELÁZQUEZ. Unfortunately, we have run out of time, and we have votes on the House floor.

Let me just thank all of you for being here. I know this is a complex issue, and we will continue to monitor it.

I ask unanimous consent that members will have 5 days to submit a statement and supporting materials. For the record, without objection, so ordered.

This hearing is now adjourned.

[Whereupon, at 12:05 p.m., the committee was adjourned.]

NYDIA M. VELÁZQUEZ, New York
Chairwoman

STEVE CHABOT, Ohio
Ranking Member

# Congress of the United States

U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

STATEMENT
Of the Honorable Nydia M. Velázquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing: "RESPA and its Impact on Small Business"
Thursday, May 22, 2008 at 10:00 am

Today, we will examine the Department of Housing and Urban Development's proposed rule on the Real Estate Settlement Procedures Act. The recent housing crisis has revealed that predatory lending remains a major problem. It has also demonstrated the importance of providing quality information to homebuyers. Over time, the closing process has become more complex, making these consumer disclosures even more critical. The recent abuses we have seen in the mortgage market have in part been exacerbated by a lack of such protections.

RESPA was initially established to provide these very safeguards. – but clearly they are not working in today's housing market. At its very foundation are the Good Faith Estimate and the HUD-1 form, which provide homebuyers with basic information concerning the cost of their purchase.

Unfortunately, HUD's recent proposal to update these forms as well as the settlement process is not the cure-all that homebuyers need. The rule creates additional paperwork and complexity, potentially adding to the confusion of an already stressful purchase. This could lead to information overload and ultimately result in more uncertainty for consumers.

In addition to these problems, it will create chaos for small settlement service providers. These firms play a key role in the home buying process and they stand to incur billions of dollars in costs due to the implementation of the RESPA regulation.

Many title insurance companies, settlement attorneys, real estate agents, mortgage bankers and brokers struggling to survive in the worst housing market in decades may be pushed to the brink. This is largely due to the cost of the proposed rule. Loan originators and settlement service providers would have to pay up to $570 million to become compliant with the proposed rule changes. They would then face recurring compliance costs of $1.2 billion per year—or $98.48 per loan.

Aside from the enormous costs posed to small businesses, it also creates an environment in which they are placed on an unlevel playing field. While HUD asserts that volume discounting will provide consumers with savings, we know better. It will lead to the bundling of services and reduce competition by forcing small firms out of business. As a result, consumers will ultimately face higher prices.

It is my expectation that Steven Preston, who President Bush recently nominated to be Secretary of HUD, will help address these problems. We know Mr. Preston well on this Committee – and I am hopeful that he will utilize his experience as head of the SBA – to ensure the RESPA rule does not unnecessarily burden small firms. Should that not happen, the Committee will be following up with him.

The changes the proposed rule makes to the settlement and closing process come at a challenging time in the housing market. It is important that we closely examine these modifications so its recovery is not undermined. We also have a responsibility to protect homebuyers by ensuring that they are given information about loan terms and closing fees in a clear, easy to understand manner.

Today's hearing will begin to answer these questions and make sure that we are not doing more harm than good to the home buying process. I look forward to today's testimony and thank the witnesses again for coming here to share their views.

U.S. House of Representatives
SMALL BUSINESS COMMITTEE
Representative Steve Chabot, Republican Leader

Thursday,
May 22, 2008

## Opening Statement of Ranking Member Steve Chabot

***RESPA and Its Impact on Small Business***

I would like to thank the Chairwoman for holding this important hearing on the Department of Housing and Urban Development's proposed changes to rules implementing the Real Estate Settlement Procedures Act or RESPA.

This is the Committee's third hearing on HUD's plan to modify regulations governing the real estate settlement process. Although HUD has made significant strides since the Committee last examined this issue in January 2004, I remain concerned about the procedures used to assess the economic impact that the proposal will have on small businesses operating in the residential real estate market.

I certainly concur with the idea that the complex process associated with the purchase of a home can be simplified. Given the state of the housing market in certain areas of the country, including my state of Ohio, there is no doubt that a more transparent process on the front end may ameliorate problems on the back end, thereby potentially reducing the number of foreclosures.

The effort to reduce confusion and increase transparency in the real estate settlement process should not be borne solely by small businesses. The Regulatory Flexibility Act or RFA requires federal agencies to consider the impact of their proposed rules on small businesses and determine whether there are any practical alternatives that would reduce the adverse effects on small business while still achieving the agency's regulatory objectives. In the case of the proposed RESPA rules, HUD must assess alternatives that increase transparency and assist consumers but do not necessarily pose undue burdens on small businesses that play a vital role in the operation of the residential real estate market.

In particular, the Department's initial regulatory flexibility analysis and regulatory impact study use data from 2002 and 2004. The data may be accurate but clearly do not reflect the current turbulence in the residential real estate market. An accurate analysis under the RFA requires an assessment of the regulation in the context of the current economy, not in the economy of five years ago. I will be interested in hearing from HUD how it plans to update this data to reflect current economic conditions. I also will be interested in hearing from our other witnesses how changes in the marketplace affect their capacity to implement regulatory changes.

I am also am concerned that HUD did not perform a detailed assessment of the consequences of volume pricing on the future viability of small businesses. There is no doubt that volume discounts will benefit consumers and may provide marginal assistance in improving the residential real estate market. However, the long-term consequences of reduced competition may argue against making changes that will further shrink an already troubled sector of our small business economy.

Finally, I also would like to hear from our witnesses whether this is an appropriate time to commence this type of significant rulemaking change. The focus of the Department's resources should be on helping the ailing housing sector, not implementing new regulations that might divert some of these resources away from the more critical mission of restoring the health of our housing sector. Once that is done, the Department could turn its attention to its modification of rules to implement RESPA.

I want to thank the witnesses for taking time to discuss this important issue and with that I yield back.

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Statement of Rep. Jason Altmire
Committee on Small Business Hearing
"RESPA and its Impact on Small Business"
May 22, 2008

Thank you, Chairwoman Velazquez, for holding today's hearing to discuss the Real Estate Settlement Procedures Act (RESPA) and its impact on small businesses. The recent housing crisis has shown that predatory lending is a major problem and that abuses in the mortgage market have been exacerbated by a lack of protections for homebuyers. Enacted in 1974, RESPA is the only federal law governing the mortgage loan process and it makes the settlement process more transparent for residential real estate.

The Department of Housing and Urban Development (HUD) issued a proposed rule on how to update RESPA. Given the significance of RESPA and its regulations, any proposed changes must be thoroughly reviewed, especially at a time when foreclosures are at an all time high and our economy is facing a recession. I recently joined with 146 of our colleagues in requesting an extension from 60 to 120 days the public comment period on the proposed changes to RESPA. I was pleased to hear that HUD decided to extend the comment period for 30 days and I hope that Ms. Jackson will consider the testimony given by today's second panel as they move toward finalizing the rule.

While little has changed in how Americans buy and refinance their homes since 1974, HUD must improve the complicated and costly home buying process in order to fend off the recent increase in home foreclosures across the country. HUD must ensure that improvements are made in the disclosure of loan terms and closing costs to consumers.

Chairwoman Velazquez, thank you again for holding this important hearing today. I yield back the balance of my time.

# # #

**WRITTEN STATEMENT OF IVY JACKSON**

Director, Office of RESPA and Interstate Land Sales
U.S. Department of Housing and Urban Development

Hearing before the Committee on Small Business

United States House of Representatives

"Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs"

May 22, 2008

Chairwoman Velázquez, Ranking Member Chabot and distinguished Members of the Committee, I appreciate the opportunity to be here today to discuss important issues related to the Real Estate Settlement Procedures Act (RESPA), and highlight aspects of the proposed rule to revise the RESPA regulations entitled *Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs*, generally referred to as "RESPA Reform."

Consumers need to know – *deserve* to know – what they are buying when they buy a home. What type of loan are they entering into? How much will it cost per month? What is included in their monthly payment? Will the amount stay the same? Today consumers have no assurance the loan terms and closing costs they are offered will be what they will see at the settlement table. Today's mortgage foreclosure problems are often associated with difficult to understand loan terms such as "teaser rates." The RESPA Reform proposal, in combination with planned Truth In Lending Act disclosure improvements, can improve consumer understanding of these terms, significantly reducing the odds borrowers will take on financing too risky for their circumstances.

Revision of HUD's RESPA regulations and related legislative proposals are a high priority of the Administration, Deputy Secretary Roy Bernardi and Federal Housing Commissioner Brian Montgomery. HUD views RESPA as very important to its mission to increase homeownership and help provide affordable housing opportunities.

Through RESPA Reform and other initiatives, HUD is undertaking meaningful mortgage reform in America – reform that will help millions of consumers to shop for and better understand the fine print in their home loans.

The RESPA Reform process has been thorough and inclusive. HUD has sought input from consumers, industry, and Congress about how to update and improve the arcane settlement process all homeowners endure when they purchase their homes. We are in the midst of a housing downturn where hundreds of thousands of Americans are faced with the prospect of losing their homes through foreclosure. There is no doubt the process of buying a house itself has been part of the problem. Many homeowners go to the settlement table and sign a mountain of documents they don't fully understand and pay thousands of dollars for services most don't understand.

Most people have never heard of the Real Estate Settlement Procedures Act. RESPA was enacted more than 30 years ago to provide consumers with certain disclosures before they buy their home. But in reality, RESPA often is ineffective as a tool to help consumers shop for the best loan. The homebuying process governed by RESPA is too confusing, and because of that confusion, buying and refinancing a home is too expensive!

We don't think the average homebuyer should need a degree in finance to understand what it takes to buy a home. In far too many cases, consumers facing foreclosure today signed on the dotted line when they shouldn't have, in large part because they didn't understand the process. HUD believes this is wrong. This settlement process is little different from how Americans bought homes in the early 1970s, when RESPA was first enacted.

**RESPA**

RESPA was enacted in 1974 to protect consumers during the homebuying and mortgage process by: (1) requiring consumers receive certain information in the form of disclosures during the process; and (2) prohibiting certain practices that unnecessarily increase the costs of settlement.

Disclosures currently required by RESPA include the Good Faith Estimate (GFE) and the HUD-1 Settlement Statement. The Good Faith Estimate given by the lender or mortgage broker is, as the name implies, required to provide a "good faith estimate" of the charges the borrower will likely have to pay to close the transaction. The HUD-1 Settlement Statement itemizes the charges actually imposed upon both the buyer and seller in connection with the settlement. All charges by the lender and other settlement service providers must be reported on the standardized HUD-1 form.

RESPA covers millions of transactions every year involving virtually all loans secured by one-to-four family residential properties. RESPA extends to all providers of settlement services required to close the loan or for which the settlement service provider requires a borrower or seller to pay (24 C.F.R. § 3500.2). Such services include, but certainly are not limited to, appraisals, credit reporting, mortgage loan origination, and title and closing services.

Another key purpose of RESPA is to eliminate practices such as kickbacks, referral fees, and unearned fees in the settlement process "that tend to increase unnecessarily the costs of certain settlement services." Specifically, Section 8(a) of RESPA provides "no person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to, or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." Section 8(b) prohibits the giving or receipt of "any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service… other than for services actually performed."

**HUD's RESPA Proposal**

In July 2002, HUD published a proposed rule that sought to improve transparency in settlement procedures and help consumers compare the prices of mortgage loans and related settlement services. The proposed rule did not become final. In 2005, HUD held seven roundtable discussions with consumer and industry groups, as well as small and large businesses, in Chicago, Ft. Worth, Los Angeles, and Washington, D.C., to gather information from stakeholders concerning how to improve the homebuying and mortgage process. The roundtables held outside of Washington were conducted in conjunction with the Small Business Administration (SBA). HUD has thoroughly considered various options and opinions arising from these meetings in developing the current proposed rule.

HUD believes its current proposal will achieve RESPA's original goals and build upon the information it obtained during the roundtables and through its outreach. HUD's current proposal is narrower than the 2002 proposal and no longer contains packaging. The current proposal is designed to promote early comparative shopping by consumers for the best loan terms and lowest settlement costs by providing clearer and more extensive loan term and settlement cost disclosures, and by limiting settlement cost increases and fee proliferation at closing.

The proposed rule includes:

- A standardized GFE to improve disclosure of loan terms and settlement costs and to make it easier to shop among settlement providers, which will help lower costs to consumers;

- Limitations on how much final charges for certain types of settlement services can vary from the estimated charges, in order to provide greater cost certainty for consumers;

- Modification of the HUD-1 settlement statement to reference the GFE cost categories, making it easier for consumers to compare the estimated charges on the GFE to their final charges and limit fee proliferation;

- A "closing script" as an addendum to the HUD-1 will be reviewed with each borrower at the closing to compare the final HUD-1 charges with the GFE estimated charges, and describe the precise terms of the loan the consumer receives at closing; and

- Clarification that volume-based discounts must be passed on to consumers, and establishing guidance for average cost pricing.

Lastly, the proposal requires indirect fees paid to the mortgage broker by the lender and charged to the borrower through the interest rate are applied to reduce the consumer's closing costs at settlement.

**Forms Design**

**(A) The GFE**

The first page of the proposed GFE provides a consumer-friendly description of the important loan terms and details, as well as an aggregate estimate of the closing costs for obtaining the loan. The costs for settlement services are delineated in categories on page two. The categorizations are designed to eliminate fee proliferation of costs for settlement services at the GFE stage, as well as on the HUD-1 at closing. Pages three and four provide information and instructions useful for the consumer to understand the relationship between up-front charges and interest rates, how tolerances apply, and other information.

Although the complete GFE is four pages, the summary information clearly displayed on the first page is the single most important comparison shopping tool throughout the proposed mortgage shopping process. Comparison shopping leads to greater price competition in the marketplace and lowers charges to consumers. HUD's consumer testing indicated consumers liked and understood the form and said they would use it.

**(B) The HUD-1**

The proposed HUD-1 has been designed to allow consumers to easily compare page two of the HUD-1 with page two of the GFE, and relate the charges they will be paying at the closing for settlement services performed to the estimates of those charges as listed on the GFE. It also compresses certain origination and title fees into categories of charges to reduce or eliminate fee

proliferation at closing. Finally, the "closing script" addendum to the HUD-1 apprises the borrower of the loan terms and details of the loan, and compares charges on the HUD-1 with the estimates of those charges on the GFE, to assure tolerances are not exceeded. The loan terms section of the "closing script" will provide similar information to that in the loan terms section on page one of the GFE, to assure the borrower is getting the loan which was negotiated.

**The Proposed Rule and Small Business**

**A: Overall Consumer Savings**

The new, standardized GFE format in the proposed rule will improve consumer shopping for mortgages, which will result in better mortgage products, lower interest rates, and lower origination and settlement costs for borrowers. There is substantial evidence some consumers are paying higher prices than others for origination and settlement services. The improved understanding of indirect charges based on the interest rate, discount points, and the trade-off between interest rates and upfront costs; improved consumer shopping among originators; more aggressive competition by originators for settlement services; and increased competition associated with discounting will benefit consumers by reducing both originator and third-party fees. Also critical to consumer savings is that clearer presentation of loan terms will improve borrower understanding of risky mortgage features such as "teaser rates," interest-only loans and balloon payments. Such features are at the root of many, if not the vast majority, of today's troubled and foreclosed mortgages. To avoid today's problems in the future, it is imperative disclosure eliminate any opaqueness about these terms.

Consumer savings achieved with the proposed GFE were estimated under a variety of scenarios about loan originator and settlement costs. In the base case of 12.5 million loans annually, the estimated savings to borrowers comes to $8.35 billion, or 12.5 percent of the $66.7 billion in total charges (i.e., origination fees, appraisal, credit report, tax service, flood certificate, title insurance, and settlement agent charges). This represents savings of $668 per loan.

**B: Overall Efficiency Gains and Costs**

The $8.35 billion in consumer savings results in transfers to borrowers from high-priced producers, with $5.88 billion coming from loan originators and $2.47 billion from other settlement service providers.

Additionally, there are efficiencies and costs associated with the rule. Mortgage applicants and borrowers realize $1.07 billion of savings in time spent shopping for loans and third-party services. It is anticipated loan originators will save $1.40 billion in time spent with shoppers because they: (1) are expected to spend less time answering follow-up questions; and (2) achieve a reduction of compliance costs from average cost pricing. Third-party settlement service providers save $113 million in time spent with consumers. Some or all of the $1.40 billion and $113 million in efficiency gains have the potential to be passed through to borrowers through competition.

**C: Compliance Costs**

The total one-time compliance costs to the lending and settlement industry of the proposed GFE and HUD-1 are estimated to be $570 million, $390 million of which would be borne by small business. Total recurring costs are estimated to be $1.23 billion annually or $98.48 per loan. The share of the recurring costs on small business is $548 million.

Recurring costs of the proposed GFE would be additional time spent by loan originators processing the new forms and making third-party arrangements to meet the tolerances. The one-time adjustment costs of the proposed GFE would be the cost of the training, software upgrades, and legal advice necessitated by switching to the new form. Recurring costs of the new HUD-1 arise from the addition of the closing script. Settlement agents would be obliged to prepare the script, read it to the borrower, and answer questions generated by the script. Requiring the script would impose a cost on the settlement industry only when it increases the average time spent to complete a settlement. It is conceivable the burden imposed on the average conscientious agent is very modest. In a worst case scenario of the added time required of a non-conscientious agent dealing with a very complicated loan product, HUD assumes the script would lead to an additional thirty minutes preparing the script, and an additional fifteen minutes to the actual closing procedure consisting of five minutes reading the script, and ten minutes answering questions. There will be one-time adjustment costs of the new HUD-1 form and its addendum, the closing script. These costs consist of software upgrades, training, and legal advice.

**D: Small Business Impacts**

**(1) Transfers from Small Businesses.** There is no evidence small businesses have been disproportionately charging high prices; for this reason, there is no expectation of any disproportionate impact on small businesses from the proposed rule. It is estimated $4.13 billion, or 49.5 percent, of the $8.35 billion in consumer savings comes from small businesses, with small originators contributing $3.01 billion and small third-party firms contributing $1.13 billion. Within the small originator group, most of the consumer savings come from small brokers ($2.47 billion, or 82 percent, of the $3.01 billion). This is because small firms account for most broker revenues but a small percentage of lender revenues. Within the small third-party group, most of the transfers come from the title and closing industry ($680 million, or 60 percent of the $1.13 billion), mainly because this industry accounts for most third-party fees. In the title analytical approach, small title and settlement closing companies account for $950 million of the $2.5 billion in savings.

**(2) Compliance Costs Incurred by Small Business.** Small business would bear $390 million of the estimated $570 million in one-time compliance costs: $280 million from the proposed GFE and $110 million from the HUD-1. The proposed rule would result in $548 million in annual recurring compliance costs on small business (out of a total $1.23 billion).

**(3) Small Mortgage Brokers.** The main issue raised by mortgage brokers concerned the treatment in the 2002 proposed rule of yield spread premiums on the proposed GFE. This was also the main small business issue with the 2002 proposed GFE because almost all mortgage brokers qualify as small businesses. The current proposed rule addresses the concern expressed by mortgage brokers the reporting of yield spread premiums in the 2002 proposed rule would disadvantage them relative to lenders. However, this assertion ignored the fact mortgage brokers have been required to disclose indirect compensation (the yield spread premium) by regulation,

since 1992. HUD has redesigned the proposed GFE form to focus borrowers on the right numbers so competition is maintained between mortgage brokers and lenders. The forms adopted in the proposed rule were tested on hundreds of subjects. The testing indicated borrowers who comparison shop have little difficulty identifying the cheapest loan offered in the market – whether from a mortgage broker or a lender – and, most important, there is no bias in the form against mortgage brokers.

The consumer outreach function brokers perform for wholesale lenders will not change with RESPA reform. Wholesale lending, which has fueled the rise in mortgage originations over the past ten years, will continue to depend on mortgage brokers reaching out to consumers and supplying them with loans. Mortgage brokers play the key role in the upfront part of the mortgage process and this will continue with the proposed GFE.

RESPA reform will also not change the basic cost and efficiency of brokers. Mortgage brokers have grown in market share and numbers because they can originate mortgages at lower costs than others. There is no indication their cost competitiveness will change in the near future. Mortgage brokers, as a group, will remain highly competitive actors in the mortgage market, as they have been in the past. The main impact of the proposed rule on brokers (both small and large) will be on those brokers (as well as other originators) who have charged above competitive market prices through the combination of high origination fees and yield spread premiums.

**(4) Small Lenders.** Lenders include mortgage banks, commercial banks, credit unions, and thrift institutions. More than 10,000 lenders would be affected by the RESPA rule, as well as almost 4,000 credit unions that originate mortgages. While two-thirds of the lenders qualify as a small business (as do four-fifths of the credit unions), these small originators account for 23 percent of industry revenues. Thus, small lenders (including credit unions) account for $540 million of the projected $2.35 billion in transfers from lenders.

In general, there was less concern expressed by lenders (as compared with mortgage brokers) about potential anti-competitive impacts of the GFE on small businesses. Small lenders – relative to both brokers and large lenders – will remain highly competitive actors in the mortgage market, as they are today. Small mortgage banks, community banks and local savings institutions benefit from their knowledge of local settlement service providers and of the local mortgage market. Nothing in the proposed rule changes that.

There will be an impact on those lenders (both large and small) who are charging above competitive market prices. Improved consumer shopping with the proposed GFE would reduce the revenues of those lenders. Thus, as with brokers, the main negative impact on lenders (both small and large) of the proposed GFE will be on those lenders who have been charging above competitive market rates.

**(5) Title and Settlement.** The title and settlement industry – which consists of large title insurers, title agents, escrow firms, lawyers, and others involved in the settlement process –is expected to account for $1.79 billion of the $2.47 billion in third-party transfers under the proposed GFE. Within the title and settlement group, small firms are expected to account for 38.1 percent ($680 million) of the transfers. Evidence suggests there are more opportunities for price reductions in the title industry, as compared with other third-party industries.

One of the primary concerns of small title firms is the potential adverse effect of volume discounting. First, it should be emphasized the rule merely clarifies volume discounting is currently legal under RESPA as long as the savings are passed along to the consumer. Firms that are currently profitable should not be negatively impacted because the change is only superficial for those that understand the law. However, there is a great deal of confusion in the industry concerning the legality of volume discounts because courts have made different interpretations of the law. Nonetheless, HUD does not expect small title firms to be adversely affected for reasons explained below.

An important issue when considering the impacts of the proposed RESPA reform on the title industry concerns the local nature of the industry. The title industry has a high degree of geographic specialization. Until there is widespread use of standardized electronic land record keeping accessible by the Internet, the information-gathering service the industry provides will require proximity to land title records (or the establishment of "title plants," i.e., duplicates of local records, the maintenance of which requires proximity to local government records). Even if a provider is efficient and charges low prices, it will not be able to compete against title and closing firms located closer to the site in question. Thus, title and closing services are, by economic necessity, provided by local firms. Reinforcing this local orientation is the value of local expertise and the importance of personal networks in receiving referrals.

The local orientation of the title industry could change over time. However, it is unlikely the RESPA rule would be the catalyst. The advances in technology that could change business practices are independent of actions HUD takes in reforming RESPA. The only change the proposed rule will introduce is title and closing services may occur at lower prices negotiated between providers and lender originators. There will be no significant change in the local provision of title and closing work. Nor will there be a reduction of the number of services purchased because this rule will not result in a drop in the number of mortgages that require these services. Large lenders will have to deal with multiple settlement services providers to ensure complete geographic coverage, and large multi-jurisdictional title firms have no apparent cost advantages over smaller title firms. In fact, large multi-jurisdictional title firms may have location-related cost disadvantages. There is no reason to believe small title firms charging competitive prices will be adversely impacted by the proposed changes in this rule. The demand for the services of these local firms will continue.

**Proposed Legislation**

The success of HUD's regulatory effort to make RESPA a more efficient tool for both industry and consumers depends greatly on realistic and effective guidance and enforcement. To further bolster consumer protection and to ensure uniform and consistent enforcement of RESPA, HUD intends to seek legislative changes to the Act that will complement the regulatory improvements made by the proposed RESPA Reform rule.

Currently, RESPA does not provide HUD with enforcement mechanisms for some of the most important consumer disclosures and protections. This lack of enforcement authority and clear remedies for violations of critical sections of RESPA negatively impact consumers and diminish the effectiveness of the statute. For example, currently RESPA does not include authority for

regulators to enforce important sections of the statute; there are no remedies for violations of the requirements relating to the Good Faith Estimate, settlement costs booklet, or HUD-1 settlement statement. The effectiveness of RESPA would be enhanced by providing the Secretary and State regulators with the necessary tools to enforce the statute.

HUD, therefore, would like to work with Congress to enact legislative changes to RESPA that include:

- Requiring delivery of the HUD–1 to the borrower 3 days prior to closing.

- Authority for the Secretary to impose civil money penalties for violations of specific RESPA sections, including sections 4 (provision of uniform settlement statement), 5 (GFE and special information (settlement costs) booklet), 6 (servicing), 8 (prohibition against kickbacks, referral fees, and unearned fees), 9 (title insurance), and portions of 10 (escrow accounts); as well as authority for the Secretary and State regulators to seek injunctive and equitable relief for violations of RESPA.

## CONCLUSION

In closing, the proposed RESPA Reform rule is designed to take much of the guesswork out of shopping for the largest and most important purchase most Americans will ever make.

HUD's proposal would revise the RESPA regulations to improve disclosure of the terms of a mortgage and control closing costs consumers will pay when they buy or refinance their home. For the first time, consumers would receive a standardized Good Faith Estimate that would disclose the key elements of the loan and control closing costs to allow consumers to shop more effectively for the lowest cost loan.

Even if industry passes along all of the recurring costs of the rule to consumers, consumers will still enjoy substantial benefits. Consumer's savings are expected to be between $500 and $700 per loan. Efficiency gains are expected to be $86 per loan for borrowers and applicants and $112 per loan for loan originators. The recurring compliance costs are estimated at $98 per loan and the one-time adjustment cost at $570 million. If industry imposes all of the adjustment costs on borrowers in the first year and does not pass on any efficiency gains, then the net consumer savings for the average consumer would be $524 per loan in the first year and $570 per loan every year afterwards. Accounting for the benefits of the time saved by consumers and assuming loan originators pass on their own efficiency gains increases the estimated benefit to consumers of this rule. There would be a positive net benefit of $722 per loan for consumers in the first year and $768 per loan every year afterwards.

In addition, other economic effects, which are important but difficult to quantify, should also be considered. For example, as a result of the proposed reform, consumers are less likely to engage in risky and uninformed borrowing, which would have positive impacts on the housing market, financial system, and the national economy. RESPA Reform and Truth In Lending Act improvements are both important and necessary efforts for improving consumer understanding and making it significantly less likely borrowers will assume too much risk. The results of overly risky borrowing are all too clearly exhibited in today's mortgage problems.

It is clear a lot of the mortgage problems we see today are directly related to the fact many people did not understand the mortgage process. Buying a home can be very intimidating. Frequently, consumers have had no assurance the loan terms and closing costs they are offered reflect what they will see at settlement, and has been one of the factors driving the current housing downturn. Our new rule fixes this. We owe it to American homebuyers to give them the information they need to make smart choices.

The time for reform is now. It is no longer acceptable to stand in the way of millions of Americans who are crying out for clarity when it comes to the biggest purchase of their lives. We need to assure homebuyers get fair value for their investments. RESPA Reform is HUD's effort to improve consumer protection for homebuyers and homeowners, while expanding a fair and competitive marketplace.

The housing market is a vital part of the economy. We all need to work together to help stabilize it and strengthen our communities. When President Bush announced the administration's comprehensive plan to address rising foreclosures last August, he pledged to offer new mortgage rules that would help families avoid getting into trouble in the first place. The proposed RESPA Reform rule makes good on that pledge. The current proposal will give consumers the tools they need to understand what they're getting into before they sign on the dotted line.

OMB No. xxxx-xxxx
Approval Expires mm/dd/yyyy

# Good Faith Estimate (GFE)

| | |
|---|---|
| Name of Originator | Borrower |
| Originator Address | Property Address |
| Originator Phone Number | |
| Originator email | Date of GFE |

## Instructions

This GFE gives you an estimate of your settlement charges and loan terms if you are approved for this loan. See page 3 for more detailed instructions.

## Important dates

1. The interest rate for this GFE is available until _____. After that date, the interest rate, some of your Loan Origination Charges, and the monthly payment shown below can change until you lock your interest rate.
2. This estimate for all other settlement charges is available until _____.
3. If you proceed with this loan, you must go to settlement in _____ days. You must lock the interest rate at least _____ days before settlement.

## Summary of your loan terms

| Your Loan Details | |
|---|---|
| Your initial loan balance is | $ |
| Your loan term is | years |
| Your initial interest rate is | % |
| Your initial monthly amount owed for principal, interest, and any mortgage insurance is | $ per month |
| Your rate lock period is<br>*After you lock in your interest rate, you must go to settlement within this number of days to guarantee this interest rate.* | days |
| Can your interest rate rise? | ☐ No ☐ Yes, it can rise to a maximum of % |
| Can your loan balance rise? | ☐ No ☐ Yes, it can rise to a maximum of $ |
| Can your monthly amount owed for principal, interest, and any mortgage insurance rise? | ☐ No ☐ Yes, it can rise to a maximum of $ |
| Does your loan have a prepayment penalty? | ☐ No ☐ Yes, your maximum prepayment penalty is $ |
| Does your loan have a balloon payment? | ☐ No ☐ Yes, you have a balloon payment of $ due in years. |
| Does your loan include a monthly escrow payment for property taxes and, possibly, other obligations? | ☐ No ☐ Yes |

## Summary of your settlement charges

| | | |
|---|---|---|
| A | Your Adjusted Origination Charges *(Table A, page 2)* | $ |
| B | Your Charges for All Other Settlement Services *(Table B, page 2)* | $ |
| A + B | Total Estimated Settlement Charges | $ |

Understanding your estimated settlement charges

## Your Loan Details

**1. Our service charge**
These charges are for the services we provide when we get and process this loan for you.

**2. Your credit or charge for the specific interest rate chosen (points)**

☐ The credit or charge for the interest rate you have chosen is included in "Our service charge." (See item 1 above.)

☐ You receive a credit of $ _____ for this interest rate of ___ %.
This credit reduces your upfront charges.

☐ You pay a charge of $ _____ for this interest rate of ___ %.
This payment (discount points) increases your upfront charges. (See the table on page 3 to see how you can change this charge or credit by choosing a different interest rate.)

**A** Your Adjusted Origination Charges $

## Your Charges for All Other Settlement Services

**3. Required services that we select**
These charges are for services we require to complete your settlement. We will choose the providers of these services.

| Service | Charge |
|---|---|
| | |

**4. Title services and lender's title insurance**
This charge includes the services of a title agent, for example, and title insurance to protect the lender, if required.

**5. Required services that you can shop for**
These charges are for other services that are required to complete your settlement. We can refer you to providers of these services or you can shop for them yourself. Our estimates for providing these services are below.

| Service | Charge |
|---|---|
| | |

**6. Government recording and transfer charges**
This includes state and local charges on mortgages and home sales.

**7. Reserves or escrow**
This charge is held in an escrow account to pay recurring charges on your property, such as property taxes or insurance.

**8. Daily interest charges**
This charge is for the daily interest on your loan from the day of your settlement until the first day of the next month or the first day of your normal mortgage payment cycle. For this loan, this amount is $ _____ per day for ___ days (if your closing date is _____).

**9. Homeowner's insurance**
This charge is for the insurance you must buy for the property to protect from a loss, such as fire.

**10. Optional owner's title insurance**
This charge is for additional insurance you can choose to buy to protect yourself from title defects.

**B** Your Charges for All Other Settlement Services $

**A + B** Total Estimated Settlement Charges $

# Important Information and Instructions

## Shopping for a loan offer

Only you can shop for the best loan for you. Compare this GFE with other loan offers, so you can find the best loan. Use the table on page 4 to compare all the offers you receive.

## Understanding which charges can change at settlement

The GFE estimates your settlement charges. At your settlement, you will receive a HUD-1. Compare the charges on the HUD-1 with the charges on this GFE. Charges can change if you select your own provider and do not use the companies your lender suggests.

The list below shows you how much the estimated charges on this GFE can change at your closing.

| These charges *cannot increase* at settlement | The total of these charges *can increase up to 10%* at settlement | These charges *can change* at settlement |
|---|---|---|
| • Our service charge<br>• Your charge or credit for the specific interest rate chosen *(after you lock in your interest rate)*<br>• Government recording and transfer charges | • Required services that we select<br>• Title services and lender's title insurance *(if we select them or you use providers identified by us)*<br>• Required services that you can shop for *(if you use providers identified by us)*<br>• Optional owner's title insurance *(if you use providers identified by us)* | • Required services that you can shop for *(if you do not use providers identified by us)*<br>• Title services and lender's title insurance *(if you do not use providers identified by us)*<br>• Reserves or escrow<br>• Daily interest rate charges<br>• Homeowner's insurance<br>• Optional owner's title insurance *(if you do not use providers identified by us)* |

## Looking at trade-offs

In this GFE, we offered you a particular interest rate and estimated settlement charges. But, you could choose other loans to get a lower interest rate or lower settlement charges.

- If you want to choose a loan with a **lower interest rate,** then you will have **higher settlement charges.**
- If you want to choose a loan with **lower settlement charges,** then you will have a **higher interest rate.**

The table below shows how the loan for this GFE compares to two other options. If you decide you want to make one of these trade-offs, you must ask us for a new GFE.

| | The loan in this GFE | A loan with a lower interest rate | A loan with lower settlement charges |
|---|---|---|---|
| Your loan amount | $ | $ | $ |
| Your interest rate | % | % | % |
| How much your monthly payment will be | $ | $ | $ |
| How much more or less in monthly payments from this GFE | No Change | You will pay $ less every month | You will pay $ more every month |
| How much more or less you will pay at settlement with this interest rate | No Change | Your lower interest rate will raise your settlement charges by $ | Your higher interest rate will lower your settlement charges by $ |
| How much your total estimated settlement charges will be | $ | $ | $ |

If this loan offer is for an adjustable rate loan, the comparisons in the table are for the initial interest rate before any adjustments are made.

## Your financial responsibilities as a homeowner

In addition to your monthly amount owed for principal, interest, and mortgage insurance, you may need to pay other required annual charges to keep your property. We must provide an estimate for annual property taxes along with homeowner's, flood, and other required property protection insurance, but we are not required to provide estimates for the other charges. You may have to identify the other charges and ask for additional estimates from others.

Different sources might use different techniques to estimate these charges, but the actual charges will be the same in the end. Therefore, do not use these estimates to compare settlement charges from different loan originators.

| | |
|---|---|
| Annual property taxes | |
| Annual homeowner's insurance | |
| Annual flood insurance | |
| Annual homeowners association/condominium fees | |
| Other | |
| **Total Other Annual Charges** | |

## Applying for this loan

If you decide you would like to apply for this loan, contact us at _____. You must pay a fee of $ _____. This fee will be subtracted from your settlement charges.

## Getting more information

The type of loan you choose can affect your current and future monthly payments. You can ask us for more information about loan types. You can also look at several government publications: HUD's *Special Information Booklet* on settlement charges, your *Truth-in-Lending Disclosures*, and consumer information publications of the Federal Reserve Board.

## Using the shopping chart

Use this chart to compare Good Faith Estimates (GFEs) from different loan originators. Fill in the information by using a different column for each GFE you receive.

By comparing loan offers, you can shop for the best loan.

| | | | | |
|---|---|---|---|---|
| Loan Originator Name | | | | |
| Initial Loan Balance | | | | |
| Loan Term | | | | |
| Initial Interest Rate | | | | |
| Initial Monthly Amount Owed | | | | |
| Rate Lock Period | | | | |
| Can Interest Rate Rise? | | | | |
| Can Loan Balance Rise? | | | | |
| Can Monthly Amount Owed Rise? | | | | |
| Prepayment Penalty? | | | | |
| Balloon Payment? | | | | |
| [illegible] | | | | |

## If your loan is sold in the future

Lenders can receive additional fees by selling your loan at some future date after settlement. Once you have obtained your loan at settlement, however, your loan terms, adjusted origination charges, and total settlement charges cannot change. After settlement, any fees lenders receive in the future cannot change the loan you received or the charges you paid at settlement.

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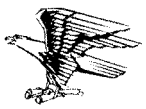
ASSOCIATION



# Testimony of the American Land Title Association Before the House Small Business Committee

Presented by Gary Kermott
President

May 22, 2008

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Thank you for the opportunity to submit testimony on the proposed rule to amend the existing regulations of the Real Estate Settlement Procedures Act ("RESPA"). We respectfully submit this statement on behalf of the American Land Title Association ("ALTA" or "Association"), the national trade association of the land title industry. Our membership is composed of nearly 3,000 title insurance companies, title insurance agents, independent abstractors, escrow officers and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders against losses from defects in title. 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 persons and operate in every county in the country.

ALTA and its members commend the U.S. Department of Housing and Urban Development ("HUD" or "Department") for its stated objectives in the proposed rule. The Association agrees that it is important for consumers to better understand their real estate mortgage transactions, and to receive easy-to-understand and reliable information about loan terms and settlement costs to facilitate consumer shopping for mortgages and title-related services. We recognize that the Department has devoted substantial time to surveying the varying interests of settlement service providers and studying consumer reactions to proposed disclosures, and the Association applauds HUD's commitment to reforming its RESPA regulations.

We are concerned, however, that certain provisions of the Department's proposals will not achieve those objectives and, indeed, may create problems that undermine those objectives. For example: (1) the proposed Good Faith Estimate ("GFE") is long and complicated and does not allow for an easy comparison to the HUD-1 Settlement Statement ("HUD-1"); (2) the imposition of tolerances and volume discounts create an anti-competitive environment that could disadvantage small businesses and give consumers fewer choices of settlement service providers and; (3) the imposition of responsibility on the closing agent to read and interpret the closing script on behalf of the borrowers will increase costs for both sellers and borrowers.

We believe that RESPA reform cannot be resolved in one sweeping change without considering and appreciating the many moving parts of a residential real estate transaction. The Association, therefore, urges the Department to carefully consider the potential problems and impractical effects of the proposed rule, many of which we will discuss below. ALTA is committed to working with the Department to craft a solution that both benefits consumers and does not adversely affect the Association's members.

The Association's comments on the proposed rule are organized as follows: Part I provides an executive summary of this comment letter. Part II discusses several of the main concerns ALTA has with the proposed rule. This part focuses on

the Department's proposals for: (1) a closing script; (2) the disclosure of certain title insurance items on the GFE and the HUD-1; (3) the use of average cost pricing and related restrictions on government recording fees; and (4) negotiated volume discounts. Part III provides comments on other aspects of the proposed rule and responds to questions posed by the Department. Finally, Part IV concludes with alternative approaches to HUD's planned disclosures that ALTA believes will achieve the Department's objectives for the rule without the adverse consequences identified in Part II.

## I. EXECUTIVE SUMMARY

Although ALTA supports the Department's underlying objectives for the proposed rule, the Association believes the Department is attempting, by regulation, to convert a statute and regulatory regime designed to (a) alert consumers to the range of closing costs they are likely to encounter (the GFE) and (b) provide a nationwide form that will reflect the distribution of the buyer's and seller's funds at closing (the HUD-1) into a new regime that was not intended by Congress and is not authorized by the statute. Irrespective of whether HUD's objectives are praiseworthy (and they are), the rule's new processes and procedures, which HUD deems necessary to achieve its objectives, are more than the statutory framework can bear.

### A. Closing Script

We believe that HUD has absolutely no statutory authority to place on title companies and closing agents the obligations contained in its closing script regulations. Suggesting that HUD has such authority by characterizing the closing script as a mere "addendum" to the HUD-1 settlement statement only demonstrates that HUD itself cannot find the statutory authority for such obligations. We, therefore, believe that HUD is forced to find a tenuous link to some statutory provision for these very new, and very substantive, obligations.

Not only is there no statutory authority for HUD to impose these new regulatory requirements on title and closing agents, but, as a matter of sound policy, such new regulatory obligations can and should **only** be placed on the shoulders of the mortgage lender. There are a number of reasons why this is so.

First and foremost, under the proposed regulations, it is unclear what, if anything, the buyer/borrower or the closing agent can do if there are significant discrepancies between the final documents/ instructions sent by the lender at the time of closing and the terms of the loan or estimated settlement costs provided by the lender to the consumer at the application stage. The information HUD believes should be provided in the closing script is information that lenders should be required to provide at an earlier date – well before closing – so that the consumer

can take action on the basis of the new information before their rate lock expires or their moving van is packed. In short, the "education" that HUD wants to provide to consumers through the closing script comes too late in the process and from the wrong party to provide any benefit to consumers. It will only provide confusion.

Second, in many states, settlement agents risk engaging in the unauthorized practice of law by reviewing loan documents and answering borrower questions about final loan terms. The closing script, which postpones the resolution of any unclear terms until closing, will certainly place settlement agents in the position of either answering those questions, in violation of state law, or delaying the closing until the borrower can resolve those questions or concerns with their lender.

Third, in states where no such concerns over the unauthorized practice of law exist, the proposed closing script, contrary to HUD's estimate, will significantly increase the amount of time required for closing. In its estimate, HUD took into consideration only the amount of time necessary to read the script to the borrower. It did not include the significant amount of time that will be necessary to address questions or resolve discrepancies in connection with loan terms and final settlement costs. This will not only increase the amount of time required to close a transaction but, as a result, will decrease the number of closings a settlement agent can perform. These are factors that will almost certainly result in higher closing fees charged to the borrower and seller.

Finally, the Association believes that HUD may not fully appreciate the impracticalities that will prevent implementation of the closing script as proposed. For instance, not all real estate settlements are conducted face-to-face with the borrower, which makes it impossible to read aloud the closing script in such "escrow closings". Moreover, in the absence of a binding obligation on lenders to provide the closing script information to the closing agent well in advance of closing, the closing agent will be unable to prepare the closing script if there is any delay by the lender. ALTA, therefore, believes these insuperable problems suggest the mortgage lender is in the best position to prepare the closing script or an alternative document, which should be presented at some point prior to closing. This will ensure there is a meeting of the minds between the lender and the borrower as to what the lender thinks it is providing and what the borrower thinks he or she is getting. Requiring the closing agent to develop this mutual understanding at settlement imposes the obligation on the wrong party at the wrong time in the transaction.

### B. Title Insurance Fee Disclosures

With regard to the GFE and HUD-1, ALTA asks the Department to reconsider the disclosure of certain title insurance services and fees on both of these disclosures. Most importantly, HUD should continue to require the itemization of all title-related charges on both the GFE and HUD-1, so that consumers can match

specific services to their individual needs and more easily shop for the title insurance services they desire. For example, lenders are primarily concerned with verifying that there are no liens against a property or judgments against their borrower and may, therefore, be willing to accept a low cost, limited title search. Borrowers purchasing a property, on the other hand, want to know that they have good title to the land they are acquiring without easements and restrictions. These "clouds" on title can only be found through a more extensive and costly search. Unless the cost of a title search is itemized on the GFE and HUD-1, there will be no way for borrowers to compare the scope of the services that are included in the costs they are quoted.

In addition, we believe that use of the word "optional" to identify owner's title insurance is misleading to consumers and could conflict with state-specific practices that require owner's coverage in residential real estate transactions. The proposed disclosure of the title agent's and title underwriter's portion of the title premium also serves no useful purpose on the HUD-1 and does not aid consumers in their understanding of title insurance fees.

### C. Recording Fees and Average Cost Price

While ALTA continues to question the Department's authority to impose tolerance limitations on estimates provided by lenders, we ask HUD to remove government recording fees from the proposed zero tolerance category. Such fees are rarely known to mortgage lenders or title insurance companies at the GFE stage, and there are a number of reasons why these fees may change before or after closing. Alternatively, if all settlement service providers were authorized to charge consumers the average cost price, the Association believes the certainty of the average cost price would benefit both consumers and our members, particularly as it relates to recording fees. Accordingly, if the Department's intent with the rule is to provide such authorization, we ask HUD to clarify these average cost price provisions.

### D. Volume Discounts

Finally, it is the Association's position that volume discounts are anti-competitive and will disproportionately harm small businesses. Small independent title agencies do not have the resources to guarantee a stream of business to local title-related service providers or discount their own prices to compete with large national title providers. While such discounts may result in lower prices for the consumer in the short term, once the small businesses have been pushed out of the competitive marketplace, large providers are left to compete only among themselves. Under these circumstances, consumers will have fewer choices for title and closing related services, and prices will inevitably increase. Because this conflicts with HUD's stated objectives for the new regulations, we ask the

Department to reconsider the effects of volume discounts on both consumers and ALTA's members.

In addition, the use of volume discounts is inconsistent with state regulators' interest in protecting the solvency of title insurance companies. Because title insurance claims may come decades after purchase of the policy, state regulators have a strong interest in preserving the solvency of title companies to ensure that consumers are protected. State laws require that title premiums be "adequate." Severe discounting of title services could threaten the adequacy of the premium reserves.

### E. Recommendations

Based on these concerns, ALTA proposes that HUD limit their efforts to simplifying the GFE and HUD-1 so that easy comparisons can be made. Page one of HUD's proposed GFE provides information about the loan terms and the total costs for settlement services in an understandable format. ALTA supports this type of summary page, but, in addition, ALTA urges HUD to improve individual fee disclosures by using a page that is identical to page two of the present HUD-1. This would allow consumers to know what is included within the total amount listed on the GFE summary page and more directly compare the fees to the final charges at closing.

## II. ALTA HAS SIGNIFICANT CONCERNS ABOUT HUD'S PROPOSALS

There are a number of important issues and problems raised by the proposed rule; however, for purposes of this correspondence, we focus on four particular aspects of HUD's proposals. The Association believes these four items could hinder a consumer's understanding of title insurance and settlement fees, increase ultimate costs to consumers, and have a severe adverse impact on our member's delivery of settlement services. We discuss each of these four items below.

### A. The Responsibility for Ensuring that Consumers Understand Final Loan Terms and Settlement Costs Should Rest with the Mortgage Lender.

Following the Department's 2005 RESPA roundtables, settlement service providers expected HUD's eventual new and improved RESPA disclosures to focus on the GFE, which garnered the most attention in these discussion groups. While the Department has proposed drastic changes to the GFE in this proposed rule, HUD also has invented a new "addendum" to the HUD-1 in the form of a closing script. The closing script, however, is not a disclosure about which the Department sought input from settlement service industries, and, as a result, ALTA believes the

proposed disclosure is a flawed and impractical solution to "ensure that at settlement, borrowers are aware of final loan terms and settlement costs."[1]

A closing agent also fills a specialized role in a real estate settlement. The proposed HUD-1 addendum would impose new responsibilities and liabilities on the closing agent that most closers are prohibited from undertaking and which are not authorized or contemplated in any statutory provision of RESPA. In fact, this proposal would shift the closer from the position of an independent third party intermediary to an apparent agent of the lender. This is a significant and dangerous change to the essential role that title and other closing agents have traditionally played in the real estate process. Although the Association agrees that it is important for consumers to understand their mortgage loan and settlement costs, this is a responsibility best fulfilled by the mortgage lender who originates the loan and discloses settlement costs on the GFE.

### 1. Nothing in RESPA's Statute Authorizes HUD to Require a Settlement Agent to Prepare a Closing Script.

Initially, ALTA questions whether HUD has the statutory authority under RESPA to require settlement agents to prepare and provide a closing script. This is a brand new concept, which we assume HUD derives from its statutory authority to develop a uniform settlement statement. However, nothing in these statutory provisions remotely authorizes the kind of new and substantive obligations that HUD is seeking to impose on title and closing agents. The Department cannot hide this lack of authority by claiming these obligations are merely an "addendum" to the HUD-1 form. Instead, if HUD were to use any statutory authority for imposing such obligations on anyone, that authority can only be derived from the obligations RESPA imposes on **lenders** to provide the GFE.

### 2. To Comply With HUD's Proposed Closing Script, Closing Agents Risk Committing the Unauthorized Practice of Law.

According to the proposed regulations, HUD proposes to require the "settlement agent or other person conducting the settlement" to read the closing script aloud to the borrower and explain, among other things, the loan terms as contained in the mortgage documents. By placing a closing agent in the role of explaining loan terms and settlement charges, a consumer is likely to view the closing agent as an expert who can advise the consumer as to the particulars of the transaction or answer any question regarding their loan. However, many states allow only licensed attorneys to answer borrower questions and explain the details of a mortgage loan transaction. If HUD requires a settlement agent to be responsible

[1] 73 Fed. Reg. 14030, 14033 (Mar. 14, 2008).

for reviewing loan documents and explaining the loan terms to a borrower at closing, the agent may be forced to commit the unauthorized practice of law under many state laws. Alternatively, only attorneys will be able to close transactions in those states, which will undoubtedly increase settlement costs.

For example, in Virginia, title insurance companies and agents must adhere to the state's Unauthorized Practice of Law Guidelines for Real Estate Settlement Agents ("Guidelines").[2] While a title entity may conduct the closing, prepare the HUD-1, receive and disburse funds, and record mortgage documents, the entity is prohibited under the Guidelines from drafting legal instruments and explaining the legal obligations of the parties under the loan documents. Similarly, the North Carolina State Bar has identified a list of services, which if performed by a non-lawyer, will constitute the unauthorized practice of law in the state. One such service is:

> Provid[ing] a legal opinion or advice in response to inquiries by any of the parties [at closing] regarding legal rights or obligations of any person, firm, or corporation, including but not limited to the rights and obligations created by a promissory note, the effect of a pre-payment penalty, the rights of parties under a right of rescission, and the rights of a lender under a deed of trust.[3]

Accordingly, if a title company or other non-lawyer closing agent in states like Virginia or North Carolina is required to read aloud a closing script to the borrower, the closing agent would be prohibited in those states from providing any explanations to the borrower with regard to the loan terms identified in the closing script. If HUD's objective for the closing script is to ensure that consumers understand their mortgage loan, a closing agent precluded from providing explanations to the borrower is the wrong person to provide this clarity. Instead, if certain loan term information is to be emphasized to the borrower at or prior to closing, the mortgage lender originating the loan should be tasked with this explanation.

### 3. The Proposed Closing Script Will Increase the Time Required for Closing and Resulting Closing Fees.

The Department spends a considerable amount of time in the proposed rule and in its Regulatory Flexibility Analysis discussing the amount of savings consumers will enjoy as a result of HUD's proposed disclosures in the rule. Yet, with

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[2] See "Unauthorized Practice of Law (UPL) Guidelines for Real Estate Settlement Agents," Parts V and VI, available at www.vsb.org/site/regulation/upl-guidelines-for-real-estate-settlement-agents.

[3] Authorized Practice Advisory Opinion 2002-1, N.C. State Bar, Jan. 24, 2003.

regard to the proposed closing script, the rule fails to appreciate the amount of additional time it will take a closing agent to prepare and read the closing script, and the effect this will have on a closing agent's resulting fee. In fact, HUD estimates that it will take an additional 45 minutes to close a loan with the closing script. This, however, is an underestimation if the goal of the script is to ensure borrower questions are answered and consumers leave the closing table understanding the terms and the costs of their loan. Our members estimate an additional 30 minutes will be needed just to respond to the questions raised by the closing script.

More specifically, HUD does not appear to anticipate the fact that borrowers will ask questions about the items identified in the closing script that the settlement agent may be unable to answer due to the legal prohibitions discussed above or a lack of knowledge and information. If state unauthorized practice of law provisions prohibit a closing agent from explaining loan terms to a borrower and a borrower has questions, a closing agent will be forced to stop the closing and contact the lender for the proper answers and explanations for the borrower. Similarly, the borrower may ask why there is a discrepancy between the final and estimated settlement charges the lender provided. The timeliness of these answers is dependent on the lender and whether the appropriate person can be reached in a single telephone call during the lender's normal business hours.

As a result, a normal hour-long closing may turn into two or even three hours to answer the borrower's questions, and the settlement agent will be forced to scale back the number of closings the agent can complete in one day. That will substantially increase the burden on closers, especially small independent businesses. With fewer daily closings, the settlement agent may be forced to increase its closing fees to sustain its operations. Although HUD already anticipates a $54 increase in closing fees to account for the time spent reading the closing script, the Association is concerned that this is too low by an order of magnitude.

The proposed rule also fails to recognize that most closings occur at the end of the month. There are many reasons for this, including the payment of daily taxes and interest charges, to name a few. HUD's economic analysis, however, fails to take into account that closers will not have the physical space or the man power to accommodate the same number of closings at the end of the month given the increased time necessary for completion of the closing documents and explanations. This will disproportionately harm smaller settlement companies and agents.

If HUD's response to these points is that the closing agent need not answer any questions that the consumer may have, then the closing script obligation will either result in a very unhappy consumer – one whose anger will be more directed at the closing agent than the lender – or the closing script could just as easily have been delivered in writing by the lender to the borrower after closing. In other words, if HUD is not expecting a consumer to be able to take any action at the closing table

as a result of having heard the closing script, then why is it essential that the closing script be provided to the borrower at the time of settlement?

Given these issues, ALTA believes the Department can eliminate any uncertainty regarding the time required to close a transaction by shifting the responsibility to explain loan terms and final settlement charges to the lender. The lender is responsible for the ultimate loan product reflected in the mortgage documents to be signed at the closing table. If the Department is concerned about resolving situations where a borrower is unaware or unsure of the terms of the loan, it should be the lender's responsibility to identify exact loan terms and explain them to the borrower before he or she gets to the closing table. Otherwise, the closing agent merely identifies final loan terms for the borrower without any ability to ensure the borrower understands them. This process could prove to take more time and be more expensive, with less benefit to the consumer, which is contrary to the Department's stated objectives for the rule.

**4. The Proposed Rule Provides No Guidance for Settlement Agents When Inconsistencies in Mortgage and Closing Documents are Identified.**

In preparing the closing script, the proposed rule obligates the settlement agent to disclose and explain to the borrower any inconsistencies between the mortgage note, between related settlement information and the GFE, and between the HUD-1 and the GFE. Other than this instruction, the rule fails to provide any guidance for the settlement agent to take action when these inconsistencies are identified. For instance, the rule provides no guidance for the settlement agent in circumstances where the lender exceeds the applicable tolerances or has changed the terms of the loan from that expected by the borrower. The rule is clear, however, that exceeding the tolerances violates Section 4 of RESPA. But, what is the settlement agent to do? If the lender exceeds the stated tolerances by $96 (as set forth in Example 6 of the sample closing scripts)[4] and the settlement agent closes the transaction, the settlement agent may find itself the defendant in a class action lawsuit.

In addition, HUD states that its intent for the closing script is to ensure borrowers are aware of and understand the loan terms. The rule, however, does not address how a settlement agent should proceed with the closing when the final loan terms are not the same as the loan terms disclosed on the GFE. If the settlement agent is prohibited by state law from explaining loan terms to the borrower and the lender is unreachable at the time of settlement, the closing agent may be forced to

[4] See 73 Fed. Reg. at 14089-14092.

delay the closing. This is small comfort to a consumer whose worldly possessions are in a moving van parked outside the settlement agent's office.

Furthermore, the rule subjects certain settlement charges to different tolerances depending on whether the borrower uses a lender-recommended settlement service provider or shops independently for a provider. In completing the comparison chart portion of the closing script, the rule does not identify how a settlement agent is supposed to know which service providers are borrower-selected and not subject to tolerance calculations. This is yet another example of how HUD's proposed rule puts the settlement agent on the spot to resolve issues created by the lender, which, without instructions from the lender, cannot be resolved. ALTA believes the proposed closing script rules fall short of providing realistic instructions to make the disclosure useful to the consumer.

**5. Implementation of the Proposed Closing Script Creates Several Practical Problems.**

The Department's proposed rule also fails to appreciate the realities of modern-day real estate settlements. As a result, the Association is concerned that the rule, if finalized, would be impractical and impossible to implement.

For example, the proposed rule would require the settlement agent to read the closing script aloud to the borrower at closing. Such a requirement assumes that all residential real estate closings are conducted face-to-face with the buyer and the seller around an actual closing table. However, not all residential real estate closings are conducted in this manner. On the West Coast, escrow companies conduct closings and arrange for the transfer of real estate without the buyer and seller having to be present at a face-to-face closing. In addition, more and more settlement companies offer the convenience of closings by mail or via the internet, where buyers and sellers separately receive final closing and mortgage documents, execute them in the presence of a self-selected notary, and return them to the settlement agent by the scheduled closing date. In each of these circumstances, escrow officers and/or settlement agents do not meet with the borrower face-to-face and would not have the opportunity to read a closing script to the borrower. Yet, the proposed rule provides no alternatives and would not allow a settlement agent to forego the reading aloud component of the closing script. Given the varying procedures for real estate closings across the country, this requirement is impractical and impossible to implement as designed by the Department.

Moreover, HUD's proposed rule is silent with regard to the language of the closing script, although the examples provided in the rule show the closing script only in English. Borrowers, however, often speak languages other than English, and the rule does not address whether the Department expects the settlement agent to translate the script into the borrower's language. If a settlement agent must read

aloud a script in a face-to-face closing and obtain the borrower's written acknowledgment that the settlement agent explained the loan terms, this may be an impossible task if the borrower does not speak and understand English. HUD states that its purpose for the closing script is to ensure that borrowers are aware of the final loan terms and settlement charges; yet the Department fails to appreciate that language could be the first barrier to a borrower's understanding of these items.

Finally, the rule fails to appreciate the time frame within which a settlement agent must prepare for closing. Although the rule would require the loan originator to transmit to the settlement agent the necessary information to complete the closing script, the rule fails to obligate the loan originator to provide such information within a specified period of time to ensure the settlement agent is able to prepare the closing script and provide it to the borrower 24 hours prior to closing. In fact, settlement agents often do not receive the closing package and instructions from the lender until shortly before closing. Should a lender fail to provide a settlement agent with the required information in a timely fashion, the closing agent risks the additional liability that could result from its failure to prepare and provide the borrower with a copy of the HUD-1 and closing script prior to closing. Furthermore, at this point, the settlement agent has little time to prepare the actual closing script, which could threaten a settlement agent's ability to close the borrower's transaction in a timely fashion. Accordingly, not only is timing an impractical (or missing) aspect of the proposed closing script, it is yet another reason why mortgage lenders are best suited to explain final loan terms and settlement charges to their borrowers.

### B. The Disclosure of Certain Settlement Services and Title Insurance Fees is Misleading and Could Discourage Consumer Shopping.

Although one of HUD's purposes for the proposed rule is to simplify and improve consumer disclosures, ALTA believes certain of the rule's disclosures related to settlement services and title insurance fees are misleading, could discourage consumers from shopping for services that are in the buyer's best interest, and could competitively disadvantage the Association's members. ALTA fully supports the Department's objective of clarity, but we believe the rule goes too far in simplifying the disclosure of settlement services and could create confusion about the role of title insurance in the settlement process.

#### 1. The Disclosure of a Single Price for "Primary Title Services" Does Not Allow a Consumer to Comparison Shop.

In a departure from current requirements regarding the itemization of settlement charges in both the GFE and on the HUD-1, the proposed rule would require that a single fee be disclosed for "title services and lender's title insurance" in

block 4 of the GFE and for "primary title services" in the 1100 section of the HUD-1.[5] The elimination of required itemization for these fees is of immense concern to ALTA and can only serve to lessen, rather than enhance, competition for these services.

HUD's belief that (a) consumers shop among lenders based on the lender's estimates of the 1100 series charges, and (b) that consumers have no need to know the amounts of the various charges that comprise the aggregate amount is in error. In a purchase/sale transaction, the title-related and closing-related charges in the transaction are **not** a function of the lender's needs, but are far more a function of the needs of the buyer and seller of the property with regard to their underlying real estate transaction. In most cases, the seller (in seller-pay jurisdictions) and the buyer will have decided on the provider of title and closing services before the lender is even involved in the transaction. Thus, how the lender estimates the costs for these services should be unrelated to how buyers decide on the lender that offers the best loan at the best lender-related costs.

With regard to the itemization of individual costs that comprise the aggregate block 4 (or 1100 series) charge, consumers who want to shop for these services will be seriously disadvantaged because there is no way to determine the lender's estimated price for the title company, the escrow company, the attorney, or the surveyor. In fact, the concept that only the aggregate amount of title and closing-related charges need be disclosed is an unfortunate – and inappropriate – hangover from HUD's ill-fated "packaging" proposal in 2002. In that proposal, HUD believed – erroneously – that if a lender packages all settlement charges, the borrower has no interest in knowing what the individual charges in that package might be. Even if that view has validity in the case of a refinance loan, it has no validity in the case of a purchase/sale transaction or in the proposed regulations. HUD and ALTA ultimately want to encourage consumers to shop among providers of title and closing-related services. A lender who provides a GFE that only discloses an aggregate figure for a range of individual charges prohibits the consumer from shopping for the title (or escrow) services at a lower price than that reflected in an aggregate price on the GFE.

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[5] ALTA also is concerned that HUD has effectively altered its long-standing definition and guidance regarding core title services. Notably, the rule would define "primary title services" to include "any service involved in the provision of title insurance (lender or owner policy) and settlement or closing services, including but not limited to: title examination and evaluation; preparation and issuance of title commitment; clearance of underwriting objections; preparation and issuance of a title insurance policy or policies; and the processing and administrative services required to perform these functions." 73 Fed. Reg. at 14056 (emphasis added). This is a sharp contrast to HUD's current definition of core title services, which includes the conducting of a closing only where customary and when the agent's compensation for such services is customarily part of the payment or retention from the insurer. 24 C.F.R. § 3500.14(g)(4); 61 Fed. Reg. 49,398-49,400 (emphasis added). If the Department's concept of core title services is changing with the proposed rule, this is an issue ALTA urges HUD to directly address in any final rule.

Similarly, with regard to the HUD-1, the entire purpose of the document is to provide a record for all parties as to how the settlement funds brought to the transaction by the buyer, seller and lender are disbursed. This information has been of value in numerous studies to determine the average or typical charges for various settlement services. But HUD's proposed handling of the 1100 series charges would undermine those objectives. By lumping together so many different charges into the category of "primary title services," no one who reads the HUD-1, including the buyer and the seller, will know how their funds were actually disbursed and to what providers.

Moreover, what exactly constitutes "primary title services" is not clear. HUD's explanatory statement describes a "primary title service" as including abstract, binder, copying, document handling, or notary fees, even if a party other than the title company listed on line 1101 provides the service.[6] However, the definition of "primary title service" in the proposed regulation is different from that description. The proposed regulation defines "primary title service" as "any service involved in the provision of title insurance (lender or owner policy) and settlement or closing services, including, but not limited to, title examination and evaluation, preparation and issuance of title commitment; clearance of underwriting objections; preparation and issuance of a title insurance policy or policies, and the processing and administrative services required to perform these functions."[7] What about title searching, abstracting, "binder," copying, document handling, document preparation, notary fees, handling of the closing, and escrow services? These services seem to be dropped from the official definition.

The instructions for completing the HUD-1[8] also indicate that those charges not encompassed by "primary title charges" include "closing attorney or escrow agent" charges. Does this mean that the closing charges made by an independent escrow company should be listed separately from "primary title services," whereas the charge for a closing made by a title company is part of "primary title services"? Similarly, while "attorney closing" services are not "primary title services" and are to be listed separately, what if the attorney is not providing closing services, but some other service, such as the examination of title? Should the attorney's fee for this "primary title service" be included in the aggregate charge? These are the types of questions that support the continued itemization of title-related services.

Finally, the disclosure of a single fee for title insurance also fails to recognize that, in most areas of the country, the seller generally pays a substantial portion of

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[6] 73 Fed. Reg. at 14049.

[7] Id. at 14056.

[8] Id. at 14060.

the title insurance charges. The Department appears to assume that the borrower pays for all closing costs, including the fees for "primary title services," and the proposed rule provides no instruction as to how to disclose title-related fees when these costs are paid by the seller. If the GFE and HUD-1 do not itemize the fees for title insurance services, the Association believes it is possible the borrower could pay for services sellers currently assume, which will only result in higher costs to the borrower. Without evidence that consumers do not currently understand the title insurance-related fees disclosed in the current 1100 series of the HUD-1, ALTA asks the Department to continue to require such fees to be separately itemized on both the GFE and HUD-1.

**2. The Word "Optional" Should Be Removed From the Disclosure of Owner's Title Insurance.**

On both the proposed GFE and HUD-1, the Department would require the cost for owner's title insurance to be disclosed separately as "Optional owner's title insurance." This reflects HUD's continuously mistaken view that, in real estate transactions, it is the loan policy that is the key policy and the owner's policy is a mere addition to the loan policy. In a purchase/sale transaction, exactly the opposite is generally the case. It is the owner's policy that is the major policy in the transaction, and the loan policy is an "add on" that is issued at a relatively small additional premium.

Moreover, by including the term "optional" in both disclosures, HUD appears to be suggesting that a consumer does not need separate coverage for title insurance, which may discourage borrowers from obtaining owner's coverage. The Association understands that it is HUD's intent to create better disclosures to reduce the consumer's overall settlement costs, but by isolating owner's title insurance coverage as a service that can be eliminated to lower fees, the Department is targeting the one item that is structured to protect the consumer in connection with a real estate transaction. The purchase of a home is the most expensive purchase most consumers will ever make, and RESPA disclosures should not in any way discourage consumers from protecting their investment.

The use of the word "optional" also ignores several significant realities regarding the sale of title insurance. Notably, in many states, owner's coverage is required in residential real estate transactions. For example, although real estate and insurance laws in Washington State do not require anyone to obtain title insurance, real estate is transferred in the state by "warranty deed," which requires the seller to guarantee to the buyer that the seller actually holds the ownership rights being sold. As a result, sellers are required to purchase title insurance protecting the buyers in Washington, which is a standard clause in real estate listing

agreements.[9] By labeling owner's title insurance as optional on both the GFE and HUD-1, HUD's directive would directly conflict with requirements for the purchase of title insurance in Washington and other states. Should a consumer in one of these states elect not to purchase owner's coverage based on the GFE disclosure, consumers will only be confused when the title insurance company requires an owner's title insurance policy to close the transaction.

Even if an owner's policy is not required, many sellers often elect to purchase owner's title insurance policies for buyers. In those states where such is the custom, the rule provides no instructions as to how to disclose the cost of an owner's title policy on the GFE. Arguably, including the cost on the GFE would require the fee to be added to the consumer's total estimated settlement charges, which inflates the charges for which the consumer ultimately is responsible. On the other hand, if the cost is left blank on the GFE, the Department should expect the consumer to be confused when he or she sees the cost for owner's insurance disclosed on the HUD-1 (even if this cost appears in the seller's column of the disclosure).

HUD also fails to appreciate the fact that it is more cost effective for the consumer when a lender's policy and an owner's policy of title insurance are purchased concurrently.[10] A title search must be performed in connection with every issuance of a title insurance policy. When a title insurance underwriter can issue both a lender's policy and an owner's policy in connection with a single title search, the price of both policies costs less than if a consumer were to purchase his own title insurance policy after closing. Further, the purchase of an owner's policy at closing frequently results in savings to consumers in the future through the application of readily-available discounted "reissue" rates when borrowers refinance their loans or sell their properties. These are savings that consumers should not be discouraged from taking advantage of, particularly at the GFE stage when consumers ideally are shopping for a mortgage loan. Thus, while ALTA has no objection to the disclosure of the cost of owner's title insurance separately from a lender's policy, including the word "optional" in the disclosure is misleading and could result in higher costs for consumers in the long run. It is the Association's position that HUD should remove "optional" from both the GFE and HUD-1.

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[9] See "Title Insurance in Washington: Improving Competition and Consumer Choice," Report of the Title Insurance Review Task Force (Sept. 2007), available at www.insurance.wa.gov/publications/news/2140-Report.pdf.

[10] The rule fails to appreciate that the price for title insurance could be vastly different depending on whether only a lender's policy is purchased or both lender's and owner's policies are purchased. The rule provides no instructions as to whether the price for title insurance should be disclosed with the assumption that a consumer may choose not to purchase the "optional" owners policy or on the assumption that both policies will be issued simultaneously.

### 3. Itemizing the Split in Title Insurance Premiums Serves No Useful Purpose on the HUD-1.

The proposed HUD-1 includes two disclosures that HUD does not propose for the GFE. In lines 1113 and 1114 of the new HUD-1, the closing agent would be required to disclose the title agent's portion and title underwriter's portion of the total title insurance premium. Although the preamble to the proposed rule is silent with regard to the Department's reasons for such a disclosure, HUD refers to its decision to exclude such a disclosure from the GFE in its Regulatory Flexibility Analysis. With an intent to eliminate items that would place a greater burden on small businesses, HUD states that it is:

> Dropping the Title Agent/Title Insurance Premium Breakout. Title agents argued that breaking out the title insurance premium that goes to the underwriter from the rest of the title charges is costly and serves no useful purpose. This requirement has been eliminated, so there will be no compliance burden associated with the title agent/title insurance premium breakout on the GFE. *The breakout was not useful for comparison shopping.*[11]

For all of the reasons that HUD identifies above, the Association questions whether such a premium breakout serves any useful purpose on the HUD-1. The compliance burden on small title agencies in making this disclosure is no different for the HUD-1, and the disclosure certainly does not aid a consumer in understanding the title insurance fees paid as part of final settlement charges. In fact, the premium disclosure has nothing to do with the final prices the borrower pays at the closing table.

Moreover, the closing agent, if it is not also the title insurance agent in the transaction, will not know a title agent's premium split and HUD has no authority to require that title insurance agents inform the person handling the closing (such as an escrow company in western states) of the agent's level of commission in the transaction. Furthermore, no other insurance agents (i.e., homeowners, auto, and life insurance) are required to disclose the percentages of insurance premium they receive as compensation. The same is the case for other settlement service providers, such as real estate agents, who are not required to disclose the percentage of the real estate commission retained by the real estate sales person and the portion retained by the real estate brokerage company. Absent a clear statutory basis and sound policy reason for requiring title insurance agents to be singled out and forced to disclose their commissions from the title insurance company, there is no basis for HUD to require this disclosure in the HUD-1.

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[11] 73 Fed. Reg. at 14109 (emphasis added).

### C. All Settlement Service Providers Should Be Authorized to Charge Consumers the Average Cost of Settlement Services to Maximize the Benefit to Consumers.

ALTA applauds the Department's proposal to allow average cost pricing in an effort to protect consumers from high settlement costs. However, as written, the Association believes the rule does not go far enough to maximize potential cost savings to consumers. The proposed rule generally would allow the cost for a settlement service provided by a third party to be an average price, but the two methods proposed for calculating the average price are both based on practices of the loan originator. Accordingly, the rule appears to effectively allow only the loan originator to measure and charge the average cost price for settlement services performed by third parties. This excludes other settlement service providers, like the Association's title insurance and settlement company members, who could use average cost pricing as an important tool in providing competitive and guaranteed prices for title-related services. This is particularly significant as it relates to government recording fees, which the rule proposes to subject to a zero tolerance or, in other words, prohibit from increasing at the closing table.

Before considering the benefit of allowing title and settlement companies to calculate their own average cost price, it is imperative that ALTA comment on the Department's plan to subject government recording fees to a zero tolerance standard in a lender's GFE. In creating such a restriction, the Department ignores the reality that the amount of government recording fees chargeable to the consumer fluctuates throughout the origination process. HUD, instead, focuses on the fact that government recording fees are set by local regulations or ordinances and are well known to mortgage lenders at the time they receive a GFE application and provide a GFE disclosure to the consumer. While it may be true that lenders know that recording fees in a certain county are, for example, $2.00 for the first page and $1.25 for every page thereafter, it is impossible for a lender to know the exact number of pages that will be recorded following settlement.

Even if a standard Fannie Mae loan document in a state is 12 pages long (and would equal $15.75 in recording fees using the example above), there are many reasons why the number of pages to be recorded can change during the origination and title search process, which will always change the amount of recording fees. For instance, the addition of another signature page to the mortgage document or a need to include the property description on an exhibit page to the deed will increase the number of pages to be recorded as well as the resulting recording fees. In addition, if the title company discovers a lien on the property during a title search, a lien release must be recorded to perfect the chain of title. Each of these extra recordings will result in additional fees, which are circumstances that neither a mortgage lender nor a title company can anticipate at the time a consumer receives a GFE. As a result, it is unrealistic to expect mortgage lenders to

disclose exact recording fees on the GFE and impractical not to allow these fees to change at the closing table. The Association asks the Department to reconsider its proposal to subject government recording fees to a zero tolerance under the rule.[12]

Of equal importance, the new regulation on average cost pricing is contained in the provision (§ 3500.8(b)(2)) that governs the completion of the HUD-1. This is not where the clarification is needed. It makes no sense to include a provision on "averaging" in a HUD-1 section of the regulations when such a provision is needed to permit lenders and others to apply average cost pricing without running the risk of violating § 8(b) of RESPA. The proposed regulations fail to clarify that average cost pricing is not a violation of § 8(b). HUD should ensure that its regulations relevant to that section of RESPA are amended to reflect its new policy on average cost pricing.

Ultimately, ALTA believes that if the rule would allow title and settlement companies to use the average cost price, particularly as it relates to recording fees, express delivery charges and other third party charges for which title companies must pay, consumers would benefit from the certainty the average cost price provides. Moreover, the average cost price could curb the significant threat of class action litigation for title insurance and settlement companies as it relates to recording fees. Notably, class action plaintiffs' lawyers recently have filed lawsuits against title companies based on the allegation that an overcharge in recording fees is a violation of Section 8(b) of RESPA. Yet, these overcharges are not intentional and occur because last-minute changes to the mortgage documents result in a fluctuation in the recording fees. If a title or settlement company were able to determine their average cost for recording fees in particular geographic areas and pass this average through to the consumer, ALTA's members could refocus their resources currently spent on costly class action litigation. In the end, any potential for an overcharge in recording fees is made up by lower costs for other services disclosed on the GFE. The Association, therefore, believes that it is in everyone's best interest to authorize all settlement service providers to charge settlement fees based on average cost pricing without fear of violating HUD's interpretation of § 8(b) of RESPA. If the Department's intent with the rule is to provide such a broad authorization, we ask HUD to clarify the application of the provisions in the proposed rule.

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[12] The proposed rule also states that a lender must estimate the sum of all state and local government fees, charges, and taxes, but does not instruct whether the lender must disclose only the borrower's portion of these fees. In many cases, the seller is responsible for certain recording fees, and the rule does not address whether the "sum" must include the seller's recording fees. As a result, not only should the Department reconsider subjecting total recording fees to a zero tolerance standard, but the rule should revisit the instructions it provides for completion of the GFE to be sure borrowers are shown and ultimately charged for only those government recording fees for which the borrower is responsible.

## D. The Allowance of Volume Discounts is Anti-Competitive and Will Disproportionately Harm Small Businesses.

### 1. Small Title Companies Cannot Compete With Discounts Offered by Large Title Companies.

HUD's proposal to allow settlement service providers to negotiate volume discounts will disadvantage small title insurance companies that do not have the resources to discount their services in the same way as large companies. Yet, based on the rule's lengthy Economic Analysis, the Department seems to assume that such a proposal will not have anti-competitive effects or disadvantage small title insurance businesses. This is not the case.

In discussing the rule's impact on small businesses, the Department focuses on the local nature of title and settlement services and highlights the perceived advantages of knowledge and networks of clients that HUD says should not be negatively impacted by the rule. In fact, HUD predicts that RESPA reform will provide opportunities for efficient third-party firms to expand their operations. HUD goes on to state that "there is not evidence to support arguments that these 'locally-provided' services will shift to larger businesses. . . . [L]arge national title companies have to rely on local title companies in order to serve all areas."[13] Based on these comments, ALTA believes the Department is misunderstanding the anti-competitive arguments the Association made in 2002 and continues to make in response to the current proposed RESPA rule.

Notably, HUD's comments are focused on certain title-related services, such as the title search and settlement, which are local services often conducted by businesses located in the same geographic location as the subject property. As a result, it is true that when title insurance is provided by a large national company, the title search and closing services are subcontracted to local companies. This, however, is unrelated to the purchase of title insurance generally, which consumers could elect to buy from small independent title insurance agencies or a large national title provider with an office in the same geographic location.[14] In either case, the title

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[13] "Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis," Ch. 3, pp. 3-139 n. 141, available at www.hud.gov/offices/hsg/sfh/res/200803/5180RIA.pdf [hereinafter Regulatory Impact Analysis].

[14] This is evident by the Department's focus on "Title Abstract and Settlement Offices" in its Regulatory Impact Analysis on small businesses. HUD states that "Title Abstract and Settlement Offices" are defined as companies that: (1) research public land records to gather information relating to real estate titles; (2) prepare documents necessary for the transfer of title, financing, and settlement; (3) conduct final real estate settlements and closings; and (4) file legal and other documents relating to the sale of real estate." The Department also notes that that the term "title agent" is frequently used in the Regulatory Impact Analysis to refer to "Title Abstract and Settlement Offices." See Regulatory Impact Analysis, Ch. 5, pp. 5-92 n. 136. HUD, however, fails to recognize

search is a service that both the small agency and the large provider must order before a title insurance policy can be issued. However, the rule and its proposals for negotiated volume discounts will create an uneven playing field where the large national lenders and large national title companies will be able to undercut small local firms on title search prices.

When a consumer is faced with the choice of a small independent agency and a large national provider in the same geographic location to purchase title insurance, the ability to negotiate volume discounts on the local services that are incidental to the issuance of a title policy (i.e., the title search) will disadvantage the small independent agency that does not have the resources to guarantee a stream of business to a third party or discount its own services when the services are performed in house. For example, if a large provider subcontracts the title search to another company, the large title company has the flexibility to pass through a discounted fee for the title search to the consumer.[15] Because the large provider's volume of business is higher nationwide, the large provider is better positioned to absorb the difference between the discounted prices passed through to the consumer and the actual fee paid to the title search company. The small independent agency, on the other hand, likely performs the title search services in house and depends on the income produced from its title search fees to sustain its operations and compensate its handful of employees. The small agency, therefore, is competitively disadvantaged as compared to the large provider when it cannot offer the same kinds of discounts to consumers.

Similarly, title insurance companies often are required, at the request of the lender or the borrower, to overnight packages of closing documents in preparation for the settlement or after the settlement has occurred. Because large national title providers have reason to use overnight delivery services more frequently than small providers, large title companies are able to negotiate discounted overnight delivery rates and pass these discounted rates through to the consumer. A small independent title agency, however, is not in a position to negotiate corporate delivery

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that the kinds of services that define "Title Abstract and Settlement Offices" are not the core title services performed by title agents. While title agents may conduct title searches, prepare documents, conduct the closing, and record documents, these are services that often are subcontracted to local service providers, which is the focus of the Department's discussion. Title insurance agents, which may be small or large companies, are defined by the core title services they perform, including the evaluation of the title search to determine insurability of the title, the clearance of underwriting objections, the issuance of a title commitment, and the actual issuance of the policy or policies on behalf of the title insurance company. Small title insurance agents that perform these core title services are the companies that will be competitively disadvantaged by the proposed rule.

[15] This example assumes that the cost for title insurance does not include the cost of the title search. In some states, the total price for title insurance includes the cost for the title search and other incidental services (i.e., all-inclusive title insurance rate).

rates and cannot compete with the lower prices the large provider can charge its consumers. Moreover, even if the small agency were to match or beat the prices charged by the large title company, the small agency is less able to absorb the costs it does not pass through to the consumer.

Under these circumstances, the ability to negotiate discounts and pass them through to the consumer disadvantages the small title insurance agency who is unable to compete with the lower prices offered by large title insurance providers. While this may result in lower prices for the consumer in the short term, once the small title companies have been pushed out of the competitive marketplace, large providers are left to compete only among themselves. Under these circumstances, the laws of economics teach us that prices eventually will increase and be higher for the consumer, which conflicts with the Department's stated objectives for the rule.

**2. Mortgage Lenders Will Favor Large Title Providers Who Offer Discounts or Their Own Affiliate Providers.**

In addition to the competitive disadvantages small title companies will experience as a result of negotiated discounts, ALTA is concerned that mortgage lenders and brokers will add to the anti-competitive effects by favoring affiliated title companies or those companies that can provide title related services on a nationwide basis. Lenders are most likely to select these companies in order to more easily manage their network of service providers and the costs they must estimate.

Notably, in connection with the Department's proposals for the new GFE form, the fees for third-party settlement services, when these services are obtained from providers recommended by the lender, are subject to a 10% tolerance. By contrast, if the borrower shops for and selects his own third-party service providers, the rule proposes no restriction on the amount the fees may increase at closing. While the Association understands that these differences in tolerances are designed to hold loan originators accountable for the prices quoted on the GFE, ALTA is concerned that such a system will result in lender-created teams of settlement service providers. The lender's message to the borrower then will be: "select other settlement service providers at your own risk; we cannot guarantee that the final prices charged by those self-selected providers will not increase at closing." By virtue of emphasizing these "guaranteed" prices to consumers, lenders are able to influence and encourage a borrower's selection of a recommended provider. Yet, there is no guarantee that these recommended service providers are the least expensive or the best. Moreover, this "preferred provider" concept would take the title agent out of the role of independent fiduciary to the *transaction* and place it in the role of "sub-contractor" to the lender.

The Association is fully aware that the circumstances described above may initially result in the consumer's receipt of lower costs for title insurance and other third-party settlement services. However, these initial savings come at the expense of small title insurance providers that are unable to offer the same substantial discounts and will not make the list of lender-recommended companies. The inability to offer substantial negotiated discounts alone is enough to harm the businesses of small providers; if these companies also do not get the recommendation of loan originators, small title insurance providers will be pushed out of the marketplace. As noted above, if a limited number of large title companies are able to dominate the market, the prices for their services eventually will increase, and the incentive to compete for a borrower's business will no longer exist. The Association, therefore, urges the Department to consider these unintended consequences of the proposed rule and pursue changes that will foster an even playing field. To create a truly competitive marketplace and ensure that borrowers shop for settlement services (not just a mortgage loan), small businesses are a necessity for the title insurance market.

### 3. The Proposed Rule Fails to Account for State Laws that Prohibit Title Insurance Discounts.

Although the rule would allow all settlement service providers to offer negotiated volume discounts, this provision is in direct contrast to many state title insurance laws that prohibit title insurance companies and agencies from discounting the title premium or offering a rebate on title insurance fees, especially in states with "all-inclusive" rates. As a result, many title companies are unable to offer consumers discounted prices under the proposed regulations.

Notably, the majority of states in the country require title insurance underwriters to file their title insurance rates with the appropriate state regulator, as well as prohibit the companies from deviating from these rates unless the planned deviations are filed with the state. This is because most state laws require state regulators to ensure that title premiums are **adequate,** non-discriminatory, and not excessive. In these circumstances, while discounted rates (like those available in a refinance transaction) are filed with the states up front, title insurance companies do not have the freedom to reduce their title insurance rates on a per transaction basis to remain competitive with other title insurance companies. Moreover, even if two title insurance companies file varying rates in the same state for the same title insurance product, the company with the higher rate is not permitted to automatically discount its title insurance.

Furthermore, most state insurance laws include anti-rebating provisions that prohibit title insurance companies and agents from making payments and/or providing discounts as an inducement for the placement of title insurance. New

York's anti-rebating provision is one example of the broad restriction on such incentives. Specifically:

> No title insurance corporation or any other person acting for or on behalf of it, shall make any rebate of any portion of the fee, premium or charge made, or pay or give to any applicant for insurance, or to any person, firm, or corporation acting as agent, representative, attorney, or employee of the owner, lessee, mortgagee or the prospective owner, lessee, or mortgagee of the real property or any interest therein, either directly or indirectly, any commission, any part of its fees or charges, or any other consideration or valuable thing, as an inducement for, or as compensation for, any title insurance business.[16]

Under this section, a title insurance company or agency in New York would be prohibited from discounting the title insurance premium, rebating a portion of the premium to the consumer (or lender), and giving any other things of value to influence the consumer's selection of a title provider. Yet, the Department proposes to allow negotiated volume discounts as a competitive technique to lower the prices for settlement services. Given these broad state-law prohibitions on title insurance discounts, we want to emphasize to HUD the restrictions under which title companies must operate. We believe the Department's proposal for negotiated discounts will have damaging effects not only on our members but for consumers who will have fewer companies from which to select title insurance services.

## III. COMMENTS ON OTHER PROVISIONS OF THE PROPOSED REGULATIONS

Although the preceding section discusses ALTA's primary concerns with the proposed rule, there are other items the Association would ask the Department to consider. Moreover, ALTA would like to respond to a few issues on which HUD has specifically requested comments. Below we identify these additional issues.

### A. ALTA Supports HUD Seeking Statutory Authority to Require the HUD-1 To Be Delivered Three Days Prior to Closing Only If The Statute Also Requires Lenders To Deliver Closing Documents and Instructions Four Days Before Closing.

In addition to the regulatory changes proposed by the rule, HUD identifies several items for which the Department plans to seek statutory authority. One such

[16] N.Y. Ins. § 6409(d).

item is the authority to require the HUD-1 to be provided to the borrower three days prior to closing. Although the preamble to the proposed rule includes little discussion of this legislative proposal, ALTA asks the Department to consider certain practical effects of such a three day requirement.

First, if HUD's closing script proposal were to become a reality, both the HUD-1 and the closing script (as an addendum to the HUD-1) would have to be prepared in sufficient time by the settlement agent to provide them to the borrower three days before closing. Whether or not a settlement agent can meet this deadline, however, depends on whether the loan originator provides the settlement agent with the necessary information to complete the documents. Based on current practice, settlement agents often receive the closing package shortly before closing, which would make it nearly impossible to complete the closing script and provide it to the borrower three days prior to closing. Moreover, while the proposed rule obligates the lender to supply the settlement agent with the necessary information to complete the closing script, the rule fails to prescribe a time by which the lender must transmit this information. As a result, if the Department pursues legislative authority to require the HUD-1 and its addendums to be supplied to the borrower three days prior to closing, any such statute must obligate the lender to provide the settlement agent with all necessary information to complete these documents at least four days prior to closing.

Second, the Department should consider whether the provision of the HUD-1 and closing script three days prior to closing will fulfill HUD's objective of allowing the consumer time to review the documents, understand the loan terms, and ask clarifying questions prior to closing. Often closing documents are prepared at the last minute because changes continue to occur to the mortgage, as well as the final settlement charges. Under these circumstances, it is possible that the documents provided to the consumer three days prior to closing will still not reflect final loan terms and settlement charges, which may make the disclosures useless to the consumer. Moreover, should these documents continue to change prior to closing, the consumer is likely to be more confused about the terms of settlement than had the documents never been provided to the borrower. Regardless of this argument, closers must have adequate time to complete the preparation of the closing documents before either delivery to the consumer or closing.

### B. HUD Should Allow Lenders the Opportunity to Cure any Violations of Tolerance Requirements.

Like the Association's comments to the Department's 2002 proposed RESPA rule, ALTA continues to question whether HUD has the statutory authority to require loan originators to disclose exact third party settlement charges on the GFE. Although we will not repeat our 2002 discussion of the legislative history that supports the Association's conclusion, we emphasize that the statute only authorizes

a "good faith estimate" of the amount or range of charges for specific settlement services.[17] Yet, the proposed rule refers to the GFE as an offer, which the consumer should compare with the offers from other loan originators. By characterizing the GFE and its contents in this manner, it is ALTA's position that the settlement charges disclosed therein cease to become mere estimates, particularly when a lender could violate the regulations by exceeding the charges at closing.

Moreover, the Department's explanations provided in the rule to defend its proposal for tolerances are unconvincing. HUD states that the proposed GFE would not require lenders to itemize an exact list of settlement charges because the disclosure allows for flexibility. As an example, HUD notes that its proposal would allow the fees disclosed on the GFE to decrease at any time. This, however, is a circular argument. The Department states that its purpose for the revised GFE is to protect consumers from high settlement costs. If this is the case, the Department cannot at the same time justify its proposal for tolerances by emphasizing that settlement costs can always decrease. HUD further justifies the tolerances by suggesting that settlement fees may increase under the proposal in the case of unforeseeable circumstances. The Department, however, should recognize that a loan originator cannot rely on unforeseeable circumstances at the time it is required to disclose settlement charges on the GFE. These are events that have yet to occur, which means the lender must assume any third party settlement fee disclosed on the GFE will be subject to the tolerance limitations. While the Association appreciates the Department's efforts to distinguish its proposed tolerances from the former Section 6 of RESPA, we stand by the position ALTA expressed in its 2002 comments.

All that said, the Association recognizes that HUD believes it has statutory authority to impose tolerance limitation. Thus, should HUD include tolerances in its final rule, we support the Department's plan to allow a lender the opportunity to cure any violation of applicable tolerances. As discussed above, ALTA is concerned about the proposed rule's lack of guidance to the settlement agent in circumstances where a lender has exceeded the tolerances. From the standpoint of the settlement agent, if the agent identifies excess charges in settlement fees, which the rule makes a violation of RESPA, the agent may be unwilling to allow the transaction to close. If, however, the regulations allow the lender to refund any settlement fees in excess of the tolerance limitations within a certain period of time after closing, this should satisfy any concern and hesitation a settlement agent may have about closing the transaction.

## IV. CONCLUSION

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[17] See 12 U.S.C. § 2604(c).

The HUD proposal would create sweeping changes for all participants in the settlement services industry that would be most detrimental to small businesses. In this current, and potentially prolonged, decline in the real estate market, the Department should avoid causing any further disruption to the market and focus on incremental changes that can be achieved without adding to the economic downturn. This would avoid questions of statutory authority, Congressional and industry opposition, and result in meaningful changes that assist consumers in understanding loan and settlement terms and disclosures.

Moreover, the proposed rule seems to fit the refinance transaction far better than the home purchase transaction. In the former, only the interests of the borrower and lender are at issue, and virtually all of the settlement services are required for the benefit of the lender. In the home purchase transaction, there is a third party whose interests are affected – the seller – and the transfer of clear real estate title is the primary concern of both buyers and sellers. The loan, while perhaps essential, is secondary to the underlying real estate transaction. While ALTA realizes that RESPA applies to all transactions in which a federally related mortgage is involved, HUD should give serious consideration to limiting many of its changes to refinance transactions rather than applying them to purchase/sale transactions where there are likely to be significant unanticipated adverse effects that could threaten recovery of the real estate market.

Based on these concerns, ALTA suggests that HUD limit its efforts to simplifying only the GFE and HUD-1 so that comparisons can be more easily made between the documents. For instance, page one of HUD's proposed GFE provides information about the loan terms and total costs for settlement services in an understandable format. ALTA supports this type of summary page. But just as important, HUD must make fee disclosures more transparent by requiring the GFE to further break down and disclose individual title and closing service fees. This would allow consumers to know what is included within the total amount listed on the GFE summary page. This is imperative in a home purchase transaction where the buyer may require services that are not required by or of importance to the lender. It would also show what services are not required to be purchased by borrowers when sellers pay for certain services. HUD could easily accomplish this by requiring an additional page on the GFE that would be identical to page two of the HUD-1. Such a document would ensure that comparisons are clear and unambiguous.

Ultimately, ALTA appreciates HUD's consideration of these comments, and we respectfully request the Department to carefully evaluate the unintended consequences of the proposed rule. While the Association applauds HUD's attempts to simplify and clarify the mortgage loan and settlement process, we are concerned that certain aspects of the rule would discourage consumer shopping and burden our members with new forms of liability and anti-competitive pressures. In the midst of a credit crunch, ALTA accepts that there will be compliance costs with

any new regulation; however, we see no consumer benefit in implementing a rule that will complicate the settlement process and make it more difficult for small settlement service providers to compete for business and sustain their operations. If RESPA reform is to become a reality, we urge the Department to seek the proper balance between the interests of the consumer and the interests of the industry providers who serve them.

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# HEARING BEFORE THE

# U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

# ENTITLED

# RESPA AND ITS IMPACT ON SMALL BUSINESS

# WRITTEN TESTIMONY OF

# ADAM D. COCKEY, JR.

# NATIONAL ASSOCIATION OF REALTORS®
# MAY 22, 2008

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EQUAL HOUSING OPPORTUNITY

**INTRODUCTION**

On behalf of 1.2 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), I am pleased to provide comments to the U.S. House of Representatives Committee on Small Business concerning the proposed rule[1] of the U.S. Department of Housing and Urban Development (HUD) to amend the Real Estate Settlement Procedures Act (RESPA) Regulation X. The proposed rule is intended to simplify and improve the disclosure requirements for mortgage settlement costs and to protect consumers from unnecessarily high settlement costs.

My name is Adam D, Cockey, Jr. I am the Senior Vice President for Prudential Carruthers REALTORS®, a real estate services firm located in DC, Maryland and Virginia. I have also served as a member of the NAR RESPA Presidential Advisory Group and the chairman of the NAR Business Issues Committee. I started in the real estate profession as a sales agent 33 years ago, the same year Congress passed the Real Estate Settlement Procedures Act. RESPA and I have been together a long time.

The NATIONAL ASSOCIATION OF REALTORS® is America's largest trade association, including five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations, and 54 state and territory associations of REALTORS®.

**REALTORS® AND RESPA**

REALTORS® have a strong stake in providing consumers with simplified disclosures of mortgage settlement costs early in the loan transaction because:

- Real estate agents typically are the first contact in the home buying process, develop close working relationships with clients, and stay with the consumer through settlement. As a result, consumers look to real estate professionals to help them understand the homebuying process from beginning to end.
- Abusive lending practices are most likely to occur when uninformed consumers are overwhelmed by a transaction laden with unfamiliar financial terms and a confusing array of compensation models and settlement services.
- Early disclosures, clearly presented, will help consumers identify the mortgage product which provides the optimal combination of cost and value for their particular circumstances.
- Thorough disclosures that use similar structure and terms in the closing documents will make it easier for consumers and their representatives to identify changes and previously undisclosed charges.

1 73 Fed. Reg. 14030 (March 14, 2008)

**THE PROPOSED RULE FAILS TO SIMPLIFY DISCLOSURES**

One of the primary objectives of the RESPA statute is to provide disclosures so that homebuyers will better understand mortgage and settlement costs. HUD has approached this task committed to improving required RESPA disclosures. NAR supports many of the innovations HUD has developed, including an improved look for the Good Faith Estimate (GFE) and putting complex financial information into language consumers will understand. But HUD has not found the right formula for determining what information to include and how to present it. As a result, HUD's proposed disclosure provisions fall short of the mark and must be improved before they are finalized.

NAR believes that the proposal would have been greatly improved if HUD had collaborated with industry and consumer groups during the past two and a half years since the RESPA Roundtables and tested its ideas with those who must implement them. For purposes of this testimony, NAR will focus on six areas:

1. The four-page Good Faith Estimate;
2. The decision not to disclose all charges;
3. The "closing script" addendum to the HUD-1;
4. Anti-kickback exemption for volume discounts;
5. The need to harmonize proposed RESPA disclosures with those required by the Truth in Lending Act (TILA); and
6. HUD's flawed economic analysis.

**THE GOOD FAITH ESTIMATE (GFE)**

Taken together, HUD's proposed changes do not simplify the disclosure process. Despite the suggestion of its own design consultants and a broad consensus of industry and consumer groups, HUD did not reformat the GFE to match the HUD-1 – an obvious design change that should have been given the highest priority. Marrying the two forms so that they each mirror the other is a common sense solution. NAR believes this change would greatly assist consumers in understanding whether or not the terms and expenses that were disclosed to them at loan application are those that are the governing terms and costs at closing. It would also obviate the need for the cumbersome and expensive "closing script" that provides information too late in the process to be useful to consumers.

Such a change has been advocated by a number of organizations for some time now. NAR, along with the Center for Responsible Lending, recommended to HUD two years ago that it provide consumers with a one-page summary GFE for shopping purposes, accompanied by a full GFE designed to mirror the format of the HUD-1.

We also believe the new four-page GFE will serve as a psychological barrier to many consumers who will be overwhelmed by four pages of data, fine print and instructions. It is

certainly unclear whether consumers will understand the system proposed for the disclosure of discount points and yield spread premiums (YSP).[2]

NAR also believes it is imperative that the consumer has access to all relevant cost information. HUD's decision to not include all costs in its revised GFE will result in consumers getting less than the full disclosure Congress intended in the original statute.[3] While HUD's intent in not itemizing all charges is to eliminate junk fees, the result will be just the opposite as the change creates the opportunity to imbed additional, undisclosed fees into "packages" to the detriment of consumers.

Finally, HUD's "closing script" comes too late in the process to help consumers and will add significant time and costs to the closing. Some closing companies have indicated that they will have to add another closing room and double their staff to maintain the current level of closings. This proposal, in particular, is ill-conceived and should be eliminated. It exposes closing agents to charges of the unauthorized practice of law and doesn't explain what alternatives should be used for non-English speaking or hearing-impaired consumers.

This one-size-fits-all requirement also fails to account for various closing models used across the country which cannot incorporate the "closing script" without making fundamental changes to how closings are conducted, e.g. Southern California's escrow model, or by adding prohibitive costs to the closing, e.g. New York's attorney model.

## THE PROPOSED RULE ATTEMPTS TO LOWER COSTS THROUGH GOVERNMENT-DIRECTED PRICING MECHANISMS

HUD's proposed rule attempts to lower prices through government-directed pricing mechanisms.[4] HUD's focus on lower prices in the proposed rule ignores the plain intent of Congress that RESPA not be a rate-setting statute. Proposed allowable volume discounts and price tolerances will favor large lenders and firms to the detriment of local, small settlement service providers. HUD's proposed GFE allows lenders to "package" unnamed third party settlement services such as title, title insurance, appraisals and inspections in a lump sum. Undoubtedly, the largest lenders will be able to apply the greatest market pressure on

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2 A recent FTC study recommended that the YSP and points not be disclosed as too confusing to the consumer. (Comments of the Staff of the Bureau of Consumer Protection, the Bureau of Economics, and the Office of Policy Planning of the Federal Trade Commission, April 8, 2008, In the Matter of Request for Comments on Truth in Lending, Proposed Rule, Docket No. R-1305, p. 14-15)

3 "Each lender shall include with the booklet a good faith estimate of the amount or range of charges for **specific** settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary." 12 USC 2604(*emphasis added).*

4 The proposed rule appropriately makes few changes with regard to the elimination of kickbacks and referral fees. RESPA's Regulation X adequately covers this Congressional purpose and NAR applauds HUD for taking the right steps in recent years to expand enforcement of those anti-kickback provisions.

independent small settlement service providers to reduce their prices in order to be included in the lender's package. We believe that such a move would drive independent small providers out of business and allow these larger in-house providers to then raise prices. Either way, the result will be anti-competitive, reduce consumer choice and be detrimental to small business.

In addition, large lenders will promote HUD's new price tolerances to their advantage. HUD has allowed large lenders to "guaranty" the cost of their packaged services within 10% of the quoted packaged price, while also allowing the large lenders to tell potential borrowers that their competition has no limits on what they can charge and that the charges can change right up to closing without limit.

HUD's proposed pricing mechanisms also ignore the role of value in the real estate transaction. NAR believes most consumers do not shop for a mortgage, settlement services, or any other significant product based on price alone. Many consumers willingly pay more for the kind of enhanced services that ensures the job is done right. While NAR strongly supports HUD's interest in increased competition and lower prices, government's role should be limited to eliminating kickbacks and strong enforcement efforts. HUD's attempt to achieve price reductions through regulation is contrary to the purposes of RESPA, artificially distorts market forces, and can promote low-quality settlement services that are not in the homebuyers' best interest.

The current mortgage market crisis provides the best evidence needed to demonstrate that quality does matter. A thorough and professional appraisal offers assurance of the value of a property. The quality of a loan officer's review of a credit report can mean a borrower gets a better interest rate and/or the most appropriate loan for their circumstances. The quality of a title report helps ensure that the buyer has unencumbered ownership of the property purchased and that title risks to lenders and other parties in the transaction are minimized.

If recent experience has taught us anything, it is that cutting corners in this business has led to shredded family dreams. The mortgages that have been most troublesome for consumers were the cheapest and easiest to close because they included no documents, no income verification and limited appraisals. The proposed rule, with its extra-statutory mechanisms to lower costs, will only encourage the kind of services that have resulted in so many inappropriate mortgages and the problems we continue to see in the mortgage and housing markets.

Creating a system promoting the lowest cost providers as HUD has done with its government-directed volume discounts and price tolerances will favor large lenders and will squeeze quality and local experience out of the system to everyone's detriment. When competition is based on price alone, consumers may receive poor service and more risk.

## COST & CONFUSION: THE GFE, CLOSING SCRIPT & TILA

### A. The Proposed Good Faith Estimate

Under the proposed rule, a guaranteed GFE will be required *prior* to loan application. While some components of closing costs are predictable, e.g. the origination fee, other components are not. These costs can change from day to day. Lenders will either have to hedge this risk, or issue a new GFE once an application has been received. Either approach will involve costs that are not considered in the Department's estimates.

The Department states that it "hopes" that the four page GFE form – along with its accompanying guarantees – will be delivered to consumers free of charge. Even if this is the case, lenders will undoubtedly seek to recoup their additional costs as part of the origination fee. Originators may also incur additional costs from doing the GFE twice. In the end, such additional costs are likely to be passed through to the consumer.

If, on the other hand, lenders decide to charge for the form, the GFE could actually *decrease* the amount of shopping that occurs – thereby negating the very benefits that the Department is attempting to achieve.

### B. The Proposed Closing Script

HUD assumes that reading the closing script will take about 45 minutes of the closing agent's time, which would almost double the amount of time typically required to close a loan. While HUD calculates the cost of this requirement on the settlement agent's part, it makes no attempt to recognize the costs to the other participants at the closing table, including the borrower/buyer, the seller and their respective real estate agents. This oversight could potentially multiple the projected "opportunity costs" by a factor of four or more, raising the projected cost per loan significantly.

The Department also fails to document the alleged benefits that flow from the closing script. By the time the borrower reaches the closing table, it is highly unlikely that he or she will walk away from the transaction unless serious misrepresentations or issues are uncovered. It is more likely that in cases where a variance exists, someone – either the buyer, seller or the real estate agents – will reach into their pocket and pay for an excess that was the responsibility of the loan originator.

In addition, the proposal would have the closing agent act as the consumer's representative but without any ability to control the information being explained. Some have argued that the proposed changes would force the closing agent to assume the role of the "RESPA police." Aside from legal questions regarding whether closing agents, other than attorneys, can play such a role, the requirement would expose the closing agent to additional legal and regulatory risk, which would once again increase the cost of closing.

### C. RESPA AND Truth in Lending Act Disclosures

HUD also has more work to do on harmonizing RESPA disclosures with the Federal Reserve Board's TILA disclosures. Harmonization is necessary to make sure the consumer is not confused by two different sets of disclosures which cover some of the same information and which could be interpreted as being inconsistent with regard to when charges must be disclosed and when and by how much they are allowed to change.

## CONCLUSION

The proposed rule imposes wholesale changes on the settlement service industry at a time when the troubled housing market can least afford the fundamental changes, inefficiencies, inequities and understated expenses which NAR believes will result[5]. The proposed rule will require the industry to modify existing software programs, assume additional risks associated with mandated tolerance levels on the GFE, and provide additional services (e.g. closing script) that may be of dubious value to the consumer.

NAR believes in better disclosures of mortgage terms and third party settlement services to help consumers understand the products they are buying. NAR also supports the Administration's policy of ensuring a fair and competitive economic system. But we believe that HUD's RESPA reform proposal should be reworked to focus on common sense disclosures while eliminating the volume discount and tolerances provisions.

On May 9, 2008, the White House Chief of Staff, Mr. Joshua Bolten, stated in a memorandum sent to the heads of all executive branch agencies:

> The President has emphasized that the American people deserve a regulatory system that ... ensures a fair and competitive economic system .... We need to continue this principled approach to regulation as we sprint to the finish, and resist the historical tendency of administrations to increase regulatory activity in their final months. We must recognize that the burden imposed by new regulations is cumulative and has significant effect on all Americans.... Every regulatory agency and department has a responsibility for continuing to ensure regulations issued in this final year are in the best interests of the American public.

NAR couldn't agree more and urges HUD to listen carefully to Mr. Bolten's good advice. NAR urges all stakeholders involved in this effort to put aside the time constraints of the political

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5 NAR is currently studying the 590-page economic analysis provided by HUD in support of the proposed rule. NAR's initial analysis indicates that HUD's estimates of costs are underestimated and that secondary negative effects on small businesses were not considered by HUD. The Department admits that "a new business model is being put in place for the mortgage industry" but dismisses the issue by stating that "It is difficult to provide comments on a market structure that does not yet exist." (Economic Analysis, p. 3-87). And, while the Department spends hundreds of pages justifying its estimates of consumer benefits, the reality is that any such benefits are extremely difficult to quantify.

calendar and focus RESPA reform on clear disclosures formatted to provide simple, clear, and relevant information to consumers. We have the ability to do RESPA reform right and we cannot afford a "good enough" approach.

Thank you for the opportunity to submit comments on the proposed rule to address improving disclosure of mortgage settlement costs.

**Testimony of David G. Kittle, CMB**

**Chairman-Elect**

**Mortgage Bankers Association**

**Before the**

**Committee on Small Business**

**United States House of Representatives**

**Hearing on**

**"The Real Estate Settlement Procedures Act (RESPA) and Its Impact on Small Business"**

**May 22, 2008**

Chairwoman Velazquez, Ranking Member Chabot and members of the Committee, my name is David G. Kittle, CMB, and I am Chairman-Elect of the Mortgage Bankers Association (MBA).[1] Thank you for the opportunity to testify before the Committee today as you consider HUD's recent proposed rulemaking concerning the Real Estate Settlement Procedures Act (RESPA) and its impact on small business.

I have been in the mortgage lending business for 30 years and am currently President and Chief Executive Officer of Principle Wholesale Lending, Inc. in Louisville, Kentucky. It is a great privilege for me to testify today before this committee as both a small businessman and a mortgage banker.

In my capacity as an officer of MBA and throughout my career, I have worked with lenders of all sizes and business models from across the nation to develop MBA's policies on mortgage reform. Our membership of 2,400 companies spans small, medium and large mortgage bankers as well as hundreds of small businesses in ancillary industries including law firms, technology vendors, mortgage brokers and title companies.

Before I begin, please let me say, Madam Chairwoman and Ranking Member that, as you know, your hearing is particularly timely. MBA, other organizations and the public at large are very much engaged in considering HUD's RESPA proposal published for public comment on March 14, 2008[2] with comments due by June 12. We at MBA have been carefully reviewing the rule and are grateful for the efforts of 148 members of the House that successfully requested an extension of the comment period.

Also, let me say that MBA commends this Committee for its ongoing efforts to carefully consider the impacts of regulatory initiatives on small business and reform of the mortgage process, in particular. While simplification of the mortgage process and reform of both the RESPA and the Truth in Lending Act (TILA) requirements is a first priority of MBA and the mortgage industry, MBA does not believe improvements should unduly harm small businesses. MBA believes that small businesses operate effectively in all aspects of the mortgage process and should continue to do so. At the same time, MBA also believes that unnecessary charges and abuses of consumers be they by large or small businesses are a stain on the industry and a burden on consumers seeking to achieve and maintain the American dream of homeownership.

The rule, as proposed by HUD, however, will have significant effects on small businesses and other businesses as well. The effects of the proposed rule would include:

1) Retooling – Extensive system changes, training and other initial costs;

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] The proposed rule (73 Fed. Reg. 14030 (March 14, 2008)) would amend Regulation X, under the RESPA statute, (12 U.S.C. §2601)

2) New disclosure requirements going forward – A more extensive GFE, a HUD-1 which is not fully comparable to it, and a new closing script all of which will necessitate additional time and resources resulting in ongoing costs; and

3) Litigation risks – A considerable number of new obligations that, in some cases, may conflict with other statutes and regulations, which present new liability and can be expected to result in additional costs.

These concerns must be balanced against statutory requirements and other alternatives, but MBA considers them significant.

**I. BACKGROUND**

*A. The Statute*
RESPA was enacted in 1974, for the stated purpose of effecting "certain changes in the settlement process for residential real estate that will result –

> (1) in more effective advance disclosure to home buyers and sellers of settlement costs;
>
> (2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;
>
> (3) in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and
>
> (4) in significant reform and modernization of local recordkeeping of land title information."[3]

Section 4(a) of RESPA[4] requires the HUD Secretary to develop and prescribe "a standard form for the statement of settlement costs which shall be used… as the standard real estate settlement form in all transactions in the United States which involve "federally related mortgage loans." The law further requires that the form "conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement..."[5]

Section 5 of RESPA[6] requires the HUD Secretary to prescribe a Special Information Booklet for borrowers. Sections 5(c) and 5(d) of RESPA require each lender to provide a Good Faith Estimate (GFE), as prescribed by the Secretary, within three days of loan application, and that the GFE state "the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement..."

Section 8(a) of RESPA[7] prohibits persons from giving and from accepting "any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that [real estate settlement service business] shall be referred to any person."[8]

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[3] 12 U.S.C. §2601(b).
[4] 12 U.S.C. §2603(a).
[5] Ibid.
[6] 12 U.S.C. §2604.
[7] 12 U.S.C. §2607(a).
[8] Ibid.

Section 8(b) of RESPA prohibits persons from giving and from accepting "any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed."[9]

Section 8(c) provides, in part, that "[n]othing in [Section 8] shall be construed as prohibiting... the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed..."

Section 8(c) provides "Nothing in this section shall be construed as prohibiting... (4) affiliated business arrangements so long as (A) a disclosure is made of the existence of such an arrangement to the person being referred and, in connection with such referral, such person is provided a written estimate of the charge or range of charges generally made by the provider to which the person is referred... (B) such person is not required to use any particular provider of settlement services, and (C) the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship, or (5) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture...."[10]

HUD's RESPA regulations, Regulation X,[11] implement the statute including, among other provisions, the requirements for the GFE, to be provided at or within three days of application, the settlement information booklet and the HUD-1 Settlement Statement (the HUD-1) as well as the anti-kickback and affiliated business provisions.

*B. Past Reform Efforts*

Though the law was enacted in 1974, as early as the 1980's, the Reagan Administration is reported to have considered reform of RESPA to simplify the mortgage process. In 1992, HUD amended its RESPA rules to implement amendments to the law to permit affiliated businesses (formerly termed "controlled businesses") in accordance with the requirements of section 8(c)(4).[12] Also in 1992, under an opinion of the HUD Office of General Counsel and then through HUD's 1992 rule revisions, HUD required the disclosure of mortgage broker fees in table-funded transactions.[13]

In 1996, Congress required HUD and the Board to simplify and improve RESPA and the TILA disclosures and, if necessary to make recommendations to Congress to do so.[14] In 1998, as a result, HUD and the Board reported to Congress and made recommendations to establish a firmer GFE and to provide an exemption to RESPA to permit guaranteed packages of mortgage services.[15] About the same time, after considerable litigation and consumer complaints that payments by lenders to mortgage brokers amounted to illegal kickbacks, HUD conducted a

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[9] 12 U.S.C. §2607(b).
[10] 12 U.S.C. §2607(c)(2).
[11] 24 C.F.R. §3500.
[12] 67 Fed. Reg. 49134 (July 29, 2002).
[13] August 14, 1992 legal opinion by Frank Keating, General Counsel, HUD.
[14] See Section 2101 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009.
[15] Personal Responsibility and Work Opportunity Reconciliation Act, Pub. L. No. 104-193 (August 22, 1996).

negotiated rulemaking and issued a proposed rule concerning the legality and disclosure of mortgage broker fees, which were not finalized.

In 1999 and 2001, in the face of continuing litigation concerning the legality of mortgage broker fees, HUD issued policy statements clarifying its position on the issue that also included a call for improved disclosure.[16] Industry groups supported the policy statement.

In 2002, nearly six years ago, HUD proposed to reform its disclosure requirements under RESPA to: (1) provide an exemption from Section 8 of RESPA for guaranteed mortgage packages; (2) revise its good faith estimate requirements to establish tolerances for those not seeking the mortgage package exemption; and (3) improve the disclosure of mortgage broker fees. As a result of opposition to the rule from the title, mortgage brokerage and (ultimately) the mortgage lending and real estate brokerage industries, HUD withdrew its proposal in 2004.

In 2005, HUD conducted a series of seven roundtables to solicit the views of industry and consumer groups regarding RESPA reform, including small businesses.

*C. The Current Proposal*

Over two years later, HUD issued its proposed rule on March 14, 2008. The new rule would:

(1) Establish a four-page standard GFE form;

(2) Impose tolerances to limit increases in GFE estimates at closing;

(3) Revise requirements for disclosure of mortgage broker fees as 'the credit or charge for the interest rate you have chosen," as quoted in the proposed GFE;

(4) Make changes to the HUD-1 intended to facilitate comparison between GFE and HUD-1 charges;

(5) Establish a new script to be read to borrowers at settlement concerning final loan terms and settlement costs;

(6) Revise regulations to permit certain average-cost pricing and volume discounts;

(7) Clarify "required use" requirements to restrict disincentives to use of non-affiliates;

(8) Make technical amendments to the RESPA rules; and

(9) Permit a 12 month implementation period for the new GFE.

The proposal also announces that HUD intends to seek legislative changes to: (1) authorize the Secretary to impose civil money penalties for violations of section 4 of RESPA (the Settlement Statement), section 5 (the GFE and Special Information Booklet), section 6 (servicing), section 8 (kickbacks, referral fees and unearned fees), section 9 (title insurance), and section 10 (escrows); (2) require delivery of the HUD-1 to the borrower three-days prior to closing; and (3)

[16] *See* RESPA Statement of Policy 1999-1, 64 Fed. Reg. 10080 (March 1, 1999), and Clarification of RESPA Policy Statement 1999-1, 66 Fed. Reg. 53052 (October 18, 2001).

expand and make uniform the statute of limitations applicable to governmental and private actions under RESPA.

## II. MBA's VIEWS ON THE RESPA PROPOSED RULE

Since HUD last issued its proposed rule in 2004, the real estate industry and the mortgage system have experienced a crisis of a magnitude that was largely unexpected and has been nearly unprecedented. While the crisis has resulted in pervasive dislocation and hardship for consumers and businesses alike, its benefit has been to again bring into focus what has been working in the mortgage system and what must be improved.

Notably, this crisis has many victims and causes. The causes range from economic conditions, excess capacity and escalating real estate prices to outsized investor and borrower appetites. The victims include more than borrowers themselves but also include future borrowers, communities and the economy at large.

While MBA does not believe that the lack of transparency in the mortgage process is the main cause of borrower difficulties, or that its improvement is the only solution, greater transparency could help stem abuses. The sheer volume and opacity of disclosures today allows abusers to hide in plain sight. Long before the current market crisis, MBA consistently supported simplification and much greater financial literacy for consumers in the mortgage market. MBA now believes that problems in the industry are a good reason to redouble efforts in both these areas.

Greater transparency would better empower consumers to understand and pick among the range of choices available from the mortgage market based on their own financing needs and risk appetites while at the same time allowing them to shop and compare offers.

MBA applauds HUD's continuing efforts at improving RESPA disclosures to simplify the mortgage process. At the same time, MBA also applauds the Federal Reserve's efforts to improve mortgage broker fee disclosure[17] as well as its recognition that TILA disclosures need updating to reflect the increased complexity of mortgage products.[18]

Having evaluated HUD's and the Board's proposals, thus far, however, it is clear that there are considerable variations between the Board and HUD's approaches to reform. Mortgage broker fee disclosure is an excellent example, where the Board proposes a clear agreement between broker and consumer while HUD's approach is far from direct. Also, HUD's proposed summary of loan terms discloses many of the terms of credit which are the Board's province under TILA but, at the same time, discloses only the note rate of the loan and not the annual percentage rate (APR). This will prove confusing to both consumers and industry.

Considering these variations, the costs of changes to accommodate new requirements and, most importantly, the unmistakable need for borrowers to better understand both the terms of their loans as well as their costs, MBA strongly believes that HUD's efforts should not be

[17] 73 Fed. Reg. 1672 (January 9, 2008).

[18] "The Board recognizes that [TILA] disclosures need to be updated to reflect the increased complexity of mortgage products. In early 2008, the Board will begin testing current TILA mortgage disclosures and potential revisions to these disclosures through one-on-one interviews with consumers. The Board expects that this testing will identify potential improvements for the Board to propose for public comment in a separate rulemaking." 73 Fed. Reg. 1673 (January 9, 2008).

finalized at this time and should be combined and harmonized with the Board's efforts to reform its TILA disclosures. Indeed, MBA strongly believes HUD and the Board should work together to develop, reissue and finalize joint rules to simplify both the RESPA and TILA disclosures.

MBA believes that only through comprehensive reform can consumers take advantage of better transparency and lower costs. MBA requests that both HUD and the Board involve industry and consumer advocates to help shape the proposals and utilize consumer testing to ensure that improvements increase consumer understanding. Separate and conflicting efforts will create more confusion for consumers and increase costs for everyone involved.

If HUD determines to go forward and finalize the proposed rule independently, MBA believes the effort should be pared back considerably and put on a timeline that would match the Board's efforts. However, assuming HUD goes forward with the rulemaking, MBA preliminarily plans to submit the following comments to HUD:

A. HUD's summary of loan terms should be excluded from the GFE for now and should instead be developed in conjunction with the Board;

B. MBA supports improvement of the GFE and HUD-1 and harmonization between the forms, it therefore has strong concerns about HUD's approach;

C. The proposed GFE is far too long and would overload the borrower with unnecessary material, counter to HUD's and MBA's goal of increasing transparency. MBA believes HUD should instead adopt a one-page GFE or, possibly, a combined TILA-RESPA form with the Board's concurrence;

D. MBA supports revision of the GFE to explicitly disclose mortgage broker charges and complement the Board's proposed mortgage broker fee agreement;

E. While MBA appreciates HUD's efforts to establish a GFE application to facilitate shopping, this aspect of the rule should not be finalized until it is made clear how this change will interface with other laws;

F. While MBA would consider supporting limits on increases in fees from lenders and mortgage brokers from the time of application until settlement, it has serious concerns about HUD's proposal to limit lenders to a zero tolerance and make them responsible for the charges of third party providers;

G. The proposed changes to the HUD-1 to refer to the new GFE fail to achieve the objective of making the GFE and HUD-1 harmonized and readily comparable;

H. Implementation of a "closing script" to be read at closing and to be signed by the borrower presents several concerns, and further underscores the lack of comparability between the documents;

I. MBA supports HUD's proposal to clarify that lenders and brokers can use average cost pricing for settlement services within any class of transactions, with some modifications;

J. While MBA supports HUD's proposal to clarify the legality of volume discounts, MBA believes the proposal is too restrictive;

K. Concerning the proposed revisions to prohibitions against requiring the use of affiliates, MBA believes it would be sufficient for HUD to reaffirm that it may scrutinize discounts to ensure that they are *bona fide* rather than depriving borrowers of certain discounts altogether;

L. MBA generally supports HUD's efforts to update its RESPA regulations concerning mortgage servicing transfers and escrows and to explicitly recognize the applicability of ESIGN[19] to RESPA;

M. MBA will consider supporting HUD's legislative proposals as they are developed in the context of the enforcement and the authorities of others; and

N. MBA supports an implementation schedule that would link implementation of this rule to the Board's forthcoming TILA reform rule for any aspect of this rule that requires retooling or systems changes.

**III. HUD and the Board Should Coordinate on Comprehensive RESPA-TILA Reform**

As I have indicated, MBA strongly supports simplification of the mortgage process. Nevertheless, having evaluated HUD's and the Federal Reserve Board's efforts thus far, MBA believes that HUD's efforts should not be finalized at this time, but HUD rather should work in concert with the Board's efforts to reform TILA.

RESPA and TILA are the primary laws Congress enacted to provide information to consumers concerning mortgages.[20] They cover different aspects of the same transaction. RESPA is intended to provide consumers information on their closing costs and TILA is intended to provide consumers information on their costs of credit. RESPA and TILA disclosures are provided to most borrowers at the same time.

Problems in the mortgage market indicate that while some borrowers may have made bad choices, the difficulties of others, in part, may have involved confusion concerning adjustments to mortgages rather than merely the costs for their loans.[21] Others may have entered into products they did not understand. Better information on both credit terms and loan costs, as well as better information on mortgage broker compensation, would better empower borrowers and protect them from abuse. The need for improvements in both understanding credit and settlement costs gravitates toward both HUD and the Board working together in the reform process so that both RESPA and TILA disclosures are compatible.

Piecemeal, *seriatim* reform of the RESPA disclosures, followed by reform of the TILA disclosures, would be exceedingly costly to businesses both small and large and ultimately to consumers. New disclosures along the lines HUD proposed will require substantial retooling of systems and considerable expenses for training, compliance and staffing. Changes to TILA can be assumed to result in similar costs. Since the mortgage crisis has led to tightened and more costly credit for lenders and borrowers alike, these very considerable expenses would occur at just the time that the industry and consumers can least afford them. Moreover, if the efforts of

[19] Electronic Signatures in Global Commerce Act, 15 U.S.C. §7001-7031.
[20] The Truth in Lending Act covers credit in addition to mortgages: "It is the purpose of this subchapter to assure a meaningful disclosure of credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices" (TILA §102, 15 U.S.C. §1601).
[21] MBA data of the third quarter of 2007 showed significant percentages of investor properties among all loan types in several states: Arizona 22 percent; California 16 percent; Florida 22 percent; and Nevada 22 percent.

the agencies are not compatible they will confuse consumers and increase the costs to industry and consumers even more.

HUD's own Regulatory Flexibility Analysis estimates that the total one-time costs to the lending and settlement industries of the new GFE and HUD-1 alone will be $570 million, $390 million of which are estimated to be borne by small business.[22] HUD estimates that the total recurring costs are estimated to be $1.231 billion annually or $98.74 per loan. While MBA believes these costs are underestimates, even if they were accurate the costs of TILA reform, following after these costs are incurred, can be expected to present at least an invoice of a similar size for retooling, retraining, re-staffing and other costs to the industry. If, on the other hand, RESPA and TILA changes were accomplished together, it is reasonable to anticipate that economies could result in costs approximating those for just the GFE and HUD-1. MBA believes HUD and the Board should work together to reduce costs to small and large businesses and consumers.

At the same time, hasty efforts at mortgage reform should not be justified based on current market difficulties. While it is clear that borrowers are experiencing higher default and foreclosure rates today than they have in recent years, the great majority of loans and borrowers in the nonprime market are performing well, as are the vast majority of prime loans. The area of greatest concern has been nonprime adjustable rate mortgage (ARM) loans and particularly hybrid ARMs (which employ an extended introductory rate period with an adjustable rate feature at the end of the introductory period) which are generally no longer available in today's market to these borrowers.

As mortgage applications have risen over the last two decades, so too have the percentage of families realizing – and successfully sustaining – the dream of homeownership. This is due to several main factors including lower interest rates (which are at historically low levels – even today), risk-based pricing and a host of industry efforts and innovations. According to the Board's own Flow of Funds data, the value of residential real estate assets owned by households has increased from $10.4 trillion in 1999 to $20.1 trillion as of the first quarter of 2007, and aggregate homeowner's equity now is $9.6 trillion. Unnecessarily increased costs that might stem from unwise reforms should not be allowed to undermine the objective of sustainable homeownership.

## IV. If HUD Goes Forward Independently

Once again, MBA strongly reiterates that HUD and the Board should work together in the interests of industry and consumer alike. However, if HUD decides to finalize the proposed rule without such coordination, MBA believes the rule should be pared down and several significant changes should be made before a final rule is published. These recommendations will be detailed in the comment letter MBA will be submitting to HUD before the deadline for public comments on the proposed rule.

### A. HUD's summary of loan terms should be excluded from the GFE for now and should instead be developed in conjunction with the Board.

MBA commends the "Summary of Your Loan Terms" proposed by HUD at the beginning of HUD's proposed GFE. It believes that, much like the so-called "Schumer block," that has been

[22] 73 Fed. Reg. 14102 (March 14, 2008).

extremely useful to credit card shoppers, such a summary could provide borrowers key information to better understand mortgages and to shop among them.

Nevertheless, MBA believes that the summary HUD proposes is illustrative of the need for HUD and the Board to work together. A useful summary must include information on the cost and terms of the credit being extended, as well as a summary of attendant settlement charges. HUD's proposed summary discloses the "initial interest rate of the loan" but not the "annual percentage rate" or "APR." Notwithstanding, a borrower will be confronted with a TILA disclosure providing the APR. HUD's proposed form also discloses to the borrower whether the interest rate may rise, whether the loan has a prepayment penalty and whether the loan has a balloon payment, all of which are matters that are addressed on TILA forms.

MBA believes a better approach is for the Board and HUD to arrive at a combined summary form, utilizing the input of concerned groups and consumer testing. Considering that the Board is expected to move forward soon, until the Board's and HUD's efforts are coordinated, MBA believes that HUD should exclude the summary material. The Board and HUD should collaborate to develop and implement such a summary.

**B. MBA supports improvement of the GFE and HUD-1 and harmonization between the forms, it therefore has strong concerns about HUD's approach.**

MBA believes as a general matter that the proposed GFE is far too long and will be largely ignored by consumers. The proposed changes to the HUD-1 also fall far short of making the GFE and HUD-1 correspond, we believe, at least in part, necessitating the use of a "closing script" to be read by the closing agent and signed by the borrower. MBA believes that a better approach would make the GFE provided at application correspond to the HUD-1, obviating the need for the closing script altogether.

**C. The proposed GFE is far too long and would overload the borrower with unnecessary material, counter to HUD's and MBA's goal of increasing transparency. MBA believes HUD should instead adopt a one-page GFE or, possibly, a combined TILA-RESPA form.**

A key portion of HUD's proposal is the establishment of a standard four-page GFE form.[23] The form would disclose:

(1) in a summary, the loan details specifying the loan amount, term, interest rate, initial payment, rate lock period, whether the amounts for principal, interest and mortgage insurance can rise, whether the loan has a prepayment penalty or a balloon payment and whether the loan includes a monthly escrow payment for taxes and insurance;

(2) the costs in ten cost categories including

(a) lender and mortgage broker charges known as "our service charge;
(b) the YSP or points as "credit or charge for the interest rate chosen," and then "adjusted origination charges;"
(c) required services selected by the originator;
(d) title services and title insurance;
(e) required services the borrower can shop for;
(f) government recording and transfer charges;
(g) reserves or escrow;

[23] See proposed GFE form at 73 Fed. Reg. 14095-8.

(h) daily interest charges;
(i) homeowner's insurance; and
(j) optional owner's title insurance;

(3) advise the borrower of the relationship between the interest rate and the borrower's settlement costs; and

(4) various other information for borrowers including how to apply for the loan, estimated taxes, flood and property insurance premium information, a shopping chart, and information about lenders receiving additional fees by selling the loan at a future date.

While MBA appreciates HUD's effort to create a comprehensive document to help the borrower shop and better understand the mortgage process, MBA believes the resultant document is far too long and would overload the borrower with material that ultimately would be ignored and therefore counterproductive to HUD's and MBA's own consumer protection objectives.

As indicated, RESPA requires that lenders provide a "good faith estimate" of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as developed by the Secretary in conjunction with a Special Information Booklet prescribed by HUD.[24]

While MBA does not object to the grouping of the amount or ranges of specific services on the GFE in a manner that is comprehensible and comparable, the form itself should be modified so it is mainly a list of charges with minimal supplementary material. MBA believes most of the material on the form, except the costs, should be moved to explanatory materials, such as the Special Information Booklet.

If HUD moves forward using its proposed GFE, MBA has numerous comments regarding the proposed GFE form which will be provided in its comment letter to HUD. These include, but are not limited to:

a. The term "originator" and "origination" services should not be used on the form. Instead the terms "lender" and "mortgage broker" should be used. The latter terms are, or should be understood by borrowers to reflect the differing roles in the transaction of these entities. As an appendix to this testimony, MBA is providing an MBA paper discussing the differences between mortgage bankers and mortgage brokers which should guide the use of this nomenclature;

b. The information concerning how long the costs and interest rate are open to borrower acceptance needs greater clarification and could be provided in accompanying materials. If this material is included in the GFE form and the accompanying rule instructions should make clear that the interest rate in the GFE may be available until a specified hour and date. Rates frequently change several times a day. If the point concerning the estimated settlement charges is included in the GFE, the form, the rule and accompanying instructions should make clear that the estimate for some of these charges may not vary from this GFE, considering that only some of these charges are subject to tolerances (see below). If the point concerning when the loan must be closed is included on the form, it should note that the date will not finally be set until the borrower actually

[24] The "good faith estimate" and the booklet are authorized under Section 5 of RESPA (12 U.S.C. §2604).

applies for a loan and that such date may be governed by the rate lock chosen by the lender and borrower;

c. As indicated, while MBA believes that a "Summary of Your Loan Terms" could be useful, the summary should be removed from the GFE and coordinated with the Board;

d. The use of term "Adjusted Origination Charge" at the bottom of the first page is not helpful to consumers. It introduces new concepts in an atmosphere where it is difficult for the consumer to understand the costs themselves;

e. Similarly, on the top of the second page, MBA does not regard the introduction of the new term "Our service charge" to cover both lender and broker fees as helpful to the lending industry or to the consumers we serve;

f. All of the material on page three, advising on how to shop, which charges can change at settlement and the trade-off chart can be moved to explanatory materials;

g. Similarly, all of the information on page four, with the possible exception of how to accept the GFE, should be moved to accompanying materials. A description of the homeowner's financial responsibilities, how they should get more information, and how to use a shopping chart, while well-intended, needlessly lengthens the form and risk its disregard by the borrower; and

h. Finally, MBA does not believe the material on whether the loan is sold is at all helpful to borrowers or relevant to the GFE.

Two years ago, MBA developed, with its members, its own proposed GFE form which it presented to HUD on a few occasions. In HUD's Economic Analysis, HUD critiqued the form.[25] In large measure, HUD objected to the presentation of the yield spread premium (YSP) and supported its own approach. HUD also expressed concerns about the presentation of some items on the forms.

MBA does not support HUD's approach to broker disclosure and is in the process of modifying its proposed GFE and HUD-1 to address the mortgage broker fee agreement that the Board has proposed and other regulators are requiring. MBA is also working through HUD's other objections. MBA is developing a revised GFE and revised HUD-1, which MBA expects to submit to HUD with the comment letter on this proposed rule. As soon as it is revised further, MBA also plans to provide it to associations across the industry and to supplement it with a model summary and a draft mortgage broker fee agreement.

MBA maintains that a form along the lines of the MBA GFE form is much more useful than the proposed GFE. It has the virtue of being much shorter and arrived at by those who make mortgage loans and day-in and day-out are presented with consumer questions. It also has the virtue of being readily comparable to a revised HUD-1, also developed by MBA and presented to HUD. MBA believes the use of these comparable forms would obviate the need for the closing script and reduce costs to small and large businesses.

[25]Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs (March 14, 2008).

As indicated, HUD's own Regulatory Flexibility Analysis estimates that the total one-time costs to the lending and settlement industry of the new GFE and HUD-1 alone will be $570 million, $390 million of which are estimated to be borne by small business.[26] HUD estimates that the total recurring costs are estimated to be $1.231 billion annually, or $98.74 per loan. While MBA believes that there will be retooling costs associated with implementation of its shorter GFE and HUD-1, it believes that its forms cover less ground and will be easier for borrowers to understand, resulting in fewer questions and concerns directed to industry. MBA believes these differences will translate into lower initial –and much lower recurring– costs for businesses large and small, as well as for borrowers.

**D. MBA supports revision of the GFE to explicitly disclose mortgage broker charges and complement the Board's proposed mortgage broker fee agreement.**

In the Board's recent TILA proposal, the Board proposed to require that mortgage brokers enter into agreements with consumers before the broker is paid by the lender or the consumer setting forth the mortgage broker's total compensation and other information on the relationship between the broker's compensation and the interest rate. Notably, Office of Comptroller of Currency (OCC) examiners have been requiring disclosures along these lines by federally regulated institutions since April 1, 2008 pursuant to the OCC's Advisory Letter 2003-3.

MBA has long supported the straight forward disclosure of mortgage broker fees along the lines the Board proposes as the best way to protect consumers and finally resolve this issue which has bedeviled businesses of all sizes as well as consumers for years. Recently, legislators have sought to limit or eliminate YSPs. While MBA strongly supports the value of YSPs and other fees paid by lenders to brokers to help defray borrowers' closing costs, MBA believes that to serve this purpose and avoid the unwitting steering of consumers by mortgage brokers to higher rate products, consumers must be advised of payments to mortgage brokers by lenders based on the interest rate.

MBA strongly believes the new GFE, therefore, should include provisions making it compatible with the mortgage broker fee agreement the Board has proposed and similar agreements required by federal regulators. HUD's proposed GFE and HUD-1, on the other hand, would revise the requirement for disclosure of yield spread premiums from lenders to mortgage brokers as "a charge or credit for the interest rate chosen." This amount would be subtracted from the lender and brokers' "service charge" to arrive at the "adjusted origination charge."

While MBA appreciates HUD's efforts to clarify the function of a YSP in relation to the interest rate, HUD's approach to mortgage broker disclosure, in MBA's view, would be unclear to borrowers. In fact, it further obfuscates the issue by disclosing discount points as charges in the same block as YSPs.

MBA believes that by adopting a new terminology for mortgage broker fees, the costs occasioned by this change for lenders, brokers and other ancillary businesses large and small will be enormous. If allowed to occur, the costs that would be occasioned by consumer confusion would also be enormous for industry.

[26] 73 Fed. Reg. 14102 (March 14, 2008).

In this vein, MBA opposes the use of the term "originator" and also opposes changes to the definition of "mortgage broker" in the rule, which confuse the respective functions of mortgage bankers and mortgage brokers.[27]

From the preamble to the proposed rule and the economic analysis,[28] MBA understands that HUD's approach was shaped by concerns from mortgage brokerage industry advocates and the Federal Trade Commission (FTC) that that the form should provide a "level playing field" between brokers and lenders. But MBA believes that both of these assertions are incorrectly premised and typify confusion about brokers' and bankers' respective functions.

Lenders and brokers perform distinct functions in the marketplace and are perceived differently by consumers. They are not the same players; they do not play the same game, and applying the same rules to them is ill-advised. Mortgage brokers act as middlemen to arrange mortgages; mortgage bankers lend money. Consumers regard brokers as shopping for them and they tend to stop shopping when they use brokers. On the other hand, consumers regard bankers as sources of their own loan products whose prices they shop and compare. Brokers and bankers have different incentives and regulations, and brokers present greater risks of consumer steering.

Specifically, considering that consumers regard brokers as middlemen shopping for them, it is wholly appropriate for the consumer to know if the broker is also receiving a fee from the lender based on the consumer's choice of a higher rate. Armed with compensation information, and other information on the relationship between the interest rate and settlement costs, the consumer can make informed choices and avoid steering and abuse.

In order to make clear the differences between mortgage bankers and mortgage brokers and policy recommendations, as indicated, MBA has just published a policy paper on this subject to assist policy makers, which it is presenting to this committee as an appendix. It comprises a careful analysis of the differences between these two businesses, why they warrant different regulatory treatment and MBA's recommendations on appropriate policies.

**E. While MBA appreciates HUD's efforts to establish a GFE application to facilitate shopping, this aspect of the rule should not be finalized until it is made clear how this change will interface with other laws.**

A significant complication that lenders will face in light of these proposed amendments stems from the proposed revisions to the definition of "mortgage application." The proposal would replace this definition now found in RESPA's implementing regulation, and would establish two new definitions that, in effect, would bifurcate the mortgage application process into two distinct phases – the "GFE application" phase and the "mortgage application" phase. The proposal is much more than a mere change of language, however. The impact of this redefinition has repercussions that extend well beyond RESPA, and may significantly alter legal and regulatory responsibilities under other laws and/or engender great confusion if not clarified.

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[27] "Today's proposed rule also streamlines the current regulatory definition of 'mortgage broker.' Under the proposed definition, 'mortgage broker' means a person (not an employee of the lender) or entity that renders origination services in a table funded or intermediary transaction. The definition would also apply to a loan correspondent approved under 24 CFR 202.8 for FHA programs. The proposed definition would eliminate the current exclusion of an 'exclusive agent' of a lender from the definition of 'mortgage broker.' The current definition essentially excludes some persons who perform the same services as mortgage brokers as defined in 24 CFR 3500.2." 73 Fed. Reg. 14043 (March 14, 2008).

[28] See 73 Fed. Reg. 14030 (March 14, 2008).

Specifically, changes in the definition of "application" impact TILA and "Regulation Z,"[29] the Equal Credit Opportunity Act (ECOA) and "Regulation B,"[30] Home Mortgage Disclosure Act (HMDA) and "Regulation C,"[31] Fair Credit Reporting Act (FCRA) rules, and Section 311 of the Fair and Accurate Credit Transactions Act of 2003 (FACTA)[32] concerning the risk-based pricing notice.

While the preamble to the rule indicates that conversations with the Board have clarified that the initial TILA disclosure will be provided along with the GFE in response to the GFE application, the preamble also indicates that whether a GFE application triggers ECOA or HMDA requirements has not been resolved. In order to save businesses large and small considerable costs, these ambiguities must be resolved before the rule is finalized or the GFE application concept should be removed from the rule.

**F. While MBA would consider supporting limits on increases in fees from lenders and mortgage brokers from the time of application until settlement, it has serious concerns about HUD's proposal to limit lenders to a zero tolerance and make them responsible for the charges of third-party providers.**

The proposed rule would prohibit lenders and brokers from exceeding the amount listed as "our service charge" on the GFE absent unforeseeable circumstances at time of closing. The charge or credit for the interest rate chosen, if the interest rate is locked, also cannot be exceeded absent unforeseeable circumstances.

The proposed rule would also prohibit the sum of all the other settlement services subject to a tolerance from increasing by more than 10 percent. Such services include originator-required services where the originator selects the third party provider, originator-required services where the borrower selects from a list of third party providers identified by the originator, and optional owner's title insurance.

While MBA opposes unjustified increases in settlement costs at closing, the establishment of tolerances, in general, and restriction to a zero tolerance, in particular, for lender fees are legally questionable under RESPA. Section 5 of RESPA requires a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary."[33] While HUD asserts that the basis for its ability to impose tolerances is grounded in its ability to define the term "good faith," MBA does not believe that, considering the legislative history of the statute, there is clear basis for tolerances and particularly a "zero tolerance."

MBA does not believe lenders can or should be held responsible for the costs of third-parties when lenders have no ability to control these costs. As more fully discussed below, the current proposal for volume discounts will not facilitate consumer-beneficial pricing arrangements. Lenders will not enter into volume discount arrangements if doing so causes them to face additional liability. MBA also believes that the establishment of a 10 percent tolerance overall on third-party charges recommended by the lender will likely prove counterproductive as long as

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[29] 12 C.F.R. §226.
[30] *See Federal Reserve Board Regulation B Official Staff Interpretations,* 12 C.F.R. § 202.2(f), Supp. I, comment 2.
[31] 12 C.F.R. § 203.2(b).
[32] Pub. L. No. 108-159 (December 4, 2003).
[33] 12 U.S.C. §2604(c).

the lender is held liable for violations of the tolerances; lenders will simply not have the incentive to make any recommendations to the consumer of beneficial services.

Additionally, MBA believes the establishment of a tolerance for government recording and transfer charges is unwarranted and presents unnecessary risks to lenders and to mortgage brokers.

While MBA appreciates the provision for relief from tolerances for unforeseeable circumstances including acts of God and exceptions for other circumstances, there must be further clarification of these provisions, which will be further detailed in MBA's comments.

Finally, MBA does not believe there is a basis for RESPA rules requiring that when a loan application is rejected, and the tolerances are inapplicable, the borrower must be notified within one day. A one-day limit is also unreasonable considering other workload constraints and, in MBA's view, will present a particular hardship to small mortgage bankers and brokers. Moreover, before the rule is finalized, it must be harmonized with other provisions of law governing notice of denial (e.g., ECOA).

**G. The proposed changes to the HUD-1 to refer to the new GFE fail to achieve the objective of making the GFE and HUD-1 harmonized and readily comparable.**

MBA does not believe that the changes to the HUD-1 in the form of minor revisions and references to the GFE are sufficient to make the forms comparable. In fact, MBA believes the introduction of the new closing script, which is intended to describe the relationship of the costs and terms on the GFE to those on the HUD-1, is, MBA believes, an admission that the forms are not comparable. HUD indicates in its economic analysis that the GFE and HUD-1 are comparable. Considering that the GFE and HUD-1 forms are not truly comparable, MBA believes the recurring cost estimates for implementation of the GFE and HUD-1 are actually too low.

**H. Implementation of a "closing script" to be read at closing and to be signed by the borrower presents several concerns, and further underscores the lack of comparability between the documents.**

As a general matter, MBA does not believe that the closing script proposed by HUD, as an addendum to the HUD-1A, is well founded. MBA believes its use raises legal concerns, is costly and its benefit to the consumer at closing is unclear.

Notwithstanding the characterization of the script as an addendum to the HUD-1or 1-A, MBA regards the script as an additional form to be prepared by the settlement agent, read to the borrower and signed at settlement which compares the loan terms and settlement charges on the GFE to the HUD-1.

RESPA requires the HUD Secretary to develop and prescribe a standard form for the statement of settlement costs which shall be used (with such variations as may be necessary to reflect differences in legal and administrative requirements or practices in different areas of the country) as the standard real estate settlement form in all transactions. While RESPA explicitly authorizes several other disclosures, the authority for establishing a closing script, which is in effect an additional disclosure, is not evident.

Just as important, MBA believes that the script will add unnecessary costs to the closing process and will do little to help the borrower. HUD itself estimates that the script will add 45 minutes of additional time per closing and estimates that cost at $54 (derived from a $150,000 salary.) HUD also says the costs in a normal year (based on 12.5 million originations) would be an estimated $676 million. It is not apparent, however, in reaching what MBA regards as an unusually low estimate, HUD considered the overhead costs and the additional time for the lender, broker and others to assist in developing the script.

There also is no apparent consideration of the borrower's time. In this vein, MBA strongly believes that closing is far too late to read this script, and that better results would occur if the borrower was provided a HUD-1 that he could compare to his GFE the day before settlement. Over the last few years, MBA, the American Land Title Association and the American Escrow Association have been working closely to develop uniform closing instructions, in part, to assure that borrowers in fact would receive their HUD-1 a day before closing. MBA believes that, enhanced by a comparable GFE, this effort may hold much greater promise than the script to inform borrowers of closing costs and facilitate comparison with the GFE.

Finally, MBA must point out that the use of such a script presents logistical problems in eMortgage and escrow state transactions that will either make these transactions unworkable and/or simply increase the paper required for borrower review. Considering that settlement agents must read the script, the script's use may be impossible in states where there are statutes prohibiting the unauthorized practice of law. Finally, use of the script may even raise privacy concerns.

**I. MBA supports HUD's proposal to clarify that lenders and brokers can use average cost pricing for settlement services within any class of transactions, with some modifications.**

MBA supports HUD's proposal to clarify that lenders and brokers can use average cost pricing for settlement services with some clarifications and modifications. MBA believes that with such modifications and clarifications, considering the benefits of average cost pricing, this aspect of the rule should be finalized even if the entire rule is not finalized. In such event, HUD should issue a policy statement or an interpretive rule in this regard.

Specifically, the proposal would allow the average price for settlement services to be determined and disclosed based on either (1) the actual average price for the service on all loans closed by the loan originator in a geographic area over the averaging period; or (2) the average price based on a tiered price contract for the service if the projected number of loans used in the calculation is equal to the actual number of loans actually closed during the averaging period. These averages must be calculated based on a recent period of six consecutive months.

HUD regards average pricing mechanisms as benefiting consumers and MBA agrees. The regulatory risk presented by insisting on precise dollar pricing in tiered pricing arrangements only serves to discourage such arrangements and deprive consumers of lower prices.

MBA would add, however, that before this provision is finalized under a rule or an interpretative rule, the rule should be further clarified. For example, the term "class of transactions" should be defined further using factors such as loan types, geographic regions, etc. Also, the documentation requirements should be carefully reviewed to ensure that they do not impede use of this provision by requiring unnecessarily burdensome documentation.

**J. While MBA supports HUD's proposal to clarify the legality of volume discounts, MBA believes the proposal is too restrictive.**

MBA supports HUD's proposal to clarify that volume discounts are not prohibited, but does not believe it goes far enough. If it is modified, MBA believes that it should be issued as a clarification whether or not HUD goes forward with this rulemaking.

In its proposal, HUD would amend its definition of "thing of value," defining violations of Section 8's anti-kickback and referral fee provisions, to exclude "discounts negotiated by settlement service providers based on negotiated pricing arrangements," provided that no more than the reduced price is charged the borrower and disclosed on the HUD-1 and HUD-1A.

Negotiated discount arrangements for services and materials result in lower costs to consumers and are therefore consistent with RESPA's purposes of lowering settlement costs in particular. These arrangements achieve this objective in other industries, such as the automobile industry, and MBA does not believe RESPA was intended to or should impede similar discounting in the settlement services industry.

Nevertheless, by including the provision that no more than the reduced price can be charged to the borrower, MBA believes that there will be little incentive for lenders to enter into discount arrangements. Scrutiny to ensure that each and every dollar of discount is passed on to the consumer will make the exception uninviting. Moreover, such a restriction is unnecessary. Market competition will result in the consumer receiving the benefit of discounts. If HUD is insistent about maintaining this provision, at the very least it should make clear that "average cost pricing" can be employed in conjunction with volume discounts, such that only the average price need be charged to the borrower and disclosed on the HUD-1 and HUD-1A.

MBA also questions the idea that discounts can only be negotiated by a settlement service provider, arguably excluding builders. MBA believes this approach could deprive consumers of negotiated discounts on house prices offered by lenders that have joint ventures and marketing agreements with builders.

While MBA recognizes that some small businesses do not support volume discounts, MBA is confident that small businesses will continue to thrive in the marketplace for settlement services as they do today and RESPA need not deprive consumers of cost savings.

**K. Concerning the proposed revisions to prohibitions against requiring the use of affiliates, MBA believes it would be sufficient for HUD to reaffirm that it may scrutinize discounts to ensure that they are *bona fide* rather than depriving borrowers of certain discounts altogether.**

HUD proposes to change the definition of "required use" so an economic disincentive that a consumer can only avoid by purchasing a settlement service from an affiliated provider would be as problematic under RESPA as an incentive contingent on a consumer's choice of a particular provider. The proposed rule indicates that it is particularly directed to homebuilder affiliates but covers other affiliate situations.

MBA believes that the proposal in this area is too broad and may result in depriving borrowers of discounts that may indeed be *bona fide*. MBA believes it would be sufficient for HUD to indicate that under its current rules it may scrutinize discounts to assure they are *bona fide* rather than risking depriving borrowers of discounts altogether.

**L. Technical Amendments – MBA generally supports HUD's efforts to update its RESPA regulations concerning mortgage servicing transfers and escrows and to explicitly recognize the applicability of ESIGN to RESPA.**

MBA generally supports aspects of the proposed rule that would update the current RESPA regulations concerning the provision of the mortgage servicing disclosure statement within three days of a mortgage application and to remove outdated escrow provisions.

Specifically, these proposals would remove requirements in the current rules that required that applicants for mortgage loans be provided a disclosure describing the lender's historical practice regarding the sale or transfer of servicing rights and sign the mortgage servicing transfer disclosure. The proposal would also remove references to the phase-in period for the requirement of aggregate accounting for escrow accounts, which expired on October 12, 1997. Finally, the proposals would also make clear that that RESPA disclosures may be provided in electronic form as long as the consumer consents to receive them in accordance with the provisions of the Electronic Signatures in Global and National Commerce Act (ESIGN).[34]

These clarifications will conform the rules to current law and practice and thereby alleviate confusion in the real estate finance industry and among the consumers it serves, thereby reducing costs to companies large and small.

**M. Additional Legislative Proposals Regarding RESPA – MBA will consider supporting HUD's legislative proposals as they are developed in the context of the enforcement and the authorities of others.**

In its proposal, HUD announced that it intends to seek legislative changes to: (1) authorize the Secretary to impose civil money penalties for violations of section 4 of RESPA (the Settlement Statement), section 5 (the GFE and Special Information Booklet), section 6 (servicing), section 8 (kickbacks, referral fees and unearned fees), section 9 (title insurance), and section 10 (escrows); (2) require delivery of the HUD-1 to the borrower three days prior to closing; and (3) expand and make uniform the statute of limitations applicable to governmental and private actions under RESPA.

There currently are provisions under Section 6, 8, 9 and 10 of RESPA to enforce those provisions. Moreover, state and federal regulators assure that RESPA requirements are met. For this reason, as the proposals are developed, MBA will consider them carefully in the context of other authorities. MBA supports strong enforcement of lending laws but it does not believe increases in the patchwork of laws would serve consumers well.

Also, as indicated, MBA has been working to ensure that the HUD-1 is available one day prior to closing as part of its uniform closing instructions project. This effort can help assure borrowers all have an opportunity to view their HUD-1 the day before settlement. MBA is concerned, however, that requiring a disclosure three days prior to closing could unduly slow settlements and delay the provision of needed financing.

Additionally, in assessing extensions of the statutes of limitations, MBA is guided both by the need to protect against abuses while, at the same time, not unnecessarily attenuating litigation

[34] 15 U.S.C. §7001-7031.

risk. Undue increases in litigation risk increase the costs to businesses large and small, ultimately increasing costs to consumers.

Finally, in its proposal, HUD asks whether a provision should be added to the RESPA regulations allowing mortgage bankers and brokers to address a failure to comply with the tolerances for a limited time after closing. MBA strongly believes that such procedures should be developed to provide borrowers needed relief and decrease unnecessary litigation.

**N. Implementation – MBA supports an implementation schedule that would link implementation of this rule to the Board's forthcoming TILA reform rule for any aspect of this rule that requires retooling or systems changes.**

Although, MBA would prefer combination of the TILA and RESPA efforts, MBA believes the objective of minimizing costs can, to some extent, be achieved through an extended implementation period if HUD goes forward independently. In such event, MBA recommends that the implementation period for new forms and any aspect of the rule that requires retooling, systems changes or other significant costs should extend to 18 months after the rule's effective date or the implementation period for the Board's new rule, whichever is later.

**V. CONCLUSION**

The Mortgage Bankers Association supports efforts to make the mortgage process simpler, clearer and more transparent for consumers. Doing so will empower consumers and help fight predatory lending. The RESPA Rule released by HUD is not simplification. Public policy should help ensure that the problems we see in the market today do not happen again. Reforming the mortgage process is an important but difficult task. It is imperative that we get this right. That would require that HUD and the Board to work together to reform their respective disclosures under RESPA and TILA. If HUD goes forward independently, the rule should be pared down considerably and implemented on the same schedule as the Board's.

On behalf of the Mortgage Bankers Association, I appreciate the opportunity to present our views on these important issues. I look forward to your questions.

# APPENDIX

## Mortgage Bankers and Mortgage Brokers:

## Distinct Businesses Warranting Distinct Regulation

MORTGAGE BANKERS ASSOCIATION

# MORTGAGE BANKERS AND MORTGAGE BROKERS:

## DISTINCT BUSINESSES WARRANTING DISTINCT REGULATION

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

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# Executive Summary

For many consumers, buying a house is the biggest financial investment they will make. The mortgage process, however, can be both complex and confusing, with a broad menu of loan offerings and a puzzling multitude of actors. Among those actors are mortgage bankers and mortgage brokers. While there is some superficial similarity in how they interact with consumers, mortgage bankers and mortgage brokers conduct very different businesses. These differences, however, are not well understood, creating confusion that can lead to inappropriate regulatory approaches.

To support policymakers working to improve the mortgage market, the Mortgage Bankers Association (MBA) has prepared this Issue Paper explaining the functional, financial, and regulatory differences between mortgage bankers and mortgage brokers. MBA believes that these differences warrant distinct regulatory approaches. Accordingly, policymakers and regulators must understand and properly consider these differences as they explore measures to increase transparency in the mortgage process, protect consumers from steering and abuse, and ensure that consumers are the beneficiaries of the lower homeownership costs that a free and fair market can produce.

Based on the distinctions set out below, this paper also proposes legal and regulatory changes that would provide borrowers with clearer information about mortgage brokers' responsibilities and compensation, improve brokers' financial accountability and strength, and ensure that loan originators are appropriately licensed and meet rigorous standards of professionalism.


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## Mortgage bankers and mortgage brokers perform different functions

### Brokers are intermediaries between borrowers and mortgage bankers.

Mortgage brokers typically have access to the loan offerings of numerous mortgage bankers. They inform borrowers of loan choices, receive loan applications, and perform certain services, such as collecting documentation, and initiating credit and other reviews.

Mortgage brokers turn loans over to mortgage bankers for underwriting and funding.

### Mortgage bankers provide funds for mortgages.

Mortgage bankers purchase and fund loans arranged by mortgage brokers and by other mortgage bankers. To do so, mortgage bankers use their own funds, funds they borrow, or funds they receive from secondary market investors. As part of the funding process, mortgage bankers are responsible for loan underwriting and, correspondingly, have a significant financial stake in a loan's performance.

Additionally, mortgage bankers often originate loans through their own retail sales force, informing borrowers about available loan products and working with borrowers through the lending process.

Mortgage bankers may also service loans, collecting and processing monthly payments and handling other ongoing customer service needs. Servicers, along with other mortgage bankers that sell loans into the secondary market, have ongoing responsibilities to investors.

## Consumers have different expectations of mortgage bankers and mortgage brokers

### Consumers perceive brokers as "trusted advisors."

Consumers working with mortgage brokers generally rely on the broker, as an intermediary with access to multiple mortgage bankers' products, to identify the best loan product(s) for them. Consumers expect that mortgage brokers are comparison shopping on their behalf.

Mortgage brokers frequently perpetuate this expectation by promoting themselves as "trusted advisors," even though brokers in most cases have no legal obligation to act in borrowers' best interests.

### Consumers look to mortgage bankers for information about their product offerings and the application process.

When consumers work directly with mortgage bankers in obtaining a loan, they view the mortgage banker as a knowledgeable source of information about their own loan products and the mortgage


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process. Consumers generally will compare mortgage bankers' loan offerings with those of other mortgage bankers and/or mortgage brokers.

### Mortgage banker and mortgage broker compensation differs

**Brokers are paid to arrange loans and they receive compensation at the time the loan is made.**

A mortgage broker is compensated at the time a loan is closed through fees directly charged to the borrower (direct fees) and payments from mortgage bankers (indirect fees), which vary based on a loan's interest rate and/or other loan pricing terms. Indirect fees, known as yield spread premiums (YSPs), generally are greater when the loan's interest rate is greater.

YSPs, when used properly, can help borrowers pay their up-front closing costs, including broker fees, by building them into the interest rate. When a consumer does not understand the YSP, which is often the case, the risk is greater that the YSP will simply augment the broker's direct fees and saddle the borrower with a higher rate and monthly payment.

**Mortgage bankers receive revenue in several ways throughout the life cycle of a loan.**

Mortgage banker compensation can come throughout the life of a loan from:

- Origination fees;
- Interest payments;
- Servicing fees;
- Proceeds from the sale of servicing rights; and/or
- Proceeds from the sale of a loan.

### Differences between mortgage banker and mortgage broker compensation mean different financial incentives

**Brokers' compensation has the potential to incentivize brokers to put borrowers into more expensive and/or inappropriate loans.**

Because broker compensation is directly tied to a loan's interest rate and brokers lack an ongoing financial stake in loan performance, brokers have a high incentive to get loans closed, maximize fees for origination, and move on to their next transaction. Furthermore, the current lack of understanding about YSPs makes it easier for some brokers to direct consumers toward loans with higher interest


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rates and other terms, such as prepayment penalties, that increase the loans' value to a mortgage banker or investor.

**Mortgage bankers' financial successes are linked to loan performance, giving mortgage bankers a stake in borrowers' ongoing ability to repay their loans.**

Mortgage bankers also are financially motivated to make loans. Origination fees, however, are but one of several sources of mortgage banker revenue. Mortgage banker revenue can come from multiple revenue streams associated with managing various risks throughout the life of a loan, including the risk that the borrower defaults.

Whether they hold loans or sell them to investors, mortgage bankers generally lose money when loans default. As a result, mortgage bankers have a greater interest in ensuring that borrowers choose products that will give them long-term financial success.

### Mortgage bankers and mortgage brokers are subject to different disclosure requirements, with broker fee disclosures inadequate for effective consumer shopping

**Current disclosures do not adequately inform borrowers of the connection between a broker's compensation and a loan's interest rate or the terms of the mortgage selected.**

While Real Estate Settlement Procedures Act (RESPA) rules require mortgage brokers to disclose the amount of their direct fees received from the borrower and the amount of any YSP received from the mortgage banker, current YSP disclosures do not explain adequately the connection between the YSP and a loan's interest rate.

As a result, consumers lack sufficient information to effectively shop among brokers and mortgage bankers and their various loan offerings. Both the U.S. Department of Housing and Urban Development (HUD) and the Federal Reserve are concerned about this problem and are trying to address it through proposed regulations to clarify YSP disclosures and enhance consumer understanding of the connection between YSPs and interest rates.

**Mortgage bankers' costs and fees related to origination — such as processing and underwriting fees, as well as discount points and origination fees — are disclosed as settlement costs.**

RESPA regulations do not require mortgage bankers to disclose loan officer compensation and payments the mortgage banker might receive, such as gains (or losses) on secondary market sales of loans. This difference is appropriate because consumers do not rely on mortgage bankers and their loan officer employees as "trusted advisors" in the same manner as they do with mortgage


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brokers. Additionally, payments related to a secondary market transaction are not always known with certainty at the time of settlement.

### Barriers to market entry differ and are greater for mortgage bankers

- **Becoming a mortgage banker requires a significantly larger commitment of financial and other resources than becoming a mortgage broker.**

A mortgage banker must have capital to fund loans, or access to credit, such as through a warehouse line of credit. Moreover, to maintain and renew its license or charter, a mortgage banker must have a specified level of net worth and/or regulatory capital.

Mortgage brokers generally are not required to have funding sources or net worth except in nominal amounts.

### Mortgage bankers and mortgage brokers are subject to different types and levels of regulatory oversight

- **Mortgage bankers are subject to greater supervision and regulation than brokers, and broker regulation is uneven across the nation.**

Mortgage bankers are subject to many complex state and federal laws that impose substantial penalties for noncompliance. Whether they are depository or non-depository institutions, mortgage bankers are routinely examined and audited by both federal and state regulators.

Mortgage bankers who sell loans to investors are subject to investor-required oversight. This oversight can include periodic reviews covering financial and business operations, origination practices, and financial safety and soundness. Similarly, mortgage bankers making loans insured by the Federal Housing Administration (FHA) are subject to oversight by HUD.

Mortgage broker licensing laws are uneven,[1] with brokers overall subject to less comprehensive and less demanding legal and regulatory oversight.[2]

### Recommendations

The fundamental differences in consumer expectations, market incentives, and regulatory oversight call for distinct approaches to improving mortgage broker and mortgage banker regulation. Because improving consumer protection and enhancing market functions and transparency can be best

1 See *State by State Tally of Mortgage Broker Rules*, www.bankrate.com, http://www.bankrate.com/brm/news/mtg/20010104b.asp

2 See Lloyd T. Wilson, Jr., *A Taxonomic Analysis Of Mortgage Broker Licensing Statutes: Developing a Programmatic Response to Predatory Lending*, 36 N.M.L. REV. 297 (Spring 2006).


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achieved through proposals that recognize these differences and address areas of weak or ineffective regulation, MBA supports measures requiring that:

- Borrowers receive clear disclosures of brokers' responsibilities and compensation;
- Mortgage brokers who claim to be or act as borrower agents be treated legally as agents;
- Mortgage brokers have sufficient financial resources — through a national minimum net worth requirement — to provide protection to borrowers and mortgage bankers where necessary;
- Mortgage brokers be appropriately bonded to give consumers greater protection; and
- All loan originators, including mortgage brokers and mortgage bankers, be appropriately licensed and registered in accordance with rigorous standards.

The current turmoil in the mortgage market and the credit markets has spurred efforts by regulators and policymakers to examine the causes and identify the right approaches to protect consumers and improve market functions and transparency. MBA supports these efforts. Policymakers, however, should avoid broad brush efforts that do not consider the complexity of the marketplace and the differing roles and responsibilities of mortgage brokers and mortgage bankers. MBA believes that measures which improve the regulation of mortgage brokers and other loan originators by addressing specific regulatory and oversight weaknesses are likely to improve the market for consumers, mortgage bankers, mortgage brokers, and other mortgage professionals and not produce barriers to efficient market operations.

MBA looks forward to working with Congress, regulators, and its industry partners to improve the marketplace and to improve the housing industry's ability to serve America's homebuyers.


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# Table of Contents

Introduction . . . . . 10

Differences Between Mortgage Bankers and Mortgage Brokers . . . . . 12

Recommendations for Regulatory Improvements. . . . . 30

Conclusion . . . . . 33


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# Introduction

The past two decades have been unprecedented for the U.S. housing market. Homeownership has reached historically high rates, borrowers have had access to a greater variety of loan products and features than ever before, and the breadth and complexity of the mortgage markets have increased exponentially.

At the same time, the mortgage brokerage industry has emerged and grown tremendously. According to the National Association of Mortgage Brokers (NAMB), there are over 25,000 mortgage brokerages in the United States.[3] Close to 50 percent of residential mortgage loans in the U.S. market are originated by independent mortgage brokers.[4] At the height of the recent boom of the subprime mortgage market, 70 to 80 percent of nonprime loans are estimated to have been mortgage broker originations.[5]

Mortgage brokers have become key intermediaries in expanding access to mortgage credit, including for communities traditionally underserved by mainstream financial institutions. Through mortgage brokers, mortgage bankers have expanded product reach, and thus served larger numbers of consumers.

3 http://www.namb.org/namb/About_NAMB.asp?SnID=1841827686. See also *Mortgage Brokers Fall on Tough Times*. USA Today (August 30, 2007).

4 MBA Research Data Notes, *Residential Mortgage Origination Channels*, September 2006.

5 Ibid.


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Although mortgage bankers' and mortgage brokers' roles may be complementary, mortgage bankers and brokers perform distinctly different functions. The differences between mortgage banking and mortgage brokerage, however, are not well understood, possibly because mortgage bankers and brokers interact extensively in the mortgage process.

Some representatives of the mortgage brokerage industry have added to the confusion by proposing identical standards for mortgage brokers and mortgage bankers because both are "loan originators." They assert that there should be a "level playing field" on which brokers and mortgage bankers should compete for consumer business. MBA shares the goal of ensuring robust competition in the mortgage market place. However, a "one size fits all" approach to regulation is not the same as achieving a level playing field and ignores the fact that there are profound differences between the two industries warranting distinctive regulation.

This paper reviews the distinctions between mortgage bankers and mortgage brokers. The most critical distinctions are that mortgage brokers and mortgage bankers:

- Perform different functions and provide different services;
- Create vastly different expectations in borrowers;
- Are compensated differently;
- Have very different financial incentives;
- Face much different barriers to marketplace entry, with brokers facing very low barriers to entry; and
- Are subject to different regulatory requirements with bankers generally subject to more stringent regulation and oversight.

Considering the profound differences between mortgage bankers and mortgage brokers, this paper concludes with recommendations for regulatory improvements to enhance consumer understanding and information in the loan origination process, and to promote greater mortgage broker accountability.


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# Differences Between Mortgage Bankers and Mortgage Brokers

## Mortgage Bankers and Mortgage Brokers Perform Different Functions in the Mortgage Process

### Brokers Act as Intermediaries between Consumers and Mortgage Bankers

Mortgage brokers are independent intermediaries who bring together prospective borrowers and mortgage bankers. According to NAMB, a mortgage broker has "a working relationship with numerous banks and other mortgage bankers and provides the consumer with access to hundreds of options when it comes to financing a home."[6] Mortgage brokers tend to be small businesses and frequently have little capital.

Mortgage brokers help arrange loans, performing application-related services, such as requesting verification of the borrower's employment, requesting credit and other information, and compiling borrower documentation.[7] Brokers typically do not provide loan funds.[8]

Brokers can — and do — provide substantial benefits to borrowers and mortgage bankers and contribute to the efficiency of the mortgage industry. Brokers are an important distribution channel for

6 http://www.namb.org/namb/Mission.asp?SnID=1411867994

7 Until recently, brokers often arranged for property appraisals. Freddie Mac and Fannie Mae recently announced several changes in their appraisal requirements, including a new policy that prohibits brokers from selecting or compensating appraisers. See http://www.fanniemae.com/media/pdf/030308_agreement.pdf

8 In most instances, the mortgage broker assigns the mortgage to the mortgage banker at settlement and the mortgage broker is paid for his or her origination services. This process is known as "table funding."


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mortgage bankers' loan products and, in particular, can enhance mortgage bankers' ability to serve traditionally underserved borrowers and communities.

### Mortgage Bankers Provide Mortgage Funds

Mortgage bankers lend money through various channels: directly to consumers through their own retail sales forces, by funding loans arranged by brokers or other mortgage bankers, and by purchasing loans originated by other mortgage bankers. In most cases, mortgage bankers offer their own products.[9] Regardless of the lending channel, mortgage bankers are responsible for underwriting the loan, which involves evaluating the borrower's credit worthiness and the value of the home.

Once a loan is funded, mortgage bankers — depending on their business models — pursue various paths. Some mortgage bankers hold the loans in their own portfolios; others sell the loan to a secondary market investor. Separately, a mortgage banker may service the loan or sell the servicing rights.

Mortgage banking is highly competitive — mortgage bankers compete with each other and at times, with mortgage brokers, for customers. Nearly 8,900 mortgage lenders reported under HMDA in 2006.[10] Mortgage bankers compete for consumers through price, products, and services. Mortgage bankers seek to offer attractive interest rates and loan terms and to develop innovative loan products and services to meet a variety of consumer mortgage needs. Additionally, if a mortgage banker services loans, they provide continuous customer service and support to borrowers during the life of the loan.

Mortgage bankers are organized in many forms, such as federal- and state-chartered banks, thrifts, credit unions, and other depository institutions, as well as non-depository mortgage companies. Mortgage bankers come in many different sizes, from small businesses to large multinational corporations.

## Differing Functions of Mortgage Bankers and Brokers Lead to Vastly Different Consumer Expectations

The different functions and services of mortgage bankers and mortgage brokers lead consumers to have vastly differing expectations of each. Consumer expectations of mortgage brokers often do not match brokers' actions and responsibilities, which effectively limits the consumer's ability to protect his or her own interests.

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9 Mortgage bankers sometimes function as mortgage brokers, offering the loan products of other, larger mortgage bankers. Where a mortgage banker performs the function of a mortgage broker, MBA believes that the banker should be subject to the same disclosure requirements as a broker.

10 Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "The HMDA Data," *Federal Reserve Bulletin*, December 2007. http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf


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### Consumers Perceive Brokers as Acting in the Consumer's Best Interest

Consumers expect mortgage brokers to act as independent advisors and work with various mortgage bankers to identify and evaluate various financing options and ultimately to arrange their loans. In their marketing, brokers often position themselves as "trusted advisors" who will shop among mortgage bankers and arrange for the best loan. A 2003 AARP survey of older borrowers who had obtained refinancings found that 70 percent of respondents with broker-originated refinance loans (compared with 52 percent of respondents with lender-originated loans) reported that they had relied "a lot" on their brokers to find the best mortgage for them.[11]

Brokers' legal obligations, however, do not match up with consumer perceptions. While a consumer expects a broker to act in the consumer's interests, unless state law[12] or written agreement exists to the contrary, brokers are not legally considered their customers' agents. Comments in the Federal Reserve Board's recent Truth in Lending Act (TILA) regulatory proposal,[13] which requires compensation agreements between brokers and consumers, address this point and the concerns it raises:

> "Several commenters in connection with the Board's 2006 hearings suggested that mortgage broker marketing cultivates an image of the broker as a 'trusted advisor' to the consumer. Consumers who have this perception may rely heavily on a broker's advice, and there is some evidence that such reliance is common...
>
> If consumers believe that brokers protect consumers' interests by shopping for the lowest rates available, then consumers will be less likely to take steps to protect their own interests when dealing with a broker. For example, they may be less likely to shop rates across retail and wholesale channels simultaneously to assure themselves the broker is providing a competitive rate. They may also be less likely to shop and negotiate brokers' services, obligations, or compensation up-front, or at all. For example, they may be less likely to seek out brokers who will promise in writing to obtain the lowest rate available."[14]

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11 Kellie K. Kim-Sung & Sharon Hermanson, *Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans*, Data Digest #83 (AARP Public Policy Inst., Washington, D.C.), Jan. 2003, at 3, available at http://www.aarp.org/research/credit-debt/

12 A handful of state mortgage broker licensing laws — including Vermont, Kentucky, Minnesota, Maine, and North Carolina — create some level of agency-principal relationship between mortgage brokers and their customers. See Lloyd T. Wilson, *A Taoxonomic Analysis of Mortgage Broker Licensing Statututes: Developing a Programmatic Response to Predatory Lending*, 36 N.M.L. REV. 297, 325-339 (Spring, 2006).

13 Truth in Lending; Proposed Rule, 73 FED. REG. 1672, 1699 (request for comment January 9, 2008).

14 Ibid.


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### Consumers View Mortgage Bankers as Offering a Set of Products

When a consumer deals with a mortgage banker, he or she looks to the mortgage banker as a knowledgeable source of information about its' own products. Consumers expect a mortgage banker (through its employee loan officers) to explain the features of its loan product offerings and to provide assistance through the application and closing process. However, a borrower seeking to obtain a mortgage directly from a mortgage banker likely will research and compare different mortgage bankers' prices and products. As noted above, a borrower using a broker generally delegates the research and comparison of loan products to the broker.[15]

The Federal Reserve's recent TILA proposal reaches the same conclusion about consumer expectations and behavior:

> "The [Federal Reserve] Board is not aware of significant evidence that consumers perceive mortgage bankers' employees the way they often perceive independent brokers — as trusted advisors who shop for the best loan for a consumer among a wide variety of sources. Accordingly, it is not clear that a key premise of the proposal to restrict creditor payments to brokers — that consumers expect a broker has a legal or professional obligation to give disinterested advice and find the consumer the best loan available — holds true for creditor payments to their own employees."[16]

### Compensation to Mortgage Bankers and Mortgage Brokers Differs, with Broker Compensation Presenting Greater Risks of Steering

Mortgage banker and broker compensation are based on the rate and terms of loans. However, mortgage banker and mortgage broker revenue and profit drivers are very different, reflecting the different services performed and financial risks borne by each:

- Mortgage brokers are paid solely for sourcing and facilitating loans, and they bear little — if any — ongoing financial risk.
- Mortgage bankers receive a variety of payments at the time of origination and after for performing a variety of services and managing a complex set of risks.

When coupled with ineffective consumer information about broker compensation, the "upfront" nature of broker compensation and its link to the borrower's interest rate pose greater risks of steering

15 The tendency to rely (to the consumer's financial detriment) on a mortgage broker can be especially strong for borrowers either from traditionally underserved market segments or with blemished credit. See Kenneth R Harney, *Study of Loan Fees Shows All Borrowers Not Equal*, The Washington Post, July 19, 2003, at F01.

16 73 FED. REG. at 1699.


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than the mortgage banking business's more varied and complicated revenue streams. Those banker revenue streams, as discussed below, are closely linked to loan performance.

### Brokers Are Paid for Sourcing and Originating Loans and Bear Virtually No Financial Responsibility for Loan Performance

The most common compensation model for mortgage brokers is a combination of fees paid or financed by the prospective borrower at loan closing (direct fees) and fees paid to the broker by the mortgage banker (indirect fees). Direct fees are typically loan origination or similar charges paid by borrowers at settlement. Once the loan is funded, brokers bear little — if any — ongoing risk. Brokers bear some risk if there is fraud in the loan documents and for very early loan payoffs (typically, within the first 90 to 180 days),[17] but the extent of that liability generally is only as large as the brokers' fees.[18]

Indirect fees are payments from the mortgage banker to the broker for origination services and are based on the rate of the loan and/or other loan pricing features. These payments are commonly called "YSPs" or "yield spread premiums." The YSP is the present value of the difference between the interest rate that the broker obtained for the loan and the lowest rate the mortgage banker would have accepted for the specific transaction (the "par rate"). The greater the spread between the rate on the specific loan and the par rate, the greater the YSP. Loan pricing features that increase the value of a mortgage loan, such as prepayment fees, may also increase YSPs.

The mortgage broker receives the YSP from the mortgage banker. However, consumers pay for the YSP through higher interest rates and higher monthly payments. Where YSPs are understood, they can provide a useful option for consumers to pay the broker's direct fees and other closing costs as part of the mortgage by essentially building them into the loan rate and payments.

### Many Mortgage Bankers Receive Compensation throughout the Life of a Loan and Are Financially Accountable for Loan Performance

Mortgage bankers earn revenue in several ways, including through fees for services related to loan origination and underwriting. Borrowers pay these fees at closing or may choose to finance some or all of these fees. The borrower may also pay the mortgage banker "points" to reduce further the interest rate on the mortgage loan.

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17 The duration of a broker's liability for early payoffs depends on the specific terms of a broker's contract with a lender.

18 In the case of early payoffs, most wholesaler agreements require the broker to forfeit some or all of his fees. Wholesaler agreements normally provide that the broker is liable for repurchase in the case of fraud. However, repurchases rarely occur due to brokers' limited capital. As a fallback, wholesalers will seek an indemnification from the broker that he/she will reimburse for any losses incurred on the loan; this usually ends up taking the form of some or all of the brokers' fees.


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A mortgage banker who holds the loan in its portfolio receives interest payments from the monthly payments over the life of the loan. A mortgage banker holding a loan in portfolio must manage and hedge against both the interest rate and credit risk associated with the loan; correspondingly, the mortgage banker's financial gain or loss is linked to the success of that risk management.

Mortgage bankers also realize gains (or losses) on the sale of mortgages when loans are pooled and sold to investors in the secondary mortgage market. A secondary market sale and the corresponding financial outcome, however, are not always a certainty at the time a loan is closed. Constant fluctuations in the market, shifting interest rates and unpredictable investor appetites for mortgages mean that there is no assurance that mortgage bankers can sell loans to investors at a profit.

Additionally, selling a loan to a secondary market investor does not fully eliminate the financial risks to the mortgage banker. When selling a loan to a secondary market investor, the mortgage banker ordinarily guarantees to the investor that the loan and borrower credit characteristics are as stated to the investor and that the loan complies with relevant legal and regulatory requirements, including applicable anti-fraud and anti-predatory lending laws and guidelines. Typically, mortgage bankers are bound contractually to buy back non-performing loans[19] found to be inconsistent with these representations and warranties. This is an on-going financial risk that the mortgage banker bears.

Mortgage bankers who service loans (known as "servicers") also earn servicing fees. However, a servicer only earns these fees as long as the borrower is making timely payments. A loan's servicing rights can be sold separately from the loan itself. A mortgage banker who sells a loan's servicing rights has ongoing financial exposure through representations and warrants made to the buyer of the servicing.

### Profit Drivers for Brokers Increase the Likelihood of Steering

Studies indicate that the fees charged to borrowers for origination activities, such as application processing and underwriting rarely result in profits for mortgage bankers.[20] Instead, these fees offset the mortgage banker's costs of processing and underwriting a loan application. Other loan-related fees, such as fees for credit reports and appraisals, are required to cover only the actual out-of-pocket costs for items provided by third party vendors, such as credit reporting agencies and appraisal companies and the costs of reviewing them. They therefore do not provide profit for mortgage bankers. The vast majority of mortgage banking income comes from interest, loan servicing, and, where loans are profitably sold in the secondary market, asset sales.[21]

19 A "non-performing" loan is a loan that is delinquent or in default.

20 See Mortgage Bankers Association, *2007 MBA Cost Study*, at 10–12.

21 Ibid.


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In contrast, origination and origination-related fees and YSPs are the main profit centers for mortgage brokers. Mortgage brokers do not generally have continuing business relationships with their borrower clients after loan closing (unless it is to refinance their loan or obtain another mortgage at a later date). Unlike brokers of other financial products, such as independent insurance agents, mortgage brokers do not receive additional compensation based on loan performance or have other meaningful incentives to assure such performance.

The importance of YSPs as a source of broker revenue, coupled with the fact that YSPs are not well understood, increases the risk that some mortgage brokers will steer borrowers to costlier mortgages because they provide the mortgage broker with more lucrative YSPs.

The difference in a mortgage banker's degree of control over a loan officer employee versus a mortgage broker also makes it easier for mortgage brokers to steer borrowers into unnecessarily costly loans. Mortgage bankers have a variety of means for monitoring their loan officer employees and disciplining loan officers engaged in inappropriate steering. While mortgage bankers can — and do — refuse to do business with mortgage brokers engaged in inappropriate steering and other unprofessional practices, mortgage brokers' independence and the fact that mortgage bankers are not present as mortgage brokers work with borrowers and shop loans makes monitoring difficult.

## Mortgage Bankers' Incentives Are Aligned More Closely With Consumers' Interests

### Mortgage Bankers, Like Borrowers, Benefit Financially from Positive Loan Performance and Lose from Negative Performance

Mortgage bankers know at loan origination that their own financial success can depend on the long-term success of the loans they originate. As discussed, mortgage banking involves a variety of financial risks. Economic loss in mortgage lending can be a function of many factors, but usually involves the risk of default (e.g., non-payment of the loan by the borrower). If a loan defaults, a mortgage banker's financial exposure can be considerable whether a mortgage banker holds a loan in portfolio or has sold the loan to a secondary market investor.

In addition to losing the cash flows that come from a performing loan (i.e., servicing fee income and interest payments), when a borrower defaults, the mortgage banker can end up owning the home and incurring the costs associated with maintaining and ultimately selling the house.[22]

22 A 2003 Federal Reserve study estimated that losses on foreclosures range from 30 percent to 60 percent of the outstanding loan balances "because of legal fees, foregone interest, and property expenses." Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, (Board of Governors of the Federal Reserve System) (May 13, 2003) at 1.


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Additionally, mortgage bankers that also offer other financial services have a significant financial stake in maintaining strong, ongoing relationships with their consumers. Business success for these mortgage bankers relies on their customers' long-term financial success.

### Mortgage Brokers' Financial Incentives Are Not Linked to Loan Performance

On top of the compensation they receive for sourcing a loan and providing application-related services, mortgage brokers do not receive compensation based on loan performance. Furthermore, brokers do not generally have loan repurchase obligations.[23] As a result, a broker has a strong incentive to close loans and maximize their direct and indirect upfront fees.

While the market for brokerage services and the availability of competition can serve as brakes on broker fees, as indicated, many borrowers do not shop among competing brokers, either because the first broker they encounter is perceived to be an independent advisor shopping for them and/or there is limited competition among originators in the borrower's community.

Since YSPs are not well understood and loan performance does not affect compensation, a broker has a strong incentive to seek the most lucrative indirect fees. There is an information imbalance between broker and borrower that works in the broker's favor. Mortgage brokers are aware of the par rates and yield spreads of various loan products and of various mortgage bankers, and this information informs the broker's decision about what loans to offer any given borrower.[24] At the same time, if a borrower delegates comparison shopping to a broker and the broker's indirect compensation is not understood, the borrower is not taking action to educate himself further about other loan options and is unlikely to question a loan product and/or fees unless or until the borrower runs into trouble with the loan.[25]

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23 Some mortgage broker agreements provide for the broker to buy-back loans, but mortgage broker accountability under these agreements is limited by (1) the cost and effort required to enforce the obligation; and (2) the limited capital of brokers, which typically would not be sufficient to repurchase loans, even where a legal or contractual obligation exists.

24 See Kenneth R. Harney, *Study of Loan Fees Shows All Borrowers Not Equal*, The Washington Post (July 19, 2003), p. F01 (discussing a study by Susan E. Woodward, Ph.D.).

25 See 73 FR at 1699 (January 9, 2008).


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## Current Federal Disclosure Requirements Do Not Reduce the Risks of Steering by Brokers

### Current Broker Disclosures Provide Consumers with Inadequate Information about Broker Compensation and Responsibilities

Since 1992, RESPA[26] regulations have required mortgage brokers to disclose on the good faith estimate (GFE), which is provided at the time of loan application, and on the HUD-1 Settlement Statement, which is provided at closing, the amount of direct fees from the borrower and the amount of any indirect fees received from the mortgage banker.[27]

Direct fees to mortgage brokers are listed and included in the borrower's total settlement costs. YSPs to brokers are disclosed as a separate number, outside the column of closing costs, designated as "YSP POC" or "Yield Spread Premium Paid Outside of Closing."[28]

Though the amount of the YSP is disclosed to the borrower and it is identified as a Yield Spread Premium, borrowers are not informed of the YSP's calculation and the fact that the borrower generally pays the YSP through a higher interest rate.[29] Additionally, current disclosures do not tell the borrower if the broker is or is not functioning as an agent of the borrower.[30]

Whether or not a broker is involved in a loan transaction, mortgage bankers' costs and fees related to origination — such as origination and underwriting fees, as well as discount points — are disclosed as settlement costs on the GFE and on the HUD-1 Settlement Statement.[31] The RESPA regulations do not require mortgage bankers to disclose payments from the secondary market or loan officer compensation. HUD has not treated these costs as equivalent to mortgage broker compensation. Unlike YSPs to mortgage brokers, secondary market payments, if they occur, are not paid at settlement and are outside RESPA's coverage.[32] These payments would also require imputation where loans are not sold.

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26 12 USC § 2601 et seq.

27 For current mortgage broker fee disclosure rules, see 24 CFR § 3500.7(a) and (c), and Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 FR 10080, 10085 (March 31, 1999).

28 24 CFR Appendix A, Appendix B.

29 See *Predatory Mortgage Lending Practices: Abusive Uses of Yields Spread Premiums: Hearing Before the Senate Committee on Banking, Housing and Urban Affairs,* 107th Cong. (January 8, 2002) (statement of Prof. Howell E. Jackson, Harvard Law School).

30 This is the case with regard to federal and state mortgage lending laws. The precise nature of a broker's fiduciary duty is a question that several state courts have addressed, including in California, Missouri, and Texas, finding that brokers' had an agency and/or fiduciary relationship with their borrower-customers. Additionally, a few state legislatures have begun examining the issue. See Joya K. Raha and Andrea Lee Negroni, *Mortgage Brokers-What Fiduciary Duties Exist?* Mortgage Banking (October 2007).

31 12 USC § 2604(c), 24 CFR 3500.7(a).

32 24 CFR 3500.5(b)(7). See also 57 FR 49600 (November 2, 1992), 67 FR 49134, 49140 (July 29, 2002), 66 FR 53052, 53053 (October 18, 2001).


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Moreover, mortgage bankers sometimes lose money on these sales. HUD has not regarded employees as separate from their employers for other purposes under RESPA.[33] Importantly, mortgage bank loan officers do not function as independent intermediaries, nor do consumers perceive loan officers in the role of an "intermediary" responsible for shopping for the most favorable loan product available.

### Regulators Recognize Broker Disclosures Are Weak and Need Improvement

For almost a decade, HUD has advocated an improved consumer disclosure that would clearly advise the consumer of the compensation the broker receives in the transaction. Most recently, HUD issued proposed changes to the RESPA regulations intended to enable consumers to compare more effectively origination costs and to inform consumers of the connection between the YSP to be paid to the broker and the interest rate.[34]

Separately, the Federal Reserve expressed "concerns that creditor payments to mortgage brokers are not transparent to consumers and are potentially unfair to them,"[35] recently proposed changes to its Truth in Lending rules (Regulation Z) pertaining to broker fees. The goal of the proposal is to "limit the potential for unfairness, deception and abuse in creditor payments to brokers in exchange for higher interest rates while preserving this option for consumers to finance their obligations to brokers."[36]

The proposed regulations prohibit a creditor (including mortgage bankers) from directly or indirectly paying a mortgage broker in connection with a mortgage transaction unless the mortgage broker enters into a written agreement with the consumer, before a fee is paid, spelling out the broker's total compensation for the transaction, including payments from the creditor and consumer, and the payment does not exceed such amount. The agreement would be required to state: (1) the total compensation that the broker will receive and retain from all sources; (2) that the consumer will pay the entire amount of the compensation even if all or part of it is paid by the creditor; (3) that the creditor will increase the borrower's interest rate if the creditor pays part of the compensation; and (4) that creditor payments can influence the broker to offer certain loan products or terms, which may not be in the consumer's interest or that they may be less favorable than can be otherwise be obtained.[37]

The prohibition would not apply if a broker is (1) subject to a state statute or regulation under which a broker may not offer loan products or terms less favorable than the consumer could otherwise obtain

33 In 1992, when HUD amended its RESPA rules to establish the employer-employee exemption under the affiliated business provisions of RESPA, it indicated that it regarded employees as indistinguishable from their own employers for purposes of RESPA's anti-referral fee provisions. See 57 FR 49600 (November 2, 1992).

34 Department of Housing and Urban Development, *RESPA: Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs*, 73 FR 14030 (March 14, 2008).

35 73 FR at 1698 (January 9, 2008).

36 Ibid., at 1699.

37 73 FR at 1734 (January 9, 2008).


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through the same broker assuming the same loan's terms and conditions or (2) where a creditor can demonstrate that the compensation it pays to the broker is not based on the interest rate.[38]

## Barriers to Market Entry Also Differ and Are Greater for Mortgage Bankers

### Entering Mortgage Banking Requires Significant Financial Resources

The barriers to entry and the costs of being in the mortgage banking and brokerage businesses differ significantly. This reflects the fact that a mortgage banker's business of funding loans and managing the corresponding credit and interest rate risk is more operationally complex and involves more ongoing financial exposure and management than a mortgage broker's business of arranging loan originations and related activities.

To participate credibly in the mortgage industry, a mortgage banker must have sources of capital for funding loans, or secure a credit line for loan originations, known as a warehouse line of credit. Moreover, to maintain and renew its license or charter, a mortgage banker must have a specified level of net worth and/or regulatory capital. The continuing (and continuously escalating) operating costs, including costs associated with regulatory compliance, also help to ensure that undercapitalized and uncommitted mortgage bankers have little incentive to enter the industry, and even less ability to continue with success.

Mortgage bankers also must operate in accordance with multiple levels of government and market oversight as well, such as the guidelines and requirements of the secondary market agencies (Fannie Mae, Freddie Mac, and Ginnie Mae), loan insurers and guarantors (the FHA and VA), and other investors (such as banks and investment funds).

Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA) approve and oversee any mortgage banker who wishes to work with or sell loans to them. This includes minimum net worth requirements ($250,000 for Fannie Mae/Freddie Mac seller-servicer status; $250,000 for FHA approved mortgagees) and pre-approval reviews for financial and operational soundness.[39] Additionally, private investors and mortgage insurance companies routinely conduct audits of the mortgage bankers with whom they work.

38 Ibid.

39 Institutions (including mortgage brokerages) can also seek approval as Fannie Mae or Freddie Mac sellers only. In the case of Fannie Mae, applicants for seller-only status, however, must have a minimum net worth of $1,000,000 and undergo extensive operational and financial reviews covering all aspects of their businesses. Freddie Mac's public materials do not specify a minimum net worth level for "seller only" status.


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### Prospective Mortgage Brokers Face Few Barriers to Entry

Entering the mortgage brokerage business requires fewer resources and less operational capacity. Mortgage brokers face little federal regulation and, as discussed in this paper, are subject to widely varying degrees of state regulation in an environment where state regulators have limited enforcement staff and resources. Mortgage brokers generally are not required to have funding sources or net worth except in nominal amounts, and even the nominal requirements of state laws are inconsistent. FHA requires brokers who wish to offer FHA-insured products to have a minimum net worth of $63,000 and undergo yearly audits.

Mortgage brokers are typically authorized or chartered only by state governments, and they are far less likely than mortgage bankers to be approved (and subject to ongoing audit by) the secondary market agencies or federal government agencies with lending related regulatory functions.

## Current Federal and State Regulatory Requirements Differ and Are More Rigorous for Mortgage Bankers

Mortgage bankers are subject to many complex state and federal laws that impose substantial penalties for non-compliance. Whether they are depository or non-depository institutions, federally or state chartered, mortgage bankers are routinely supervised by federal and state regulators and must comply with a vast array of state and federal laws applicable to their lending activities. Federally chartered mortgage bankers are subject to regulatory review and examination by the federal financial regulatory agencies, and other mortgage bankers are subject to regulation and examination by state regulatory agencies. All mortgage bankers are subject to federal loan origination laws, such as RESPA, the Truth in Lending Act (TILA)[40] and HMDA.[41]

Notwithstanding that the mortgage brokerage industry has grown rapidly since mortgage brokers first appeared in the late 1980s, there are far fewer substantive laws regulating mortgage brokers at the state and federal levels. Additionally, the consequences of noncompliance by mortgage brokers are less severe. The number and variety of regulators focused on mortgage broker regulatory compliance is also fewer and these regulators are concentrated at the state level, where constrained state budgets and thin staffing often translate into minimal oversight.

40 The Truth in Lending Act (TILA) is the popular name for Title I of the Consumer Credit Protection Act, 15 USC § 1601 et. seq.

41 12 USC § 2801 et. seq.


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### State Laws

Both mortgage bankers and mortgage brokers are subject to state licensing and registration under a diverse set of state laws. In addition, state mortgage regulatory agencies (typically, banking and financial institutions departments) have adopted a patchwork of administrative rules that apply to various aspects of the mortgage business. These laws and regulations vary from state to state and, in many cases differ in their treatment of mortgage bankers and mortgage brokers. Even in states whose licensing requirements do not differ substantially between mortgage bankers and brokers, the sheer volume of licensed brokers suggests that brokers are not likely to be subject to the same degree of scrutiny and supervision as mortgage bankers.[42]

National policymakers have identified the inconsistency of broker regulation as an area in need of reform. In fact, the March 2008 report of the President's Working Group on Financial Markets (PWG) includes, among several recommendations affecting the mortgage and credit markets, a call for state financial regulators to implement strong nationwide licensing standards for mortgage brokers.[43]

While mortgage banking regulations also vary state to state, mortgage bankers overall are generally subject to state licensing laws that are more rigorous and extensive than those affecting mortgage brokers.[44] Specifically, state licensing laws tend to impose more burdens (financial, experience, reporting and otherwise) on mortgage bankers than on brokers. Additionally mortgage bankers are sometimes subject to multiple licensing laws depending on their loan product offerings. For example, several states have additional licensing laws for mortgage bankers depending on the loan finance charge, principal amount, or other criteria.[45]

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42 For example, in Nevada, mortgage bankers and mortgage brokers must have two years of verifiable experience in mortgage lending, and neither bankers nor brokers are subject to minimum net worth or surety bonding. However, as of August 2007, the Commissioner of Mortgage Lending in the Nevada Department of Business and Industry had oversight of 294 mortgage bankers and 1,029 mortgage brokers. With the same staff to investigate and enforce the statutes involving both bankers and brokers, there is a greater statistical likelihood that a mortgage banker will be examined and regulated than will a Nevada broker.

43 The President's Working Group on Financial Markets, *Policy Statement on Financial Markets Developments*, (March 2008) p. 12 http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf

44 There are exceptions to this general rule, as described below. For example, the states of Alabama, Montana, Ohio and Texas regulate mortgage brokers under comprehensive licensing statutes, while most mortgage companies (mortgage bankers) are currently exempt from licensing in these four states, or are subject to a lesser degree of state regulation. In Alabama, the Mortgage Brokers Licensing Act, Ala. Code § 5-25-1 et seq., requires mortgage brokers to be licensed, maintain net worth of $25,000, and complete approved education, but mortgage bankers approved under the National Housing Act (FHA lenders) are exempt from licensing in Alabama. Ohio's mortgage broker registration law, Oh. Rev. Code § 1322.01 et seq., requires registration of mortgage brokers but exempts "mortgage bankers." Mortgage bankers include persons and entities that make, service, buy or sell mortgage loans, underwrite loans and are approved by HUD or the VA or one of the secondary market agencies. Texas has supervisory laws for both mortgage bankers (who must register under Tex. Fin. Code Ann. § 157.001 et seq.) and mortgage brokers (who must be licensed under Tex. Fin. Code § 156.001 et seq). The registration process is simplified; the registration of Texas mortgage bankers is primarily designed to facilitate the handling of complaints from the public. The licensing procedure for mortgage brokers, on the other hand, requires each licensed broker to maintain an office in Texas, have a minimum level of experience and/or education, and pass an examination.

45 For example, the Florida Mortgage Brokerage and Lending Act, Fla. Stat. Ann. ch. 494 et seq., requires both mortgage bankers and mortgage brokers to be licensed by the Office of Financial Regulation. This licensing law applies to residential mortgage loans and to loans on commercial property with five or more dwelling units where the borrower is a natural person or the lender is a noninstitutional investor. The Florida Consumer Finance Act, Fla. Stat. Ann. ch. 516, on the other hand, applies only to lenders (not to brokers) of loans of $25,000 or less where the annual interest rate exceeds 18 percent.


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Virtually every state requires the registration and licensing of mortgage broker companies, and almost two-thirds require individual broker licensure or registration. However, the requirements are uneven, and in one case — California — any individual licensed as a real estate agent is automatically licensed as a mortgage broker. Some states call for individual brokers to meet various continuing education, examination, and criminal background check requirements, as well as net worth, surety bond, and auditing requirements, while others do not. Mortgage brokers generally are not subject to multiple licensing laws in a single state based on the size or terms of loans they arrange. Also, recently enacted high-cost loan laws targeted at "predatory lending" generally are directed mainly to mortgage bankers, not to brokers.[46]

State laws regarding a broker's obligation to a borrower vary significantly. Some state laws hold that a broker must act as an agent of the borrower. In other states, courts have ruled that agency relationships exist based on the broker's conduct. Other states have concluded there is no agency relationship implied.[47]

Mortgage bankers are subject to a continuous examination schedule by their chartering agencies, their funding sources, loan guaranty and insurance agencies, and investors. Mortgage brokers are typically authorized or chartered only by state financial institution regulators. They generally are not required to have funding sources or net worth except in nominal amounts, and they are unlikely to be subject to ongoing examination or audit.[48]

New York is an illustrative example of the differences in the state qualification and regulation of mortgage bankers and mortgage brokers.[49] Both mortgage bankers and mortgage brokers are subject to licensing by the New York Banking Department, but the approval criteria are quite different, and the extent of supervision of licensees varies significantly.[50]

In New York, a mortgage banker must have a minimum net worth of $250,000 and access to a $1 million line of credit, plus a surety bond that varies with the volume of loans closed in the calendar

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46 For example, the Florida Fair Lending Act, Fla. Stat. Ann. § 494.0078, applies principally to mortgage bankers of high-cost mortgage loans and their assignees.

47 For an overview of the state-by-state imposition of fiduciary duties on mortgage brokers, see "Mortgage Brokers — What fiduciary duties exist?" by Andrea Lee Negroni, Esq. in the October 2007 issue of Mortgage Banking Magazine.

48 As indicated above, the general rule is not universal. For example, in Arizona, the experience required to obtain a mortgage broker license is three years (for each individual licensed broker) but for a mortgage banker, only the "responsible" individual must have three years of lending experience. Moreover, mortgage brokers licensed under Arizona law must take and pass an examination to test their competency, but mortgage bankers are not subject to pre-licensing exams.

49 N.Y. Banking Law § 589 et seq.

50 New York Banking Department data indicates that for calendar year 2006, there were 321 New York-licensed mortgage bankers, of which 124 were examined, an examination rate of 38.6 percent. Only 527 of the 2,431 New York-registered mortgage brokers were examined in 2006, an examination rate of 21.6 percent. Thus, in 2006, mortgage bankers were 70 percent more likely to be examined than mortgage brokers. (The statistics for the first nine months of 2007 reflect an examination rate of 15.1 percent for mortgage bankers and 13.3 percent for mortgage brokers, indicating that the examination frequency gap between the two types of licensees was substantially reduced in 2007.) Moreover, the average duration of an examination of a licensed mortgage banker is 10 days, whereas for a mortgage broker, the average duration of an examination is three days, meaning a mortgage banker's examination was more than three times as long as a broker's.


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year preceding the license year. The minimum bond is $50,000, while the maximum is $500,000. An applicant for a mortgage banking license must have five years of verifiable experience in the business of making residential mortgage loans or similar lending and credit evaluation experience.[51]

In contrast, a residential mortgage broker in New York is not required to maintain any minimum amount of net worth, not required to maintain a credit line, and its surety bond requirement ranges from $10,000 to $100,000 depending on the number of loan applications taken in the year prior to the license year.[52]

New York's registration requirements for mortgage brokers are much looser, the main requirement being that the Superintendent of Banking find the applicant's financial responsibility and experience "acceptable."[53] This generally means two years of experience, though some applicants — such as real estate brokers and attorneys — are not required to demonstrate any experience at all.[54] Moreover, a mortgage broker may apply for registration on the sole basis of having completed relevant coursework (with no test or other objective evaluation of whether he or she has learned from the coursework). In contrast, an applicant for a mortgage banker license does not have the option to substitute coursework for the required five years of experience.

### Federal Laws

Mortgage bankers of all types are subject to an array of federal laws governing loan originations, including TILA, RESPA, the Fair Housing Act, the Equal Credit Opportunity Act,[55] and HMDA.

While mortgage brokers are subject to fair lending laws, they are not subject to HMDA's reporting and disclosure requirements. While mortgage brokers are subject to RESPA and TILA to some extent, consumer disclosure obligations under these laws are mainly the responsibility of mortgage bankers.

#### *TILA*

The Truth-in-Lending Act (TILA)[56] is designed to promote the informed use of credit by consumers through meaningful disclosure of its costs. Creditors (i.e., mortgage bankers) making residential mortgage loans for personal, family, or household purposes must provide TILA disclosures except where transactions satisfy specific exceptions. TILA disclosures are detailed and mandatory and

51 3 N.Y. Comp. R & Regs. § 410.1.

52 3 N.Y. Comp. R & Regs. § 410.15(a).

53 3 N.Y. Comp. R & Regs. § 410.3.

54 Individual real estate brokers and attorneys are not required to demonstrate any particular experience to engage in the mortgage brokerage business, despite the fact that the qualifications for these occupations and professions do not ordinarily demand specific familiarity with mortgages or consumer credit.

55 15 USC § 1691 et seq.

56 15 USC § 1601 et seq.


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failure to make them timely and accurately subjects the creditor to significant penalties and remedies, including the borrower's right to rescind the loan.

The principal TILA disclosures for mortgage transactions include: the amount financed; the prepaid finance charge;[57] the finance charge; the finance charge expressed as an annual percentage rate (APR); the number, amounts, and due dates of payments; the total of payments; any late payment, prepayment or nonpayment provisions; whether a security interest is taken in the transaction; and the creditor's assumption policy. While a broker may furnish the initial TILA disclosure forms to a mortgage applicant, TILA's disclosure requirements fall squarely on creditors or mortgage bankers in covered transactions.

The potential liabilities and penalties associated with TILA violations provide significant incentives for mortgage bankers to comply.[58] Furthermore, market mechanisms (e.g., the salability of covered loans in the secondary market) add another layer of incentives for creditor compliance. An error in calculating any of the key terms in a TILA disclosure has significant consequences for the creditor.[59] A large body of case law attests to the frequency with which borrowers sue mortgage bankers for TILA non-compliance, both perceived and real. Consumers injured by creditor violations may rescind their loans and sue to recover their damages plus penalties, costs and attorneys' fees. Moreover, assignees of creditors may be liable for violations by original creditors.

Unlike mortgage bankers, mortgage brokers have no liability under TILA, although they may deliver TILA disclosures to consumers.[60] A mortgage broker who verbally underestimates loan costs, finance charges, payments or other key elements of a loan in connection with soliciting an application undermines the purposes of TILA, but bears no liability.

*RESPA*

The Real Estate Settlement Procedures Act (RESPA)[61] mandates disclosure of certain settlement costs to consumers, including direct broker fees and YSPs, and prevents certain fees among settlement service providers which may increase settlement costs.[62] RESPA requires a mortgage banker to provide a good faith estimate (GFE) of settlement charges at the time of mortgage application

57 "Finance charge" is a difficult definition to work with under the law because of the lengthy list of items included and excluded from its calculation.

58 15 U.S.C. § 1640(a).

59 15 U.S.C. § 1601 et. seq. See also Brophy v. Chase Manhattan Mortgage Co., 947 F. Supp. 879 (E.D. Pa. 1996).

60 15 USC §§ 1602(f), 1631(b).

61 12 USC §§ 2601-2617.

62 "It is clear that at the time RESPA was passed, its basic thrust was to enable consumers to understand better the home purchase and settlement process, and, where possible, to bring about a reduction in settlement costs." Paul Barron and Michael A. Berenson, "Federal Regulation of Real Estate and Mortgage Lending," Fourth Edition, § 2:1 (Thomson/West 2003) (hereafter, Barron, "Federal Regulation of Real Estate and Mortgage Lending").


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and a statement of costs at settlement. RESPA prohibits kickbacks, referral fees, and unearned fees among settlement service providers for federally related mortgage loans.[63]

Mortgage brokers may provide GFEs as well. As long as the mortgage broker has provided the GFE, the funding mortgage banker is not required to provide an additional GFE, but the funding mortgage banker is responsible for ascertaining that the GFE has been delivered.[64] However, to ensure compliance, lenders customarily provide their own GFEs to borrowers. A mortgage banker that requires the use of affiliated providers for settlement services is obligated to disclose any relationship between itself and the provider(s).[65]

There are no statutory penalties under RESPA for failure to provide RESPA-required disclosures,[66] but various courts have held that the lack of a statutory penalty does not obviate a borrower's right of action for violation of the disclosure rules,[67] so mortgage bankers can be subject to lawsuits for noncompliance with RESPA. More frequently, federal and state regulators enforce mortgage banker compliance with RESPA disclosure requirements. Mortgage bankers must keep HUD-1 settlement statements and all other documentation in connection with loans, including the application. This recordkeeping obligation does not fall on brokers.

*The Fair Housing Act and the Equal Credit Opportunity Act (ECOA)*

The Fair Housing Act prohibits discrimination both by direct providers of housing (such as landlords and real estate companies) and mortgage bankers and others who provide services in connection with a "residential real estate-related transaction." Both mortgage brokers and mortgage bankers are subject to the Fair Housing Act. Under the Fair Housing Act, it is unlawful for "any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin."

ECOA prohibits a "creditor" from discriminating against a loan applicant "with respect to any aspect of a credit transaction" and an "arranger" of credit (such as a mortgage broker) from discriminating on the basis of race, color, religion, national origin, sex or marital status, age (provided the applicant has the capacity to contract), "because all or part of the applicant's income derives from any public assistance program," or "because the applicant has in good faith exercised any right under [ECOA]." While both mortgage bankers and mortgage brokers are subject to these laws, consumers

63 The term "federally related mortgage loan" is broadly defined under RESPA. 24 USC § 2602 (1).

64 24 CFR § 3500.7(b).

65 24 CFR § 3500.7(e).

66 RESPA also requires that prospective borrowers be given a Special Information Booklet which describes settlement costs. The receipt of an application for a federally related mortgage loan triggers the obligation to provide the Booklet. Mortgage bankers or mortgage brokers may provide the Special Information Booklet. 24 CFR § 3500.6.

67 Barron, "Federal Regulation of Real Estate and Mortgage Lending," § 2:41.


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and regulators are more likely to make claims against mortgage bankers for any discrimination by independent mortgage brokers because mortgage bankers are perceived to have the resources to pay fines and judgments.

*Home Mortgage Disclosure Act (HMDA)*

Although mortgage bankers and mortgage brokers are subject to the fair lending laws, only mortgage bankers are required to report and disclose data on mortgage lending activities under HMDA and, thus, are subjected to the scrutiny that HMDA brings. HMDA regulations are the responsibility of the Federal Reserve. The Federal Reserve has stated that the three main purposes of HMDA are:

- To provide the public and government officials with information that will help show whether financial institutions are serving the housing needs of the neighborhoods and communities in which they are located;
- To help public officials target public investments to promote private investments in neighborhoods where investment is needed; and
- To provide data that assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.

HMDA, among other things, requires covered mortgage bankers to collect, report, and publicly disclose detailed data relating to mortgage applications, denials, and loan pricing. These data include loan type and amount; property location and type; the disposition of the application, such as whether it was denied or resulted in an origination; and the applicant's ethnicity, race, sex, and income.

For 2004, the Federal Reserve began requiring mortgage bankers to report pricing data for first-lien loans with an Annual Percentage Rate (APR) equal to or greater than the rate payable on a Treasury security of comparable maturity plus three percent and for subordinate-liens with an APR equal to or greater than the rate on a comparable Treasury security plus 5 percent. In establishing these requirements, the Federal Reserve sought data on lending patterns in the subprime mortgage market.

As a consequence of these HMDA amendments and the availability of pricing data, hundreds of governmental reviews have been initiated concerning loan pricing by mortgage bankers. These reviews include several by the Department of Justice, the Federal Trade Commission (FTC), the Office of the Comptroller of Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) the Federal Reserve, the Office of Thrift Supervision (OTS), and various state attorneys general. These agencies have continued to use HMDA data in support of other fair lending initiatives, including the review of traditional denial disparity issues, redlining, predatory lending, and steering.


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# Recommendations for Regulatory Improvements

MBA believes that by appropriately recognizing the differences that exist between mortgage bankers and mortgage brokers, legislators and regulators can take important steps toward addressing consumer protection shortcomings in the mortgage process. MBA recommends the following:

### Borrowers Should Have Access to Improved and Timely Disclosures Regarding the Services Furnished by Brokers and Compensation for Those Services

Some have proposed broad prohibitions on compensation linked to loan terms without differentiating between mortgage bankers and mortgage brokers. MBA believes that consumers and the market would be better served with clear information on the amount of total broker compensation, its sources and the broker's functions, early in the process. Such information would encourage consumers to comparison shop among brokers just as they currently do among mortgage bankers, help the consumer understand how compensation derived from rate can be used to pay origination charges and other settlement costs, and increase the likelihood that the consumer ends up with the most favorable loan terms. Additionally, clear information on whether the broker is or is not serving as the borrower's agent would similarly inform the consumer's decision about shopping among multiple brokers.

The recent Federal Reserve proposal to require mortgage brokers to enter into a written agreement with the consumer before compensation is paid to a broker is notable. It would require disclosure of the broker's direct and indirect compensation and help borrowers avoid steering. Additionally, HUD's most recent RESPA proposal seeks to improve YSP disclosures to make clear to the consumer the


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link between YSP and a higher interest rate. While MBA has concerns with the HUD and Federal Reserve proposals, MBA applauds both HUD's and the Federal Reserve's work in producing them. Additionally, MBA encourages both agencies to work together as they finalize their proposals.

Some have pointed to studies by the Federal Trade Commission (FTC) to refute the position that more information about broker compensation would better equip consumers to comparison shop for mortgages and mortgage providers.[68] The FTC tested various forms of YSP disclosures with consumers and found that the disclosures did not help consumers identify the least costly loans. The FTC staff report also concluded that the YSP disclosures caused a bias against broker sourced loans. While the FTC's findings highlight the challenges in improving consumer mortgage disclosures, they do not address the problem of consumers' often incorrectly placed reliance on brokers as trusted advisors. Nor do the FTC staff conclusions obviate the need to counter steering through improved consumer information about brokers' compensation and legal responsibilities.

### Brokers Who Claim to be or Act as Borrowers' Agents Should Be Treated As Agents Under the Law of Principal and Agent

If a broker asserts or acts in a manner that indicates that he or she is shopping for the borrower, the broker should be subject to the duties of agency.[69] This would clarify that a broker is acting on the borrower's behalf and has an obligation to act in the borrower's best interests.

MBA believes that this is best accomplished through a declaration (or disclaimer) of agency relationship by the broker. This clearly would inform a borrower as to whether he should rely on a broker to shop for him. Mere imposition of an undefined standard of fiduciary duty on all mortgage brokers, irrespective of the borrower's wishes, would likely increase liability and costs to both mortgage bankers and borrowers.

### All Loan Originators Should Be Registered and Subject to Appropriate, Rigorous Licensing Standards

MBA supports the President's Working Group on Financial Markets' recommendation that mortgage brokers should be held to stronger licensing and enforcement standards. In fact, MBA supports requiring licensing for all individual loan originators — brokers and bankers — except those employed by an institution with a federal charters (current law exempts employees at federally chartered institutions from state licensing laws). Additionally, there should be a nationwide registry

68 James M. Lacko and Janis K. Pappalardo, "The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment," Federal Trade Commission Bureau of Economics Staff Report (February 2004).

69 Agency is a fiduciary relationship created by express or implied contract or by law, in which one party (the agent) may act on behalf of another party (the principal) and bind that other party by words or actions, C.J.S. Agency §§ 2, 4-6, 23, 25-27, 33, 38-40, 58.


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of mortgage broker and mortgage banker employees who originate loans. All originators, including those employed by federally chartered institutions, should participate in this registry. A nationwide registry would provide a powerful tool for regulators, industry participants, and consumers in tracking unscrupulous actors.

MBA also supports rigorous and appropriate licensing standards for loan originators. Ensuring that loan originators fall under rigorous licensing requirements will ensure that mortgage brokers, as well as mortgage bankers have the competence and professionalism required to serve consumers. Additionally, MBA supports greater appropriations at the state and federal level for enforcement of such requirements.

### Brokers Should Have Sufficient Financial Resources to Provide Relief to Borrowers and Mortgage Bankers Where Necessary

Brokers should be required to maintain a minimum level of financial net worth. Currently, FHA requires brokers offering FHA-insured mortgages to have a net worth of at least $63,000, plus $25,000 for each branch office.

MBA supports establishing a nationwide financial net worth requirement for all mortgage brokers consistent with these requirements. A requirement for minimum financial worth would provide greater protection to consumers and mortgage bankers and help brokers meet their repurchase obligations, making brokers more financially accountable.

### Brokers, Where Possible, Should Be Sufficiently Bonded

Additional protection for the public can be obtained if surety bonds are required in connection with licensing of mortgage brokers. MBA supports minimum bonding, where available, of $75,000 or an amount equal to 10 percent of the broker's annual loan volume, whichever is higher.

A number of states already require brokers to maintain surety bonds. Fidelity bonding for the employees of mortgage brokers would be an additional protection for consumers who put their trust in a mortgage broker to obtain mortgage financing. Bonds commonly are available from commercial insurers, and obtaining them would not generally create a hardship on brokers.

Aggrieved consumers and mortgage bankers could file claims for economic losses against the bonding companies. Moreover, since bonding in many cases requires a financial audit, such an audit can provide additional protection to the public and is consistent with existing FHA regulations.


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**Mortgage Brokers, as Independent Entities, Should Not Be Made Agents of Mortgage Bankers as a Matter of Law**

The foregoing recommendations will solve key regulatory concerns in a more targeted manner. Recently, however, one federal legislative proposal suggested that mortgage bankers should be liable for the acts, omissions, and representations made by mortgage brokers whenever they sell or deliver a subprime mortgage to a mortgage banker or for any loan where a mortgage broker receives a YSP from a mortgage banker.

MBA strongly believes this proposal would have deleterious, albeit unintended, effects. Mortgage brokers are independent entities and act independently from mortgage bankers during the loan sourcing and application process. Mortgage bankers lack the ability to control and oversee broker conduct. Making mortgage bankers liable for mortgage brokers, considering brokers' independence, would result in fewer purchases of mortgage broker loans by mortgage bankers. This would decrease competition and lessen choices to borrowers, ultimately increasing borrowers' costs.

# Conclusion

The U.S. mortgage market offers a wide array of mortgage credit options and has been a critical factor in increasing national homeownership rates, which are near record levels. Nonetheless, a rising foreclosure rate and recent excesses in the subprime market have brought calls for greater regulation of all aspects of the mortgage process, including the duties and responsibilities of mortgage brokers. The current challenges that the housing market and some homeowners face point to weaknesses in the quality of consumer information and required disclosures.

Both mortgage bankers and mortgage brokers perform beneficial functions in the mortgage market and have been able to offer borrowers an array of credit choices. As this paper illustrates, although complementary, mortgage bankers and mortgage brokers have fundamentally distinct functions and responsibilities. MBA, therefore, urges legislators and regulators to resist pressure to embrace an unwarranted one-size-fits-all regulatory approach. Instead, MBA believes the differences between the brokerage and lending industries should be recognized, considered, and carefully addressed to assure that regulatory inadequacies are properly addressed, consumers are protected, and that the market functions fully and fairly for the benefit of all.


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Prepared Testimony of

Marc Savitt, CRMS NAMB President-Elect

National Association of Mortgage Brokers

On

"RESPA and its Impact on Small Business"

Before the

Committee on Small Business

United States House of Representatives

Thursday, May 22, 2008

Good morning Chairwoman Velázquez, Ranking Member Chabot, and Members of the Committee, I am Marc Savitt, CRMS, President-Elect of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on the Real Estate Settlement Procedures Act ("RESPA") and its impact on small business. We appreciate the opportunity to discuss this issue of vital importance to the small business community and specifically, mortgage brokers.

NAMB is the only trade association exclusively devoted to representing the mortgage broker industry and speaks on behalf of more than 18,000 members in 50 states and the District of Columbia. Our members are independent, small business men and women that adhere to a strict

code of ethics and best lending practices[1] when taking consumers through the loan process. We typically maintain business relationships with various lenders to provide consumers with numerous financing options. These partnerships allow our members to offer consumers the most competitive mortgage products available, often in areas where traditional mortgage lenders may not have offices.

We would like to thank Chairwoman Velázquez and the members of this Committee for your leadership and interest in the proposed Department of Housing and Urban Development ("HUD") RESPA rule[2] ("Proposed Rule") and your continued commitment to protect small businesses. NAMB commends this Committee for holding this important hearing to examine the Proposed Rule and the impact on small businesses in America. NAMB would also like to thank this Committee for its vigilance in holding hearings on this issue, the first of which was held March 11, 2003 on the effects of the RESPA rule on small business. We will not reiterate all of our concerns with HUD's proposal as we have detailed our concerns previously through several Congressional hearings and will submit full comments to HUD by June 12, 2008. Instead, we will focus today on the regulatory process HUD used in promulgating their Proposed Rule and the impact on small business mortgage brokers.

## I. Mortgage Brokers & the Current Market

### A. Licensing & Regulation of Mortgage Brokers

Today, all 50 states[3] and the District of Columbia license or otherwise regulate the occupation of finding, placing, negotiating, or soliciting residential first mortgage loans. The laws regulating mortgage brokers are designed to protect the public from the incompetence, fraud, misrepresentation, or dishonesty of those engaged in brokering loans. The majority of the states that regulate mortgage brokers have enacted specific licensing laws. In some states, however, mortgage brokers fall within an occupational category known as "loan brokers," which refers to persons who find or arrange loans for others, whether or not the loan is secured by real property. At least one state, Maine, subjects mortgage brokers to the law applicable to credit services organizations. In California, one may broker mortgage loans if licensed as a real estate broker.

While each state's mortgage broker law defines the terms "mortgage broker" or "loan originator" in specific terms, generally speaking, mortgage brokers under state law are defined as persons or entities that (i) find or arrange real estate-secured loans for borrowers, or (ii) find potential borrowers for lenders, or negotiate loan terms with borrowers on behalf of lenders. A

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[1] All mortgage originators who wish to be members of NAMB will be required to meet the Lending Integrity Seal of Approval® criteria as a requirement of membership by January 1, 2009. In order to use the Lending Integrity Seal, members must meet the following criteria: 1) must hold a valid state license/registration; 2) national criminal background check; 3) minimum of six (6) hours of professional education yearly; minimum of two (2) hours of ethics training every two (2) years; 4) three letters of reference or three professional references; 5) pledge to adhere to NAMB Code of Ethics and Professional Standards, *and* abide by NAMB's grievance review process and rulings.

[2] Real Estate Settlement Procedures Act (RESPA): Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs 73 Federal Register 14,030 (March 14, 2008) Docket No. FR-5180-P01.

[3] The Alaska mortgage broker licensing act has been enacted, but will not be effective until July 1, 2008. All other states have applicable laws currently in effect.

mortgage broker solicits prospective borrowers, through advertising or otherwise, and places loan applications with lenders, or offers to find lenders who will make mortgage loans. The receipt of compensation, or the expectation of compensation, is generally essential to the characterization of the foregoing activities as those of a mortgage broker.

Federal law governs how mortgage brokers relate to their customers and how brokers participate in real estate financing transactions. In general, federal law is focused on how real estate transactions are conducted, not on the licensing or other regulation of individual mortgage brokers. Three federal statutes are most directly applicable to mortgage brokers: 1) RESPA; 2) the Truth in Lending Act[4] ("TILA"); and 3) the Home Ownership and Equity Protection Act[5] ("HOEPA").

In addition, NAMB supports legislation, *e.g.*, H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007 passed by the U.S. House of Representatives, which creates minimum standards for education, criminal background checks and a national registry for *all* originators. NAMB supports these efforts, so long as, the proposals apply to all mortgage originators. All consumers deserve the same standard of professionalism, information and protection against fraud and abusive lending practices regardless of where they go to get their mortgage. A national registry that assigns a permanent, non-transferable identification number and requires a national criminal background check, such as the one in H.R. 3915, promotes accountability and tracking of all loan originators.

### B. The Role of Small Business Mortgage Brokers

Mortgage markets have evolved rapidly in recent years, as have the roles of mortgage professionals and entities, who may work in multiple capacities. A real estate financing professional or entity acts in a mortgage broker capacity when the professional or entity works with both borrowers and lenders, though representing neither, to obtain a mortgage loan. A mortgage broker adds value through various means, by providing goods with quantifiable value, such as a customer base and goodwill, facilities, and services. A broker works with consumers throughout the complex mortgage origination process. Accordingly, a mortgage broker's role may include taking the application; performing a financial and credit evaluation; producing documents; working with realtors; ordering title searches, appraisals, and pay off letters; assisting in remedying faulty credit reports or title problems; and facilitating loan closings. The assistance a mortgage broker may or may not provide varies widely, depending on the nature of the transaction, the requirements of the lender or loan purchaser, and other factors.

A mortgage broker may have a working relationship with one or more banks and other lenders and may provide the consumer with access to a wide range of options for financing a home. This allows mortgage brokers to provide consumers a highly efficient and cost-effective means to obtain a mortgage that fits the consumer's financial goals and circumstances. Because brokers facilitate competition, a 2005 independent study conducted by economists at three major universities concluded that "broker-originated mortgages are less costly to the borrower than lender-originated mortgages after holding other loan terms and borrower characteristics

[4] 15 U.S.C. §§ 1601-1667f.
[5] 15 U.S.C. §§ 1602(aa), 1639.

constant." [6] Similarly, a study by Mr. Todd of the Federal Reserve Board of Minneapolis and Professor Kleiner stated, "Brokers have helped to shorten the loan process and made it cheaper."[7] That study also showed that when certain state regulatory burdens were imposed on brokers that impeded brokers' entry into mortgage markets, the number of brokers declined, and those states also experienced "higher foreclosure rates, and a greater percentage of high-interest-rate mortgages."[8]

It is in the brokers' own interests, as well as in the interests of the customers they serve, to ensure that mortgage markets work effectively. Lower prices to consumers, and the relative pricing advantage brokers often confer, result from the same dynamic that brings down price and improves quality for almost any other good or service: competition. For that reason, NAMB welcomes any initiatives by HUD that will increase access to mortgages and foster competition among mortgage originators.

Through enhanced competition, markets expand, costs decline, and service improves—developments which benefit the general public. NAMB strongly supports measures which empower consumers to select mortgages based upon their own assessment of the comparative price, most appropriate product, and highest quality service (regardless of whether such a mortgage is obtained with the assistance of a broker). NAMB is confident that if rules are established and enforced to ensure that consumers are given the tools to make informed decisions in their own best interests, then the members of NAMB will compete successfully.

### C. Converging Roles of Mortgage Originators

The roles of mortgage originators have rapidly converged in recent years. As a result, as noted in the Broker Regulations Analysis by the Federal Reserve's Richard Todd and Professor Kleiner of the University of Minnesota, "[T]he actual roles of brokers, loan officers, lenders, and others are not rigidly bound and often blur."[9] Even the Mortgage Bankers Association has acknowledged this fact, recently stating that "Mortgage bankers sometimes function as mortgage brokers, offering the loan products of other, larger mortgage bankers."[10] However, the regulations promulgated under RESPA, which are largely unchanged since 1992, have failed to keep pace with fundamental changes in market realities.

Historically, mortgage brokers and mortgage lenders could be readily distinguished. Brokers did not lend money, and lenders did not serve as portals for competing providers of funds. However, in recent years, the lines between distribution channels have blurred, as the "originate to distribute" model of mortgage financing, in which lenders promptly repackage and

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[6] Amany El Anshasy (George Washington University), Gregory Ellihausen (Georgetown University) & Yoshiaki Shimazaki (Oklahoma State University), *The Pricing of Subprime Mortgages by Mortgage Brokers and Lenders*, July 2005 ("Mortgage Pricing Study"), at 12. That study was prepared without the knowledge or support of NAMB.
[7] Morris Kleiner & Richard Todd, *Mortgage Broker Regulations that Matter: Analyzing Earnings, Employment, and Outcomes for Consumers*, National Bureau of Economic Research Working Paper 13684 (December 2007) ("Broker Regulations Analysis")© Morris M. Kleiner and Richard M. Todd, at 7.
[8] Broker Regulations Analysis at 1.
[9] Id. at 5, n.4.
[10] *Mortgage Bankers and Mortgage Brokers: Distinct Businesses Warranting Distinct Regulation,* Mortgage Bankers Association (May 2008), fn 9, at 13.

sell loans they originated, is commonplace. Moreover, as the Mortgage Pricing Study observed, "Borrowers may canvass mortgage originators without taking into account or even knowing whether an originator is a broker or lender."[11] Nor, quite often, is it even possible to tell the difference: the on-site signage or internet logos are typically indistinguishable.

Increasingly, mortgage bankers or lenders functionally act as a brokers because they often (i) have entered into multiple contracts with various banks and lenders to offer an array of products, (ii) know at the time of closing they will quickly sell the loan, and (iii) generally know how much they will make off the loan when the sell it. Today, most lenders quickly sell their loans onto the secondary market. Mortgage bankers and lenders that operate as correspondent lenders are simply fronting the funds for another bank, lender or the secondary market, and then being compensated from the market, in addition to the consumer, for such temporary fronting of funds.

Conversely, some brokers may act as lenders. For example, a broker may fund a loan through accessing a warehouse line of credit, and promptly sell that loan to a purchaser who had committed to buy it before funding. Accordingly, some state laws now expressly acknowledge that a single entity may be acting in multiple capacities as both lender and broker.

Dramatic advances in technology also have served to accelerate the convergence of the roles of mortgage originators. The introduction of automated underwriting, web-enabled credit scoring, and the ubiquity of computers have helped blur the distinctions among historically different functions. In fact, originators tend to use the same software regardless of whether they are acting in a broker or loan funder capacity. The distinctions among originators have come to be determined largely through the click of a mouse.

It is now common for mortgage companies to act in multiple capacities. Indeed, even within a single transaction, the role in which a company may act may change during the application and processing functions from a lender to a broker, and back again, depending on circumstances. In addition, since HUD authorized affiliated business arrangements ("AfBAs"), many entities in the mortgage industry have established such relationships with developers, builders, real estate agents, and title companies, thus further confusing traditional roles and responsibilities.

To the consumer, none of this is readily apparent. Moreover, consumers are largely unaware of, and indifferent to, the specific attributes of the originators with whom they are dealing. Consumers also seek, and would benefit from, the same information about the mortgage transaction regardless of the type of originator involved. Yet, unlike brokers, lenders do not need to disclose what they are paid for originating loans that they do not retain for their own portfolios, but sell days after closing. As discussed below, regulations implementing RESPA and other provisions of applicable law drafted before the "originate to distribute" model became ubiquitous retain vestigial distinctions between brokers and lenders that are no longer meaningful, creating market dysfunction which the Proposed Rule should seek to remedy, not exacerbate.

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[11] Mortgage Pricing Study at 8.

To serve consumers' interests effectively, any regulatory initiatives relating to mortgage originators must address the mortgage market as it is today, not as it existed a generation ago. That means acknowledging the convergence of the roles of brokers, banks, and lenders, and, as a consequence, applying rules equally to all originators.

In April 2007, the Joint Center for Housing Study at Harvard University released a 75 page report which detailed the similarities between different loan originators, including the way both brokers and loan officers are compensated, and the common consumer protection concerns each origination channel presents. In view of that convergence, the Harvard Mortgage Markets Study presented among its four key recommendations for reforming mortgage markets a call for federal regulators to "Establish Minimum Standards and Apply Rules Equally to the Marketplace", which it further stated would require regulators to "Create effective and adequately funded enforcement strategies to ensure that all mortgage brokers, loan officers, and mortgage originators play by the same rules."[12]

One of the Harvard Mortgage Markets Study's two authors, Ren Essene, made similar points at a June 14, 2007 hearing on the Home Equity Lending Market held by the Federal Reserve Board, stating:

> Fundamental fairness suggests that the nature and extent of federal oversight and consumer protection should not depend on the details of which particular mortgage broker or loan officer takes the mortgage application, which particular retailer or wholesaler originates the mortgage, and which secondary market channel is tapped to secure the investment dollars that ultimately funds the loan.[13]

Neither the Harvard Mortgage Markets Study nor Ren Essene's testimony is discussed, or cited, by the Proposed Rule.

## II. HUD's Proposed RESPA Rule & the Current Market

The Proposed Rule, published on March 14, 2008, seeks to simplify and improve the disclosure requirements for mortgage settlement costs under the Real Estate Settlement Procedures Act of 1974 ("RESPA"), and, as a consequence, to protect consumers from unnecessarily high settlement costs. Accordingly, the Proposed Rule would, among other initiatives, revise and standardize the Good Faith Estimate form ("GFE"), modify the HUD-1 Uniform Settlement Statement ("HUD-1"), impose additional disclosure requirements, require recitation of a "closing script" to borrowers, and clarify instructions as to how applicable forms are to be completed.

NAMB applauds HUD's forceful response to problems in mortgage markets, and shares HUD's resolute commitment to protecting consumers from unnecessarily high settlement costs. NAMB believes that measures which target abusive practices and enhance transparency of the loan origination process benefit not only consumers, but also NAMB's members, who are already

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[12] Harvard Mortgage Markets Study at vi.

[13] Testimony of Ren Essene, Research Analyst, Joint Center for Housing Studies at Harvard University, Before the Board of Governors of the Federal Reserve System Hearing On the Home Equity Lending Market (June 14, 2007) http://www.federalreserve.gov/SECRS/2007/August/20070823/OP-1288/OP-1288_90_1.pdf, at 8.

required to adhere to a professional code of ethics and best lending practices. In fact, for that reason, NAMB strongly supports numerous consumer protection measures in addition to those presented by the Proposed Rule, including provisions which are beyond the jurisdiction of HUD and within the purview of other federal agencies or state regulators.

NAMB objects, however, to those components of the Proposed Rule that would not best serve the consumer, either because they would impede competition, treat direct competitors differently, fail to reflect the most authoritative research, or do not consider the most effective and least burdensome alternatives.

HUD proposes to make bold changes in the marketplace through implementation of the Proposed Rule. In light of the current market situation – rising home foreclosures, the credit crunch and recent changes proposed to the Federal Housing Administration ("FHA") Program,[14] among other factors – NAMB questions the appropriateness of the timing and implementation of the Proposed Rule. Today's, mortgage market is significantly strained and continues to experience turmoil and change. The market has lost over 250 lenders, underwriting standards have tightened, minimum credit scores have increased and new rules are being considered by the Federal Reserve Board (*e.g.*, the proposal to implement standards under TILA Section 32 and the Risk-Based Pricing Notice). In addition, Congress is considering sweeping changes to how loans are originated in the United States. Before implementing sweeping changes to the origination process, a thorough analysis should be undertaken to ensure the market can accommodate the changes in the Proposed Rule.

At this time, NAMB believes HUD's efforts, and the mortgage market in general, may be better served by focusing on the market today and providing support for consumers currently at risk of losing their home to foreclosure. NAMB believes HUD should continue to move forward with the RESPA reform process, but should consider delaying implementation of any new policies or procedures until all originators can digest the multitude of events already occurring in today's market. As Regulators, Congress and industry focus on the issues at-hand we must ensure the market is able to stabilize, accommodate changes and provide assistance to the high volume of borrowers currently in need of refinancing and/or foreclosure assistance through programs administered by HUD.

## III. Compliance with Federal Law

### A. Regulatory Flexibility Act Compliance

The Regulatory Flexibility Act was passed in 1980, in an effort to help reduce the burden placed on small businesses by federal regulatory action. The Regulatory Flexibility Act requires federal agencies to prepare an Initial Regulatory Flexibility Analysis ("IRFA") anytime a regulation is proposed. The IRFA must describe the impact of the proposed regulation on small businesses.[15]

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[14] In August 2007, HUD announced the creation of the FHA Secure program, which will enable homeowners to refinance various types of adjustable rate mortgages (ARMs) that have recently "reset" through the FHA. For more information see MORTGAGEE LETTER 2007-11.

[15] 5 U.S.C. § 603.

Among other things, the IRFA must: (1) describe the economic impact of the proposed rule on small entities; (2) include a description of the projected reporting, record keeping and other compliance requirements outlined in the proposed rule; (3) identify any existing rules that may conflict with or overlap the proposed rule; and explore and analyze alternatives to the proposed rule, which would accomplish stated objectives, but minimize the economic impact on small entities.[16]

NAMB believes that HUD has failed to adequately comply with the Regulatory Flexibility Act when promulgating its proposed rule for two primary reasons. First, HUD's IRFA relies upon outdated information when estimating the economic impact of the proposed rule on small entities, including mortgage brokers. Second, HUD's IRFA does not reflect sufficient comparative analysis of less burdensome alternatives to the proposed rule, which would minimize the adverse impact on small entities.

**i. HUD's Economic Impact Analysis Fails to Consider Current Market Realities, Instead Relying on Data from Previous Years**

HUD readily acknowledges in its IRFA that the mortgage industry is continuously evolving.[17] Today's mortgage market is vastly different from the market that existed five years ago. Moreover, today's market is vastly different than the market that existed just one year ago. As such, it is imperative that HUD's economic impact analysis under the Regulatory Flexibility Act reflect current market realities in order to accurately determine the true costs and burdens of the proposed rule on small businesses.

HUD's IRFA estimates significant compliance and implementation cost burdens for small business entities under the proposed rule. However, HUD's IRFA bases these estimates on data that may not accurately reflect the current state of the mortgage industry, thus potentially under- or over-estimating the burden on small businesses.

Since early 2007, we have witnessed unprecedented turmoil in the mortgage and housing markets. This turmoil, which has not yet subsided, has inflicted a credit crunch on American consumers and has driven both small and large entities out of the mortgage industry in record numbers. The result of this has been, and continues to be, an ongoing reorganization of the mortgage origination industry landscape.

To ensure compliance with the requirements of the Regulatory Flexibility Act and to adequately protect small business entities from unnecessary and costly regulatory burdens, NAMB believes it is HUD's responsibility to demonstrate that it's IRFA examined the most current and accurate data on today's mortgage industry and the impact of the proposed rule on small business.

**ii. HUD's Comparative Analysis is Limited to its own Earlier Proposals, and Fails to Sufficiently Weigh other Alternatives that Would Reduce the Impact on Small Businesses**

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[16] *Id.*
[17] 73 Federal Register 14105.

While HUD's IRFA indicates that the impact of the proposed rule is likely to be significant, and will likely affect a substantial number of small entities, the agency has failed to sufficiently explore alternatives that would be less burdensome than the current proposal is to those entities.

HUD explains in Appendix VI of its IRFA that the agency considered many alternatives to the proposed rule and describes in detail steps taken to minimize the impact of the proposed rule on small business. However, it is clear from the IRFA that HUD focused its exploration of "alternatives" on its own prior proposals and the requirements set forth in the current rule.

HUD's IRFA must contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. HUD is not the only regulator responsible for addressing consumer costs disclosures in mortgage transactions. There are other federal agencies, as well as virtually every state, that have promulgated rules dealing with mortgages and specifically mortgage cost disclosure. However, the IRFA does not indicate whether HUD has seriously investigated how different states or other regulatory agencies have addressed the issue. NAMB believes it is important for HUD to analyze what these other regulators are doing.

**B. Administrative Procedures Act Compliance**

The rulemaking process by federal agencies, including HUD, is governed by the Administrative Procedures Act ("APA"), which sets forth clear standards that any proposed rulemaking must meet. In its current form, the Proposed Rule fails to comply with some of the most critical APA standards. Moreover, because of the materiality of those shortcomings, they may not be remedied in the final rule. At a minimum, the APA concerns relating to the Proposed Rule require the rule to be proposed again in a form which satisfactorily addresses those concerns, and which permits the public to comment upon changes and additions to the Proposed Rule's rationales and supporting materials.

The animating principles of the APA are relatively straight-forward: an agency may not abuse its authority by acting either arbitrarily or unilaterally. Although agencies develop regulations pursuant to statutory authority, they nonetheless may only act after articulating an adequate rationale for the proposed action, and identifying any data, studies, or analyses supporting the proposed policy course. Moreover, that rationale and supporting authorities must be presented to the public, which must be given an opportunity to comment on the proposed rule and its premises. In short, an agency may not simply assert that a regulation is in the public interest, it must demonstrate that the regulation is so, and it must afford the public it presumes to serve the right to examine and challenge the rule's premises.

Under the APA, if the final rule is not adequately justified by the rationale articulated by the issuing agency, if that rationale is not properly supported by the facts and data presented, or if the facts and data are not timely presented to the public to permit comment prior to adoption of a final rule, that rule is not valid.

**i. The Proposed Rule fails to articulate an adequate rationale and supporting basis for key provisions**

The APA requires agencies to "incorporate in the rules adopted a concise general statement of their basis and purpose."[18] The Proposed Rule exhibits several shortcomings. Most obvious, perhaps, is the Proposed Rule's failure to explain, let alone justify, its arbitrary distinctions among mortgage originators, and the harm to consumers which would result from that competitive imbalance. More generally, the Proposed Rule fails to cite any bases for some of its key provisions, and did not address relevant information that was readily available. Perhaps most egregiously, the Proposed Rule attributes unethical conduct to mortgage brokers without any basis for doing so, yet assumes that originators competing against brokers would not abuse the marketing advantages which the Proposed Rule would confer to drive consumers away from brokers.

Under the APA, issuing regulations and presenting policy proposals without first conducting the appropriate research is simply not enough. HUD's flawed research methodology and failure to address key issues presented by the Proposed Rule does not constitute "reasoned decisionmaking" under the APA. HUD proposed key policies without first conducting appropriate research, soliciting critical input from the public, or giving proper consideration to some of the most relevant and authoritative studies in the field. HUD must conduct further research into the operation of mortgage markets and the efficacy of proposed disclosures which utilizes all these sources of information. HUD should then disclose its findings anew to the public in a subsequent proposal to permit proper consideration of the Proposed Rule.

**ii. The Proposed Rule failed to consider less restrictive, reasonable alternatives for its chosen policies and offer a reasoned explanation for rejecting them**

The APA requires an agency engaged in a rulemaking proceeding to consider less restrictive, reasonable alternatives for its chosen policies and offer a reasoned explanation for rejecting them. The Proposed Rule fails to address alternatives to achieve its stated policy goals. For example, with respect to the proposed broker compensation disclosures, the Proposed Rule does not adequately assess the merits of several clear alternatives, including those already provided by current or proposed law and industry practice, and those presented by the Federal Reserve Board in its proposed amendments to Regulation Z, with which the Proposed Rule stated it would be coordinated.

The Proposed Rule's failure to consider such alternatives must be remedied if it is to withstand scrutiny under the APA. The Proposed Rule must consider a full range of alternative means to achieve the articulated policy goals and subject each of those possible alternatives to rigorous examination to determine, based on all available studies and the most thorough empirical research, which alternative best achieves the policy objectives. In particular, HUD must carefully consider data and quantifiable evidence produced by other government agencies with particular expertise in the subject area or independent academic researchers whose backgrounds permit them to make an informed and disinterested assessment of the relevant facts.

[18] 5 U.S.C. § 553(c).

### iii. The Proposed Rule's unsubstantiated allegations about the conduct of mortgage brokers suggests impermissible prejudgment by HUD

In the Proposed Rule, HUD makes harsh, unsubstantiated allegations about improper conduct among "many" brokers, and speculates, without basis, about what brokers "*may* even assert".[19] No other mortgage originator—indeed, no other participants in mortgage markets—are singled out for such impugning. HUD's comments are so remarkable that they suggest an impermissible prejudgment of how to proceed with respect to the Proposed Rule. The content of HUD's language suggests that mortgage brokers as a class should be a particular target of any RESPA regulations, and the tone of HUD's statement suggests that no public comments are likely to alter that view, notwithstanding, for example, overwhelming evidence of the convergence of the role of mortgage originators and the need to treat all originators similarly.

Under the APA, the proposition is well established that a rulemaking is not valid if the agency has "an unalterably closed mind on matters critical to the disposition of the proceeding."[20] As the District Court in the Eastern District of California recently noted in discussing "troubling" evidence of prejudgment in a HUD rulemaking, "Allowing the public to submit comments to an agency that has already made its decision is no different from prohibiting comments altogether."[21]

To remove that taint, HUD must not only show that "many" mortgage brokers engage in the conduct alleged through data that is more compelling than ""flimsy anecdotal evidence".[22] In addition, HUD also must show why other participants in mortgage markets do not share culpability with those brokers, if any, who act as HUD suggests.

### iv. The Proposed Rule solicits significant new data or other information relevant to its provisions, impermissibly denying the public the opportunity to comment

On numerous points, the Proposed Rule solicits significant new data or other information relevant to its provisions. Although HUD should seek that information, that is only the first step in the rulemaking process. In addition, commenters on the Proposed Rule must also have the opportunity to review and comment on any studies or data upon which HUD relies in developing any proposed regulations. By soliciting information in the Proposed Rule, rather than gathering it earlier and presenting it in the Proposed Rule, HUD is impermissibly denying commenters essential input into the final rule. Unless the public is afforded that opportunity, the Proposed Rule cannot stand under the APA.

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[19] 73 Fed. Reg. at 14,042 (Emphasis added).

[20] *See Alaska Factory Trawler Ass'n v. Baldridge*, 831 F.2d 1456, 1467 (9th Cir. 1987) (citing Ass'n of Nat'l Advertisers, Inc. v. FTC, 627 F.2d 1151, 1170 (D.C. Cir. 1979)).

[21] *Nehemiah v. Jackson*, Civil Action No. S-07-2056 LKK/DAD (D.E.D. Ca. 2008) at 31, 33.

[22] *See AmeriDream v. Jackson*, Civil Action No. 07-1752 (PLF)(D.D.C. 2008) at 18 (holding that "flimsy anecdotal evidence 'is not sufficient to enable [the Court] to conclude that the [Final Rule] was the product of reasoned decisionmaking.'"; *citing Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. at 43.

**v. HUD must repropose its revisions to the regulations implementing RESPA to permit public comment on rationales and supporting data not presented not in the Proposed Rule**

Given the extent and materiality of the Proposed Rule's (i) failure to articulate an adequate rationale and supporting basis for key provisions; (ii) failure to consider less restrictive, reasonable alternatives for its chosen policies; and (iii) solicitation of significant new data or other information relevant to its provisions, those shortcoming can only be remedied by presenting another proposed regulation which includes all material information that HUD may regard as a basis for a final rule.

**vi. HUD must address key questions before moving forward in the rulemaking process**

In reproposing the Proposed Rule, HUD must not simply present its updated research or discuss alternatives, it must also address the policy concerns raised by the proposed Rule's provisions. Particular attention must be given to those legitimate objections that have been raised by commenters.

The Proposed Rule presents many important questions and prompts many legitimate objections. For example, how does HUD justify basing the Proposed Rule on vestigial distinctions between brokers and lenders that are no longer meaningful, creating market dysfunction which the Proposed Rule should seek to remedy, not exacerbate? Similarly, how does the Proposed Rule explain how consumer interests are protected, and comparative shopping encouraged, by creating a systemic preference for originators that are not required to disclose their compensation over those that are required to disclose?

Prior to finalizing any regulation, HUD must respond to those questions and many others raised in this comment letter. NAMB looks forward to that response, and is committed to continuing to work with HUD and this Committee to develop policies that best serve the public interest.

## IV. Specific Proposals Negatively Impacting Small Business Mortgage Brokers

### A. Yield Spread Premiums ("YSP")

The Proposed Rule reclassifies YSP as a credit to the borrower. The practical effect of this change is to put mortgage brokers at a competitive disadvantage by imposing asymmetrical disclosure obligations among originators receiving comparable compensation. Recharacterizing YSP as a credit to the borrower also may invite gamesmanship by competing originators that may create, rather than eliminate, confusion among consumers.

The Proposed Rule perpetuates the basic inequity between broker and lender transactions that exist in the marketplace as regulated under RESPA. Despite the fact that almost all originators act as brokers (even temporarily) in the "originate to distribute"[23] marketplace, the Proposed Rule will maintain, and accentuate, the difference between a broker transaction (disclosure of

[23] Broker Regulations Analysis at 5, n.4.

YSP) and a lender transaction (no disclosure of similar in-direct payments – *i.e.*, Service Release Premium ("SRP")). The era of clear differentiation between competitors in the mortgage market is gone. This arbitrary distinction represents a fatal flaw in the Proposed Rule.

NAMB urges HUD and this Committee to treat direct competitors the same and remove this artificial distinction between originator transactions, which overwhelmingly disadvantages small business mortgage brokers. In today's market originators across channels act in the same capacity, use the same computer software and perform the same functions. By accentuating the form of disclosure over the function of the marketplace, the Proposed Rule seeks to reinforce a difference without a distinction. The Proposed Rule disadvantages small businesses by maintaining and accentuating the distinction between broker and lender transactions.

In addition, exhaustive studies of mortgage disclosures by the Federal Trade Commission ("FTC"), the government's principal consumer protection agency, in 2004 and 2007[24] show that additional disclosures of mortgage broker compensation created confusion, caused consumers to choose more expensive loans, led to a bias against broker-assisted transactions, and impeded competition, thus hurting consumers. In order to promote comparison shopping, and meet the objectives for the Proposed Rule, there should be a corresponding requirement for lenders to disclose compensation paid to their own sales staff. Fees similar to the YSP are present in any mortgage origination distribution channel, regardless of whether a broker is involved.

Requiring brokers, but not other loan originators, to make compensation disclosures enable the brokers' competitors to steer consumers away from brokers, even if brokers offer more favorable loans. In addition, this policy will inhibit competition, limit consumer choice, increase prices, and hurt borrowers. For these reasons, NAMB believes the FTC should conduct a through analysis and field testing to ensure the market remains competitive and new disclosures do not lead to biases or fraudulent practices between distribution channels.

### B. Volume Discounts

Volume Discounts disadvantage small business. Negotiating discounts based on how much volume an originator produces disadvantages small business originators. Naturally the larger entities in the marketplace will be able to obtain larger discounts due to the volume of loans they originate. Thus placing small business originators at a disadvantage because they cannot offer the same volume to service providers they cannot offer the same discounts to their consumers.

In the short run, this practice may reduce the competitiveness of small business. In the long run, if smaller players are not able to compete, larger players will raise prices. The policy may initially save consumers money however, overtime the policy will likely harm consumers because it will force small businesses out and limit the market to a few large entities leaving consumers with limited choice.

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[24] James M. Lacko & Janis K. Pappalardo, The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment (2004)("2004 FTC Study"); James M. Lacko & Janis K. Pappalardo, Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms (2007)("2007 FTC Study").

## V. Conclusion

Again, thank you for the opportunity to appear before this Committee today to discuss this timely issue. I am happy to answer any questions that you may have.

**Testimony of Julia Gordon**
**Center for Responsible Lending**

**Before the U.S. House of Representatives**
**Committee on Small Business**

**"RESPA and its Impact on Small Business"**

***May 22, 2008***

Chairwoman Velázquez, Ranking Member Chabot, and members of the subcommittee, thank you for holding this hearing on RESPA.

I am Policy Counsel at the Center For Responsible Lending (CRL), (www.responsiblelending.org), a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help (www.self-help.org), which consists of a credit union and a non-profit loan fund.

For the past 28 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get home loans. In other words, we work to provide fair and sensible loans to the people most frequently targeted for predatory and abusive subprime mortgages. Self-Help has provided over $5 billion of financing to 60,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Although Self-Help is technically a subprime lender, its responsible lending practices keep its annual loan loss rate under one percent – far less than the typical subprime loss rate.

In addition to making direct loans, Self-Help encourages sustainable loans to applicants with blemished credit through a secondary market operation. Self-Help buys high-risk loans from banks, holds on to the credit risk, and resells them to Fannie Mae. Self-Help has used the secondary market to provide $4.5 billion of financing to 50,000 families across the country, loans that have performed well and increased these families' wealth.

Today, as the U.S. economy faces significant challenges, there has never been a stronger need to ensure a transparent accounting of costs in real estate transactions. Right now, it is estimated that 20,000 foreclosures on subprime mortgages take place every single week.[1] The negative spillover effects from these foreclosures are substantial: property values are dropping by billions of dollars, crime is up in high-foreclosure communities, cities are losing their tax bases, and millions of Americans who depend on a robust housing market are losing jobs and income. As foreclosures accelerate during the next two years, these economic effects will be felt even more strongly.

As an affiliate of Self-Help, we appreciate the impact the requirements of the Real Estate Settlement Procedures Act (RESPA) may have on relatively small lenders. At the same

time, we understand that confusing, misleading, and inaccurate information has played a contributory role in this crisis, and we believe that reforms to the current disclosure requirements are long overdue.

We must acknowledge, however, based on overwhelming evidence, that poor disclosure has not been the sole, or even the most destructive, culprit in the slew of forces that has brought us all to where we are now. Inadequate disclosure has been only part of a broader system of skewed incentives that have encouraged brokers and lenders to steer consumers into the riskiest, highest cost loans available – because investors paid the most for these loans. Brokers could wash their hands clean of them as soon as they collected their origination fees and lenders could do the same as soon as they sold them off into the secondary market.

In these comments, I will offer the following recommendations:

- **Coordinate with the Federal Reserve Board (FRB).** It is crucial to coordinate the information disclosure requirements of RESPA and the Truth-in-Lending Act (TILA). HUD and the FRB must consider how best to harmonize these disclosures to avoid yet more confusion for consumers.

- **Eliminate yield-spread premiums that do not offer benefits to consumers and significantly improving disclosure.** CRL believes that, at least in the subprime market, lender-paid origination fees to brokers, known as yield-spread premiums, constitute impermissible kickbacks under RESPA. Although we do not believe better disclosure will necessarily avert the harm caused by the yield-spread fee incentive system, we offer a few recommendations to strengthen the proposed disclosure. Our recommendations concerning yield-spread premiums are confined to subprime mortgages, and would have no effect on mortgages made in the prime market.

- **Add key information to the Good Faith Estimate (GFE)**: Because consumers shop primarily on total monthly payment, the GFE needs to include that number and ensure that it accurately states the true, grand total monthly housing payment. We also are concerned that the proposed GFE focuses so much on settlement costs that it does not give proper weight to the cost of credit over time. The total cost of the loan is a function of both origination cost and interest rate. We therefore recommend to HUD that the annual percentage rate (APR), which factors in both some settlement costs and the note interest rate, be included on the GFE.

- **Strengthen protections related to the closing script**. While we support efforts to ensure that the consumer understands the mortgage, we cannot rely on this script to do so. Therefore, we offer several protections that will ensure the script does not cause more problems than it solves.

- **Pass along discounts**. We support volume-based discounts as long as those discounts are passed along to the consumer.

- **Charge consumers an average price only when the originator pays an average price.** *Average cost pricing*, i.e., passing along a price paid to a third party as an average, is fine, but *average pricing*, i.e., paying a specific price to a third party but charging the consumer an average, is not.

- **Ensure adequate enforcement to ensure that RESPA does what it's meant to do**. Not only should Congress add or enhance civil penalties and equitable relief under several sections of RESPA, but it should add a private cause of action for all elements of the RESPA requirements.

**I. The misaligned incentives and predatory lending of recent years have caused not only a foreclosure crisis in the housing market, but a national and international economic crisis.**

It seems like a distant memory, but less than one year ago, some in the mortgage industry were still insisting that the number of coming foreclosures would be too small to have a significant impact on the economy overall.[2] No one makes that claim today. As foreclosures reach an all-time high and are projected to grow higher,[3] the "worst case is not a recession but a housing depression."[4] At least two million American families are expected to lose their homes to foreclosures initiated over the next two years.[5] Industry projections forecast that by 2012, 1 in 8 mortgages – that's all mortgages, not just subprime mortgages – will fail.[6]

Recent data shows that 30% of families holding recent subprime mortgages now owe more on their mortgage than their home is worth.[7] These families are at an increased risk of foreclosure because "negative equity" precludes the homeowner from selling, refinancing or getting a home equity loan or other mechanism for weathering short-term financial difficulty.[8]

As we show in our recent report on the "spillover" effect of subprime foreclosures, the negative effects of foreclosures are not confined to the families who lose their homes. Forty million of their neighbors will see their property values decline as a result by over $200 billion.[9] Federal Reserve Chairman Ben Bernanke recently noted

> At the level of the individual community, increases in foreclosed-upon and vacant properties tend to reduce house prices in the local area, affecting other homeowners and municipal tax bases. At the national level, the rise in expected foreclosures could add significantly to the inventory of vacant unsold homes—already at more than 2 million units at the end of 2007—putting further pressure on house prices and housing construction.[10]

Robert Schiller recently noted that the meltdown and resulting crisis has erased most of the gains in the homeownership rate since 2001, which stands to fall further yet.[11] Even

more ominous, according to the IMF, direct economic losses stemming from this crisis will likely top $500 billion and consequential costs will total close to a trillion dollars.[12]

Sadly, many of the families losing their homes to foreclosure today might not have found themselves in this position if they had been given the type of loan that they actually qualified for. Last year, the Wall Street Journal found that of the subprime loans originated in 2006 that were packaged into securities and sold to investors, 61% "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[13] Even those applicants who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate loans for -- at most -- 50 to 80 basis points above the "teaser rate" on the unsustainable exploding ARM loans they were given.[14] Indeed, many consumers were charged 100 basis points more for "no-doc" loans when they had already handed over their W-2 statements or readily would have done so, but for the broker's desire to originate these riskier loans. That made the typical risky adjustable rate subprime loan more expensive than far safer thirty-year fixed-rate loans *even at the initial payment.*

Wall Street's appetite for risky loans incentivized mortgage brokers and lenders to aggressively market these highly risky ARM loans instead of more sustainable loans. As Alan Greenspan told Newsweek:

> The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime loan market would have been very significantly less than it is in size.[15]

Market participants readily admit that they were motivated by the increased profits offered by Wall Street in return for risky, higher-yielding loans. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the New York Times, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?"[16] Even the chief economist of the Mortgage Bankers Association, when asked why lenders made so many loans that they knew were unsustainable, replied, "Because investors continued to buy the loans."[17]

In short, this crisis was caused by loan originators selling unnecessarily risky loans to homebuyers and homeowners who did not understand what they were getting into, either because they were affirmatively misled or because the information they were given was simply too complex and voluminous. We believe that a primary role of RESPA reform should be to make such steering less likely by providing potential homebuyers with the clear and concise information that will help them fully understand their mortgage options. We note that even improved disclosure, however, will not provide sufficient protection to consumers dealing with complex mortgage transactions, particularly when they are subjected to inherently abusive practices and provisions. Only substantive protections, in

addition to improved disclosures, can adequately protect consumers, curb abusive lending practices, and restore health to the market.

**II. HUD needs to coordinate disclosure requirements with the Federal Reserve Board's HOEPA rules.**

Nearly ten years ago, HUD and the FRB recognized the importance of coordinating the information disclosure requirements of RESPA and the Truth-in-Lending Act (TILA). [18] One set of disclosures focuses on the overall cost of the loan, while the other focuses solely on closing costs (an important part of any loan, but not the biggest cost item of a mortgage), but the consumer must digest and make sense of them both.

For close to a year now, the FRB has been working toward issuing rules for mortgage origination under the authority delegated to it by HOEPA. There have been several rounds of public comment and discussion, culminating with the promulgation of rules that are expected to be issued in final form this July.[19] One of these rules establishes a required disclosure of anticipated broker origination fees prior to a consumer paying any fees to a broker.[20]

Especially since the proposed RESPA changes also relate to disclosure of origination fees, we strongly suggest that HUD await the issuance of the final FRB rules and attempt to coordinate the RESPA disclosures in such a way that works with any new FRB disclosures.[21] Given the enormous confusion already faced by consumers in relation to yield-spread premiums, it is crucial that HUD and the FRB harmonize these disclosures to avoid yet more unnecessary and costly confusion for consumers.

**III. It is crucial that the GFE disclosures facilitate understanding of the riskiest features of the loan.**

**A. The GFE should include total monthly payment information in a clear and conspicuous location.**

The vast majority of consumers shop for a mortgage focusing not on rates or settlement costs or other loan features, but on the one key number that signals to them whether they can afford the loan: the grand total that they will have to pay each month for their home. Most people know how much income they take home each month, and they try to figure out whether out of that monthly amount, the monthly mortgage payment will fit into their budget.

Unscrupulous lenders fully understand the desire to shop on monthly payment amounts, and one of the ways to sell abusive loans is by failing to include certain costs in the "total" for the monthly payments. For example, many subprime lenders do not require escrow for property taxes and insurance, which makes the monthly total appear very low in comparison to totals that included the full PITI. This deception has been particularly useful for lenders seeking to refinance people out of an existing loan into a loan that looks cheaper, but is in reality much more expensive.

The new RESPA rules propose that the GFE disclose the monthly total of principal, interest, and mortgage insurance. We recommend that the GFE also disclose the estimated monthly payment for property taxes and insurance as well as a grand total of principal, interest, taxes, and all insurance. For any adjustable rate mortgages, the GFE should present a grand total both for the initial monthly payment and for the maximum monthly payment that could be reached under the loan terms.

**B. The GFE must include the Annual Percentage Rate (APR) and reduce its disproportionate focus on settlement costs.**

While consumers look first to the total monthly payment in assessing loan affordability, to the extent that they shop in any more detail at all, they are accustomed to looking at the APR. The APR is used in disclosures of other, more routine, consumer transactions, such as credit cards and auto loans, and consumers are familiar with it.

While looking at the note rate might be helpful to some extent, we believe that the APR is far more representative of the total cost of the loan than the note rate, as it puts the closing costs in context. Further, it enables an apples-to-apples comparison of loans in a single price tag, rather than by comparing the components of the price tag one by one, as is the case when the stand-alone note rate and settlement costs are the sole focus of the disclosures. The GFE should therefore disclose the APR instead of the note rate to give consumers some ability to shop based on the total cost of the loan.

Further, HUD should un-bold and un-shade the "Total Estimated Settlement Charges" figure at the bottom of page one. Such emphasis on this figure will give consumers the impression that settlement charges are the most important cost to consider when selecting their loan, when in reality the APR is the far better measurement of the entire cost of the loan. While we understand how important settlement costs are, they are not the major price component of a mortgage loan, and the "cheapest" settlement costs may, or may not be the cheapest loan. (As we discuss below, this is particularly the case when settlement costs include charges that ostensibly buy up, or buy down, a rate.)

**C. The GFE must disclose the first possible date on which the interest rate can rise on page one.**

In most adjustable rate loans, an increase in the monthly payment will follow an increase in the interest rate. Where it does not, as in payment option ARMs, it is still important that the consumer understand that the typically very low initial interest rate will likely last a very short time, usually just a few days or weeks. Therefore, the GFE should disclosure the first possible date on which the interest rate could rise, both to warn borrowers when they should be prepared to meet a higher monthly payment obligation and to alert them to the fact that some "teaser" rates are extremely ephemeral.

**D. In disclosure of prepayment penalties, the GFE also needs to explain what they are and how they are triggered.**

In its new rules, HUD recommends that the GFE include disclosure of whether or not there is a prepayment penalty and, if so, the maximum amount of the penalty, on the first page. We commend HUD for adding this disclosure, because prepayment penalties have played the nefarious role of locking millions of customers into overly risky loans. In our comment to HUD, we will recommend some improvements to help explain the fee.

**E. In crafting RESPA rules, HUD should take into account that yield-spread premiums have been a primary driver of the subprime fiasco.**

Although we are glad to see the effort to improve the disclosure of the service charge brokers earn from lenders in the first chart, "Your Loan Details," on the top of page two of the proposed GFE, we believe that the proposed disclosure of the service charge and the "credit or charge for the specific interest rate chosen" is misleading and confusing and must be simplified.

In the Proposed Rule, HUD explains its desire to avoid disadvantaging mortgage brokers in the marketplace through its treatment of the service charge disclosure: "Many mortgage brokers offer products that are competitive with and frequently lower priced than the products of retail lenders, as evidenced by brokers' large and growing share of the loan origination market, and HUD wishes to preserve continued competition and lower cost choices for consumers."[22]

While this claim may be true in the prime market, empirical evidence demonstrates that in the subprime market, nothing could be further from the truth. In April, CRL released a study that found subprime borrowers pay *significantly* more for loans when using an independent broker than a retail lender.[23] In summary, subprime borrowers steered into higher rate loans pay additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[24] And it doesn't take long for the disparity to become significant: at the four-year mark, a time period chosen to reflect average loan life, the difference in costs is stark: $5,000.[25]

What was the primary driver of this inequity? We believe it is the yield-spread premium. Simply put, Wall Street investors were willing to pay more for ARMs with prepayment penalties that locked borrowers into riskier, higher-rate loans. To satisfy this demand, lenders used yield-spread premiums to reward brokers for steering consumers into higher-rate loans than those for which they qualified, and then rewarded them even more for locking in those higher rates with a prepayment penalty. The high penetration of potentially dangerous loan products in the subprime and nontraditional markets is inextricably linked to the distortions produced by these perverse incentives.

Our data did not permit us to examine the relationship between yield-spread premiums and direct broker fees, but prior studies indicate that yield-spread premiums on subprime loans do not serve to reduce fees significantly. One study has shown that borrowers only receive 25 cents in reduced fees for every one dollar paid in yield-spread premiums to brokers and that upfront fees are actually lower for retail loans than for brokered loans.[26]

Most subprime loans carry significant direct upfront broker fees *along with* the yield-spread premium. They compensate the broker at both the front and back end, essentially buying the rate down, then buying it right back up.

This understanding of the way yield-spread premiums have operated in the market informs both our recommendations for HUD as to RESPA revisions, and our recommendations to the Federal Reserve Board as to the proposed HOEPA UDAP rules. In both cases, we hope the agencies will address the fundamental problem, not merely try to improve the gloss.

**1. Yield-spread premiums, when paid in exchange for nothing but a higher interest rate or inclusion of a prepayment penalty, constitute illegal kickbacks under Section 8 of RESPA.**

It is our long-held position that yield-spread premiums, when paid in conjunction with direct broker compensation or other closing costs or made contingent upon inclusion of a prepayment penalty, essentially overcompensate brokers in a way that is not transparent to consumers. In RESPA terms, it does not constitute a fee in exchange for any goods, services, or facilities as required by Section 8. The premium is either duplicative, or, in fact, may be paid for the "service" of steering consumers into higher-cost or riskier loans than those for which they qualify. Again, to put that in RESPA terms, we believe that such yield-spread premiums violate RESPA's prohibition on kickbacks.

HUD in the past has said that yield-spread premiums are not compensation for services if they simply pay for "delivering a loan with a higher interest rate."[27] Rather than *assuming* that a yield-spread premium is a price trade-off, we believe that it is incumbent upon HUD to *require* that it be so, by clearly identifying the circumstances in which it is a "kickback" instead of compensation for services. Just as we hope the FRB will ensure that the purported trade-offs are real, we urge HUD to do the same.[28] Our research suggests that such a requirement would help curb the abuses in the subprime market without interfering with the legitimate practice as it may prevail in the prime market.

**2. The indirect compensation to a broker should be explicitly disclosed and should not suggest a price trade-off benefit of lower origination costs unless such trade-off actually exists.**

The proposed disclosure of origination fees is structured as if there is definitely a price trade-off between back-end fees paid to the originator by the lender and upfront closing costs. As discussed above, while this purported price trade-off may occur in the prime market, it virtually never occurs in the subprime market.[29] The proposed disclosure even refers to the yield-spread premium as a "credit," which we believe is misleading since the premium in fact results in an increase in costs. Indeed, even when there is a real price trade-off, a yield-spread premium is not a "credit," but an alternative method of payment,[30] one which, in the long run, could result in higher overall loan costs.

We hope that HUD will assure that real benefits accrue through clarifying when a yield-spread premium is a "kickback". Improvements to disclosures must follow reform of practices. Only then do we believe that the disclosure of indirect broker compensation can assume a price trade-off.

**F. The GFE should educate consumers about their right to negotiate with mortgage originators**

While we hope that an improved GFE and other RESPA rules can facilitate mortgage shopping, the fact is, most consumers, especially those working with a mortgage broker, do not shop extensively for loans, and many of them do not understand that mortgage costs and rates are negotiable. The formal format of the proposed GFE may play a role in suggesting that the costs disclosed are fixed and are standard terms offered to every customer, much like the price of a gallon of milk. Because loan applicants need to understand that their mortgage terms are negotiable, we will recommend that the GFE provide consumers with that valuable information.[31]

**IV. Prescribed tolerances will help prevent unwelcome surprises at the settlement table.**

As HUD recognizes with these rules, a significant problem for consumers is what is often a complete disconnect between the costs disclosed in the GFE and the costs appearing later on the HUD-1. Establishing realistic tolerances for the maximum percentage that originator-controlled costs can change from the GFE to the HUD-1 is an excellent way to prevent this most unwelcome surprise.

We would like to propose that the tolerance be calculated on each item rather than in the aggregate. Calculating the tolerance in the aggregate could still permit very significant changes in one or two cost categories. We believe a 10% tolerance on each item will make manipulation by originators less likely and thus do more to protect consumers.

It is true that for many reasons, consumers find it easier to look at total amounts rather than many different line items, and calculating the tolerance on each item may cause some confusion. Therefore, we propose that consumers also be presented with a total percentage change highlighted in a conspicuous manner at the top of any itemization of tolerances.

**V. Volume-based discounts may offer value to the consumer, but safeguards are essential.**

CRL believes that volume-based discounts may offer value to homebuyers, but this value is only realized if the cost savings are passed on to the consumer rather than retained by the lender. We commend HUD for requiring that all savings be passed through to the consumer and for further requiring that, if a violation is alleged, the burden is on the settlement provider to demonstrate compliance.

However, we remain concerned that discounts may lead originators to steer consumers to certain settlement service providers, limiting their choices. We would therefore support additional safeguards to ensure that volume-based discounts in fact benefit the borrower.

**VI. Average cost pricing is fine, but *average pricing* is not, and the actual cost charged to the consumer must be the cost disclosed on the HUD-1.**

We agree with HUD that average cost pricing may benefit consumers. However, in the Proposed Rules, HUD appears to use the terms *average cost pricing* and *average pricing* interchangeably, and we do not support average pricing. In the industry, average cost pricing generally describes an arrangement between an originator and the third-party settlement service provider whereby the service provider charges the originator an average price each time the service provider performs the service for the originator. Therefore, the originator pays the same amount for each consumer, and that amount is the cost disclosed on the HUD-1. We do not object to this method.

In its proposal, however, HUD appears to attempt to allow *average pricing*, whereby the originator charges the consumer an average cost while paying the third party settlement provider a different amount for each loan applicant. We believe there is no reason that the originator should not charge the actual cost of the third party service and reflect such cost on the HUD-1, as the vast majority of all settlement costs are known at the time the HUD-1 is completed. We further believe that RESPA requires such treatment. Therefore, we recommend that HUD clarify its proposal and ensure that *average pricing* is not allowed.

We also believe that even average cost pricing is inappropriate for certain costs that are partially dependent upon loan amount, such as title insurance premiums, recording costs, and transfer taxes, since average cost pricing would disadvantage those people purchasing or refinancing less expensing homes.

**VII. Without additional protections, the risks entailed by this closing script may outweigh the benefit of providing an oral explanation to the consumer at settlement.**

Given the extensive damage wrought to the international economy by the failure of lenders to explain highly complex loans to consumers, a clear, oral explanation of the loan seems both obvious and crucial. We commend HUD's efforts, and we agree that the opportunity for consumers to hear an oral explanation and ask questions is more effective than being handed a stack of forms with no discussion. However, in practice, it is difficult to figure out how to require such an explanation.

First, there is the possibility that closing agents or settlement attorneys might fail to read through the closing script in a meaningful way that adds to the consumer's understanding. Second, the agent or attorney might fail to read it at all, yet the consumer might still unwittingly sign it as part of the barrage of other signatures required at closing or might be persuaded to sign it as just another "meaningless government form."[32] Third, the agent or attorney themselves might not fully read through the loan documents and

therefore provide the consumer with incorrect information received from the lender. Fourth, the existence of the signature might be used in court as evidence that the consumer understood the loan, even if that is simply not the case.

If this script is to be required, we strongly recommend that it does not have a consumer signature requirement. Alternatively, the rules should clarify that the borrower's signature is not conclusive evidence that the disclosures were made.

In addition, HUD should clarify that the lender is ultimately liable for any inaccuracies in the closing script. While we believe closing agents and settlement attorneys do have a duty to understand the loan that they are closing, reality suggests that sometimes, that understanding might be less than complete. If closing agents and settlement attorneys are the sole actors liable for inaccuracies in the closing script, the lender has no incentive to ensure that the agents or attorneys fully understand the loan. Additionally, most closing agents and settlement attorneys will be thinly capitalized, and if liability rests solely with them, it is unlikely that consumers will be able to be compensated for violations of the law. Thus, we recommend the new rules establish that the lender is jointly liable along with the closing agent or settlement attorney for the proper exercise of the closing script.

Finally, if a closing script is used, it must disclose and explain the APR. It must also prominently disclose the borrower's right to rescind through language similar to that contained in the Right to Cancel Notice required by the Truth in Lending Act.

**VIII. Civil penalties, injunctive relief, equitable relief, *and* a private cause of action – particularly with respect to the GFE and HUD-1 – are vital to the effectiveness of RESPA.**

RESPA violations are notoriously underenforced at this time. Consequently, we are glad to see that HUD is planning to ask Congress to provide for civil penalties, injunctive relief, and equitable relief for several sections of RESPA. However, unless a private right of action is also included for all sections of RESPA, enforcement will continue to be minimal and RESPA violations will continue to be rampant throughout the industry. Given the volume of mortgage lending in this country – and the credit crunch will heal some day – there will never be enough public resources to rely solely on public enforcement.

Therefore, we recommend that Congress add a private cause of action to RESPA, especially with respect to the HUD-1 and GFE, by codifying that the violation of those provisions constitutes an unfair trade practice, as some states have done. Absent the availability of a private cause of action, relief to borrowers taken advantage of by abusive lending practices is often completely out of reach.

## CONCLUSION

In conclusion, we commend HUD for addressing the challenge of reforming RESPA. We believe the proposed GFE provides several important improvements over existing

requirements. At the same time, we are hopeful that HUD will take our recommendations to heart. While we remain convinced that disclosure alone cannot solve the perverse incentives pervasive in today's mortgage market, we hope that HUD will shape its disclosure requirements with the aim of alerting those whom RESPA is designed to protect to the most hazardous loan terms that have been most detrimental to homeowners, the housing market, and the overall economy.

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[1] *See* Written Testimony of Mark Zandi, Moody's Economy.com before House Subcommittee on Commercial and Administrative Law (January 28, 2008), available at: http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; *See also* Center for Responsible Lending , Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[2] *See, e.g.*, Statement of John M. Robbins, CMB, Chairman, Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, DC (May 22, 2007) (Speaking of predicted foreclosures, Mr. Robbins stated: "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy."); Julia A. Seymour, "Subprime Reporting , Networks blame lenders, not borrowers for foreclosure 'epidemic,'" Business & Media Institute (Mar. 28, 2007) ("[T]here are experts who say the subprime 'meltdown' is not the catastrophe reporters and legislators are making it out to be. 'We don't believe it will spill over into the prime market or the U.S. economy,' said [Laura] Armstrong [Vice President, Public Affairs] of the Mortgage Bankers Association.").

[3] Renae Merle, Home Foreclosures Hit Record High, Washington Post, March 6, 2008.

[4] David M. Herszenhorn and Vikas Bajaj, "Tricky Task of Offering Aid to Homeowners," The New York Times (Apr. 6, 2008) (quoting Susan M. Wachter, a real estate finance professor at the Wharton School of the University of Pennsylvania. According to Professor Wachter, "In the market that we have in front of us, prices decline and supply increases, driving prices down further.").

[5] *See* Written Testimony of Mark Zandi, Moody's Economy.com before House Subcommittee on Commercial and Administrative Law (January 28, 2008), available at: http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; *See also* Center for Responsible Lending , Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[6] Rod Dubiksky, Larry Yang, Wen Zhang and Thomas Suehr, *Foreclosure trends – a sobering reality*, Credit Suisse, Fixed Income Research (April 23, 2008).

[7] Edmund Andrews, Relief for Homeowners is Given to a Relative Few, New York Times (March 4, 2008) (loans originated in 2005 and 2006).

[8] A recent Los Angeles Times article has called into question the widespread industry claim that people are simply walking away from underwater mortgages. However, when homeowners who cannot afford their abusive loans also have no options to refinance or modify, they are ultimately pushed into defaulting. Michael Hiltzik, Walk Away Homeowners May be Urban Myth, Los Angeles Times (March 10, 2008).

[9] *See* Center for Responsible Lending, Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[10] Statement of Federal Reserve Chairman Ben Bernanke on March 4, 2008, reprinted by Bloomberg.com and available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=apeU.0IaETdM ("Bernanke statement")

[11] Robert J. Shiller, *The Scars of Losing a Home*, New York Times (May 18, 2008), noting that the homeownership rate has fallen from 69.1% in 2005 down to 67.8% in the first quarter of 2008, nearly the 67.5% rate at the beginning of 2001.

[12] Christopher Swann, *IMF Says Financial Losses May Swell to $945 Billion,* April 8, 2008, *available at* http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=aK1zAj5FZ9lo.

[13] Rick Brooks and Ruth Simon, Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market, The Wall Street Journal at A1 (Dec. 3, 2007).

[14] January 25, 2007 letter from CFAL to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3.

[15] "The Oracle Reveals All," *Newsweek* (Sept. 24, 2007) pp. 32, 33.

[16] Vikas Bajaj and Christine Haughney, Tremors At the Door -- More People with Weak Credit Are Defaulting on Mortgages," The New York Times (Fri. Jan. 26, 2007) C1, C4.

[17] "Subprime Loans Defaulting Even Before Resets," CNNMoney.com, February 20, 2008. *See also* Atif Mian and Amir Sufi, *The Consequences of Mortgage Credit Expansion: Evidence from the 2007 Mortgage Default Crisis*, NBER Working Paper 13936, http://www.nber.org/papers/w13936; and Benjamin Keys, Tanmoy Mukherjee, Amit Seru and Vidrant Vig, "Securitization and Screening: Evidence From Subprime Mortgage Backed Securities, working paper (January, 2008)

[18] Joint Report to Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act, Board of Governors of the Federal Reserve System and the Department of Housing and Urban Development (July 1998).

[19] The proposed rules were published at 73 Fed. Reg. 1672 (January 9, 2008), and the public comment period closed April 8, 2008.

[20] *Id.*, Proposed Rule 226.36(a).

[21] Many advocacy groups, CRL included, have continued to advocate for a ban on subprime yield-spread premiums, at least in situations where the yield-spread premium is not a true trade-off for closing costs. While it may be unlikely, it is theoretically possible the FRB would take such an action, which is something that would require HUD to revise the RESPA rules accordingly.

[22] Real Estate Settlement Procedures Act (RESPA): Proposed Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs, 73 Fed. Reg. 14030-124 (March 14, 2008), hereafter "Proposed Rule,"at 14043.

[23] Keith Ernst, Debbie Bocian, and Wei Li, *Steered Wrong: Brokers, Borrowers & Subprime Loans* (Center for Responsible Lending, April 2008), hereafter *"Steered Wrong."*

[24] *Id.* at 16.

[25] *Id.* at 3-4.

[26] Howell E. Jackson and Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield-spread premiums*, 12 Stan. J.L. Bus. & Fin. 289, 332 (2007); *see also* Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 Harvard J. on Legis. 123, 139 n.94 (2007) and sources cited therein.

[27] 1999 Statement of Policy, affirmed in Statement of Policy 2001-1, 66 Fed. Reg. 53052, 53055 (Oct. 18, 2001).

[28] The language we suggested in our FRB comment for ensuring a trade-off was:

> "It is an unfair and deceptive practice to make or approve a mortgage loan that includes a yield-spread premium, or to collect a yield-spread premium imposed in violation of this paragraph, unless –
>
> (A) the mortgage broker receives no other compensation, however denominated, directly or indirectly, from the consumer, creditor, or other mortgage originator;
> (B) the loan does not include discount points, origination points, or rate reduction points, however denominated, or any payment reduction fee, however denominated;
> (C) the loan does not include a prepayment penalty; and
> (D) there are no other closing costs associated with the loan, except for fees to government officials or amounts to fund escrow accounts for taxes and insurance."

[29] CRL surveyed a listserv of hundreds of foreclosure attorneys, and of the thousands of subprime loans these attorneys had reviewed, there were literally not more than two or three loans where the higher rate and/or prepayment penalty actually reduced closing costs. Rather, the consumers paid numerous upfront fees and charges – more than typical in the prime market – ALONG with having a higher rate than that for which they qualified and a prepayment penalty.

[30] In fact, one of the sales tricks reported by an Ameriquest customer to a former assistant attorney general who is now one of my colleagues was to "upsell" the loan principal by $16,000 by pointing to two charges and saying that the extra $16,000 was "crediting" back those charges. In this, it is not dissimilar to the potentially confusing disclosure of "discount points," which nearly a third of survey respondents thought meant a discount to the settlement costs, not a fee *paid* that is supposed to [though sometimes does not] purchase a rate-buydown. James M. Lacko and Janis K. Pappalardo, *Improving Consumer Mortgage Disclosures*, at 34 (Federal Trade Commission, June 2007).

[31]Negotiations cannot work to a consumers' advantage when they do not know they are in a negotiable situation: it's hard to win a game if you don't know that it is a game. After all, we rarely haggle over prices at the grocery store or Wal-Mart. In Ian Ayres classic 1991 study on negotiations in car sales, he cited a study from the Consumer Federation of America that found that 37% of Americans did not know that the sticker price of a car was negotiable, and that African- Americans were almost twice as likely to be unaware of that fact than whites (61% of blacks did not know that, as opposed to 31% of whites.) Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 Harv. L. Rev. 817, 856 (1991).

[32] Predatory loan recipients often report that upon asking questions about a document that they didn't understand, they were told that it was just "red tape that the government requires" and that they shouldn't "worry' about it.

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**Testimony of**
**Peter J. Birnbaum**
**President, Attorneys' Title Guaranty Fund, Inc.**
**Regarding**
**HUD's Proposed Regulation**

**Before the**
**House Small Business Committee**

**May 22, 2008**

We offer herein our testimony on The Department of Housing and Urban Development ("HUD") "Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Settlement Costs."

It feels like Groundhogs Day. Just like 1992 and 2002, HUD has again proposed a rule that has laudable goals but miscalculates the marketplace turmoil and abuse it will unintentionally create.

Attorneys' Title Guaranty Fund, Inc. is a lawyer service organization that provides Title Insurance and Trust Services through more than 3,500 law firms throughout Illinois, Wisconsin and Indiana. The vast majority of these law firms are small businesses that rely on their title insurance business as an integral part of their income. Each of those firms provides title services as part of their representation of legal clients in the sale and purchase of their home. The consumer benefits by having legal counsel protecting their interests in what is invariably the largest financial transaction of their lives. In our forty-five years of business we have insured nearly three million real estate transactions through these law firms.

While we applaud HUD's efforts to make real estate transactions more transparent and understandable, we believe that the HUD proposal will undermine these otherwise laudable goals by embracing the special interests of a handful of big banks to the detriment of small businesses and consumers. The HUD proposal has serious flaws which will negatively impact consumer choice, clarity and transparency in real estate transactions, discourage shopping, increase settlement costs; and severely impair the ability of small businesses to compete in the settlement services industry.

We oppose the implementation of this rule for the following reasons:

**THE CLOSING SCRIPT WILL MANDATE THAT NON LAWYERS ENGAGE IN THE UNAUTHORIZED PRACTICE OF LAW.**

- The proposed closing script is to be read by the title company closer, usually a non-lawyer. In many states, sellers and buyers are represented by lawyers. In those states the Supreme Court or Legislature have mandated that the explanation of closing documents is the exclusive province of lawyers.

- By HUD's estimation, reading the closing script will add 45 minutes to the closing process. Increasing the time it takes to close the loan will result in longer increased costs. This directly conflicts with HUD's objective to reduce the cost of closing real estate transactions.

- The closing script shifts from the lenders to title companies, the burden of determining whether the lender's loan terms meet the terms laid out in the Good Faith Estimate but does not provide guidance on how settlement service providers should handle discrepancies. Additionally, settlement providers are not in a position to make that determination.

**LENDER PACKAGING WILL RESULT IN HIGHER PRICES / FEWER CHOICES.**

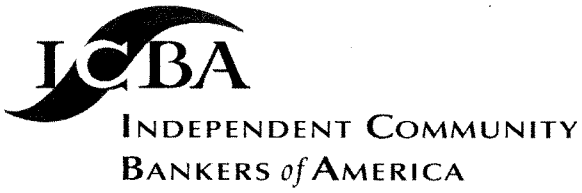
- By allowing negotiated discounts, we believe HUD has either intentionally or unintentionally provided an avenue for lenders to dominate the settlement service industry. Average cost pricing and the ability to bundle services provide lenders the opportunity to abrogate the consumers' ability to understand and distinguish the prices of the product for which they are paying. This will discourage shopping for settlement service providers. It will give near monopoly power to mortgage banks, the very entities that have brought the industry to the brink of collapse.

- GFE Tolerances: By providing zero tolerance for lender recommended settlement services and a 10% tolerance for non-lender recommended settlement services HUD is creating a scenario wherein purchasers are in an unequal bargaining position. It does not stretch credulity to imagine that most purchasers will feel pressured to defer these choices to the party lending them the money to buy their home. Again, this discourages shopping and will likely lead to less competition and higher prices. Additionally, the exact amount of the government recording and transfer tax charges are not known at the time the GFE is produced. Yet HUD provides zero tolerance for these fees. The settlement agent will be stuck having to determine whether they can close the loan based on a fee which will in most cases not match the actual closings cost.

**WHAT WE SUGGEST:**

We believe that a simplified Good Faith Estimate that is coordinated with the HUD-1 Settlement Statement is a good first step. We urge HUD to proceed with a rule embracing this concept but deleting the provisions relating to the closing script and price guarantees. That simplified rule would achieve HUD's goals without conferring a benefit on a particular class of providers. A benefit, that at the end of the day will harm consumers.

Thank you for your consideration.




# Independent Community Bankers of America

**Written Testimony**
**for the**

## U.S. House of Representatives
## House Small Business Committee
**hearing on**

# "RESPA and its Impact on Small Business"

**May 22, 2008**
**Washington, D.C.**

The Independent Community Bankers of America[1] (ICBA) welcomes the opportunity to share its preliminary views with members of the Small Business Committee on the Department of Housing and Urban Development's Proposed Rule, "Real Estate Settlement Procedures Act (RESPA): To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs." Our statement will focus on our general comments on the proposal's impact on community banks and other small businesses they rely on in the mortgage process.

The proposed rule is HUD's latest attempt to simplify and improve the disclosure requirements for mortgage settlement costs under RESPA. HUD intends its proposal to protect consumers from unnecessarily high settlement costs by improving and standardizing the Good Faith Estimate (GFE) form to make it easier to use for shopping among settlement service providers, to facilitate comparison of the GFE and the HUD-1/HUD-1A Settlement Statements, and to clarify HUD's current regulations concerning discounts and expressly state when RESPA permits certain pricing mechanisms that benefit consumers including average cost pricing and discounts, including volume based discounts, among other provisions.

ICBA has long supported mortgage disclosures that are simple and easy to understand, clearly specifying the obligations and responsibilities of all parties. Disclosures should focus on the information consumers want most: the principal amount of the loan, the simple interest rate on the promissory note, and the amount of the monthly payment. They should be provided at the appropriate stage of a transaction to allow consumers to make informed decisions and to shop for the best mortgage for their situation. ICBA has raised concerns that previous attempts to amend RESPA rules unfairly disadvantaged small lenders and settlement service providers. ICBA has similar concerns about this proposal.

The changes proposed by HUD are significant and will substantially change disclosures and elements of the mortgage transaction. They will cause significant disruptions to a mortgage industry already in turmoil. If HUD goes forward with the proposed rule, community banks and other small businesses will face significant burdens in implementing the changes due to changes in systems and forms and employee training. It will be far more difficult for community banks to absorb the costs as they have relatively low mortgage volume to spread the costs over as compared to larger loan originators.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

*With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.*

**Need for Consistency Among Laws, Regulations**
ICBA has serious concerns about the lack of consistency between this proposal and amendments to Regulation Z (Truth in Lending) recently proposed by the Federal Reserve. For example, proposed changes to Regulation Z address broker compensation in a different manner than does this proposal. In addition, requirements regarding when the lender must provide the consumer with a GFE rejection notice in the HUD proposal is inconsistent with the requirements of the Equal Credit Opportunity Act and the Fair Credit Reporting Act. Amendments to regulations implementing RESPA should be consistent with laws and regulations implementing the Truth in Lending Act, Home Ownership and Equity Protection Act, Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, and the Fair Credit Reporting Act. Lack of consistency among existing or proposed laws and regulations will further disrupt the industry.

**GFE Application**
HUD proposes that potential borrowers be provided a new GFE Application form comprised of items of information that the borrower would submit to receive a GFE. The GFE Application only provides the borrower's name, social security number, property address, gross monthly income, borrower's estimate of the house price, and the amount of loan sought. The loan originator would use this information to make an initial credit decision and provide the borrower a GFE. The borrower can only be charged a limited fee for providing the GFE, including the cost of an initial credit report. No other fees, such as for an appraisal or inspections, can be collected before the GFE is provided. Thus, to provide a GFE, the loan originator must complete more work than what HUD would allow them to be compensated for. This is particularly burdensome for smaller volume originators that may not have some of the automated systems used by large volume originators that provide cost efficiencies.

In addition, HUD proposes more paperwork for the loan originator in the event that the borrower requests changes in the loan identified in the GFE, such as changes to settlement charges and/or terms of the loan. The originator must then notify the borrower within one day of its decision to reject the loan. A revised GFE must be provided if another loan is available. Thus, a borrower could ask for information about an ARM versus a fixed rate loan, or slightly change the amount of the loan or the amount of points—all requiring a revised GFE. Borrowers with new homes under construction often make changes to the home before closing that necessitate changes to the loan and the generation of revised disclosures. Again, this will be more burdensome for smaller volume loan originators whose limited staff resources must generate this additional paperwork.

**Settlement Cost Tolerances**
The proposal would prohibit charges of loan originators at settlement from exceeding the amount listed as "our service charge" on the GFE, absent unforeseeable circumstances. And, originator required services where the originator selects the third party provider, originator required services where the borrower selects from a list of third party providers

identified by the originator, among other items, could not increase more than 10 percent at closing from the amount disclosed on the GFE, absent unforeseeable circumstances.

ICBA is concerned that these tolerances are too narrow and limited. What HUD sees as "unforeseeable circumstances" is not flexible enough to reflect what can and does change in many mortgage transactions between the time the GFE is provided and settlement. It appears that an originator could not pass along to the borrower increases in government recording and transfer charges that it has no control of, or the cost of additional work needed on an appraisal or survey (though the cost of a second appraisal is allowed). It will be far more difficult for smaller loan originators to absorb variances in these costs that cannot be passed on to borrowers due to their lower volume of loans (and thus income) as compared to that of larger volume market participants. The rule would provide the originator with the ability to provide new disclosures to the borrowers when costs rise due to unforeseen circumstances (defined in the proposal), but this may be costly and burdensome to the originator. As a result, some smaller volume lenders, such as community banks may find it is no longer profitable to continue to offer residential mortgages if they experience many costs that exceed tolerances. They may exit the market, thereby reducing competition and consumer choice.

**Discounts**

The proposal intends to clarify HUD's current regulations concerning discounts and expressly state when RESPA permits certain pricing mechanisms that benefit consumers including average cost pricing and discounts, including volume based discounts, for settlement services. ICBA is concerned that the use of average cost pricing and volume based discounts unfairly disadvantages smaller lenders and small businesses that provide settlement services.

ICBA strongly opposed a previous HUD proposal that permitted package pricing of settlement services due to concerns that it would create an environment where the largest originators and settlement service providers would drive out the smallest. Larger market participants have a greater ability to negotiate volume discounts for services needed in the settlement process than do smaller participants because of their size. ICBA remains concerned about the ability of smaller lenders and settlement service providers to compete against larger participants.

**Timing of Proposal**

While clearly there is a need to make appropriate changes to any parts of the mortgage lending business that are broken, we have serious concerns about implementing such broad changes during a time when lenders are working to help troubled borrowers restructure their loans so they can remain in their homes if possible. Significant changes are occurring in the Federal Housing Administration and other lending programs intended to address the problems in the mortgage industry. Many community banks have responded positively to these changes and are learning about the programs so to they can offer them to consumers in their communities. Community banks were not generally participants in subprime lending and did not engage in the irresponsible lending practices that placed borrowers in mortgages inappropriate for their financial situation. However,

community banks are stepping forward to assist these borrowers when able and are working to provide mortgages when other lenders have stepped aside.

If HUD goes forward with the proposed rule, community banks and other small businesses will face significant costs and burdens in implementing the changes due to changes in systems and forms, and training. It will be more difficult for community banks to absorb the costs as they have relatively low mortgage volume to spread the costs over as compared to larger loan originators. HUD's own analysis in Appendix II.C.3. *Savings and Transfers, Efficiencies, and Costs* notes that total one-time compliance costs to the lending and settlement industry of the proposed GFE and HUD-1 predominately will fall on small business ($390 million or 68% of an estimated $570 million to the industry).

We have serious concerns about the ability of community banks with limited staff resources to implement such broad RESPA changes concurrently with learning new loan programs and reaching out to help troubled borrowers, functions so important to getting our country out of the current mortgage credit crisis. In our view, it is the wrong time to make such drastic changes to the mortgage lending process.

**Summary**

Consumers need adequate and appropriate disclosure about the terms and costs of mortgages to enable them to understand the transaction and facilitate shopping for the best mortgage for their situation. HUD has proposed amendments to its RESPA rules that significantly and substantially change mortgage disclosures and elements of the mortgage transaction. These changes do not reflect the realities of the mortgage market and industry, may cause more serious disruption, and may increase the cost of homeownership at a critical time when lenders and borrowers are endeavoring to work through many challenges.

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May 21, 2008

The Honorable Nydia Velazquez
Chairwoman
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Velazquez:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am writing in conjunction with your Committee's hearing on the impact on small businesses from the Department of Housing and Development's (HUD) Real Estate Settlement and Procedures Act of 1974 (RESPA) regulations. We would like to express some of our concerns about the recently proposed RESPA rule changes.

NAFCU appreciates HUD's current efforts to update its RESPA regulations. We agree with HUD's goal to make RESPA disclosures easier to understand for consumers. However, we do not believe that the current proposed rule would accomplish this goal and urge the Committee to push HUD for further changes for the rule. We believe that aspects of the proposed rule would likely create more consumer confusion, while likely increasing the cost of lending for institutions, which must ultimately pass the cost on to borrowers.

At the heart of the current proposed rule is a requirement to use the proposed "Good Faith Estimate" (GFE) form. While the idea of a standard form is a good one, the proposed GFE form is far too long and detailed and will create confusion rather than provide simple information that borrowers can readily understand.

NAFCU believes that many aspects of the proposed rule would create or worsen consumer confusion because some of the required disclosures are inconsistent with disclosures required under other statutes, while at the same time unnecessarily creating more regulatory burden (and ultimately cost) on credit unions. For example, as HUD acknowledges, the monthly payments that the proposed rule would require to be disclosed is different from that which lenders must disclose under the Truth in Lending Act (TILA). The increased costs created by this discrepancy are likely to have a bigger impact on smaller lenders such as credit unions.

The Committee should call on HUD to ensure that any final rule amending its RESPA regulations clarifies that disclosures under other statutes than RESPA and those required

under RESPA are consistent, thus minimize confusion by borrowers and regulatory burden on lenders.

NAFCU appreciates this opportunity to share our comments with the Committee on the proposed rule to amend HUD's RESPA regulations. If we can answer any questions or provide you with additional information please call me or Brad Thaler, NAFCU's Director of Legislative Affairs, at (703) 522-4770.

Sincerely,

B. Dan Berger
Senior Vice President of Government Affairs

cc: The Honorable Steve Chabot

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