Testimony
to the
Subcommittee on Oversight and Investigations
of the
House Committee on Financial Services

regarding

HUD's Proposed RESPA Rule

by

on behalf of the low income clients of the
National Consumer Law Center
and the
National Association of Consumer Advocates

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by
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Chairman Watt, Congressman Miller, Members of the Committee, thank you for inviting me to testify today regarding HUD's proposed RESPA rule. My comments today are provided on behalf of the low income clients of the National Consumer Law Center ("NCLC"), as well as the National Association of Consumer Advocates.

The staff of NCLC applauds HUD for its consistent efforts, over more than a decade, to improve the regulations under RESPA . As you know, this is its second set of proposed regulations, following a series of public and private meetings over many years. HUD has consulted with representatives from the diverse industries RESPA, as well as consumer representatives. We can see the impact of these discussions in the language of the proposal. The issues addressed in the proposed regulations are difficult and complex, and their resolution will affect millions of consumers and industry participants in the home mortgage business.

The latest proposal is a good way down the road toward positive reform of the RESPA regulations. **We do not believe that the current effort should be suspended – just continued.** ***HUD should continue to improve the regulations – as recommended by us – and finalize them.*** These regulations must be improved as recommended in our comprehensive comments before they are finalized.[1]

I have been asked to testify today on a variety of topics:

1. Any changes you believe would be desirable to the proposed RESPA rule.
2. The need for harmonization of HUD's proposed RESPA rule with the TILA rule issued by the Federal Reserve Board.
3. The adequacy of consumer testing regarding the proposed GFE.
4. Whether changes are needed to the Good Faith Estimate (GFE).
5. The potential challenges with implementing the proposed "closing script."
6. The benefits and limitations of the disclosure of yield-spread premiums to consumers.
7. Other needed legislative and regulatory changes to RESPA.

Although I have not been asked what we *like* about the proposed regulations, HUD's proposal includes many positive features which we heartily endorse and which we believe will

[1] NCLC's comments on the proposed RESPA regulations, were filed on behalf of the low income clients of NCLC, as well as Consumer Action, the Consumer Federation of America, and the National Association of Consumer Advocates. The comments can be found at http://www.consumerlaw.org/issues/predatory_mortgage/content/NCLC-RESPAcomments08.pdf.

improve the transparency of the complex mortgage settlement process. Please refer to our extensive comments on the proposed regulation for a full explanation of these provisions.

The issues I was asked to address are separately answered below.

1. Summary of Recommended Changes to the RESPA Rule.

There are several overarching concerns (and a myriad of important details) that need to be improved to ensure that the Rule does in fact protect consumers, instead of simply providing a shield behind which mortgage originators can hide inappropriate, unfair, and illegal activities. While much of HUD's work on the Good Faith Estimate (GFE) is excellent, as detailed in our comments, several specific provisions must be retooled to prevent harm to consumers. These include:

- Most importantly, the APR must be included instead of the interest rate. The APR is the sole unitary measure of the cost of credit, combining the effect of both rates and fees. Failure to include it on the GFE limits consumers' ability to shop for credit.

- The total of settlement costs should be highlighted, rather than various subtotals. In general, detail on settlement costs should be downplayed. Interest and other loan terms are almost always the largest component of cost; consumers should not be encouraged to focus on settlement costs instead of the combined effect of rate, fees, and term—the APR.

- The HUD-1 should be further synchronized with the GFE.

- The disclosure of mortgage broker fees must be changed. As currently written, the disclosure of mortgage broker fees presumes that borrowers receive a tradeoff between settlement costs and lender payments to brokers. Most available evidence suggests that in most instances, and certainly when both the borrower and the lender pay the broker, that all costs, including interest, fees, total broker compensation, and settlement costs, increase. HUD should not mandate a counterfactual presentation of reality.

- The closing script (or any application script, if required instead), must notify borrowers of the loan's APR and any applicable rescission rights and must omit the acknowledgement.

- The proposals to permit average cost pricing and volume based discounts only if consumers unequivocally benefit require important tweaks in the language of the regulations to ensure that all charges actually imposed on the consumers are always disclosed.

- The prohibition against required use needs amendments to ensure that HUD's intentions are fulfilled.

2. The Need for Harmonization of HUD's Proposed RESPA Rule with the TILA Rule Issued by the Federal Reserve Board.

The revision of the settlement statement, important as it is, must not undermine the enforceability of the Truth in Lending Act ("TILA"). Enforcement of the TILA and the Home Ownership and Equity Protection Act ("HOEPA") depend on full itemization of settlement costs. Remedies for the violation of TILA and HOEPA can include significant statutory damages and the right to rescind the loan, with the result of saving a home from foreclosure. In transactions to which RESPA applies, TILA rules say that the lender need not give an itemization of the amount financed if it provides both the GFE and settlement statement.[2] The itemization of the amount financed is essential for regulators, consumers, and their advocates to determine if TILA's fundamental disclosures – the APR, the finance charge, and the amount financed – were made correctly. Mortgage lenders consistently use the GFE and settlement statement as a replacement for the itemization of the amount financed.

HUD proposes to require lenders to disclose as a lump sum their origination charges and all title services.[3] This is certainly an improvement from the perspective of consumer understanding. However, not all origination services and title services are clearly all-in or all-out of the TILA finance charge. Under the statute, for example, title insurance is excluded from the finance charge.[4] Other charges related to title insurance, including the settlement fee, courier fees, or document preparation fees, may be included in the finance charge, however, particularly if they are not bona fide and reasonable.[5] Similar inconsistencies plague other origination fees.

Effective disclosure of costs requires bundling of all closing costs. However, the Federal Reserve Board has allowed the finance charge to become debundled.[6] As a result, HUD's improvement of disclosure in the settlement context could impede review of lender's compliance with the disclosure requirements of TILA.

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[2] Official Staff Commentary on Regulation Z, § 226.18(c)-4.

[3] 73 Fed. Reg. 14030, 14058 (Mar. 14, 2008).

[4] 15 U.S.C. § 1605(e)(1).

[5] *See generally* National Consumer Law Center, Truth in Lending §§ 3.9.5, 3.9.6 (6th ed. 2007.)

[6] *See, e.g.,* Elizabeth Renuart & Diane E. Thompson, *The Truth, the Whole Truth, and Nothing But the Truth: Fulfilling the Promise of Truth in Lending*, 25 Yale J. on Reg. 181 (2008).

Absent coordination with the Federal Reserve Board on a more useful and expansive definition of the finance charge, and statutory changes to the TILA itself, the final settlement statement must not bundle either all title or origination charges. Consumers should be provided, as HUD proposes, a summary of the charges and a comparison to the total disclosed on the GFE, to facilitate shopping. Consumers must also, however, be provided the detail in a form they can keep, to permit review for TILA compliance.

The closing script proposed by HUD does not address the TIL disclosures. Its failure to do so undermines the clear and conspicuous disclosure required under TILA. The closing script, in addition to reflecting the contract terms of the note, must reflect the TIL disclosures.

3. <u>The Adequacy of Consumer Testing Regarding the Proposed GFE.</u>

HUD's consumer testing focused exclusively on whether consumers could chose the cheapest loan when the only difference in cost was a change in settlement costs, dependent on how large the lender-paid broker compensation was. Unfortunately, an increase in lender-paid broker compensation often means an increase in both the rate and the total settlement costs. HUD has not tested whether or not consumers can use the loan summary sheet, or the tradeoff box, or any other element of the proposed GFE, to determine which of two loans that vary by more than settlement costs—by interest rate, term, or loan features—is cheaper or otherwise more desirable. What HUD tested was consumer's ability to choose the loan with the lower settlement costs when the two loans are otherwise comparable. Most loans in the market will vary by more than the total settlement costs. Any two loans offered a consumer are likely to vary by the interest rate, the amortization schedule, the term of the loan, whether the rate is fixed or adjustable, and a myriad of other factors, all of which affect the overall price. While the simplified, standardized GFE and the tradeoff table do a good job of aggregating most of that key information, HUD has done no testing to see whether consumers can, on average, using the GFE, determine which of two loans is cheaper or which better fits individual circumstances.

4. <u>The *Major* Changes Needed to the Good Faith Estimate (GFE).</u>

In its proposal, HUD has taken many important steps towards improving market transparency. The standardization of the GFE, increasing the linkages between the GFE and the settlement statement, and mandating the early provision of a binding GFE should increase consumer understanding and competition in the mortgage marketplace. The inclusion of key loan terms, including the maximum payment and the maximum loan balance, is vital information consumers do not currently receive and essential to consumer choice.

In the current marketplace, GFEs – when given – often bear no relationship to the final closing costs. Some originators only provide the GFE at the closing; others give GFEs

that significantly low-ball total costs. The variance in GFE forms, the lack of congruence between GFEs and settlement statements, and the failure to place any of these documents in consumers' hands in a final format before closing all have hindered competition in the mortgage marketplace. HUD's movement to standardization will improve its comparability to the settlement statement. More importantly, by requiring that some of the terms of the GFE be binding, HUD will reduce bait and switch tactics among the most unscrupulous originators.

HUD should go further in standardizing and simplifying the GFE and settlement statement. HUD must require the prominent disclosure of the annual percentage rate ("APR") on the GFE. In addition, as discussed below, without substantive regulation of yield spread premiums that permits them only in the case of no-cost loans, where homeowners can realize the potential benefits of lender-paid broker compensation, homeowners nevertheless will continue to make costly errors in purchasing home-secured credit.

A. The Early and Binding Provision of the GFE is Essential for Consumer Shopping

We applaud HUD for requiring that the GFE be provided early and at a uniform time in the mortgage shopping process.

HUD proposes to only require that the GFE be held binding for 10 business days before a complete mortgage application is submitted.[7] This does not seem to be sufficient time for consumers to shop for a different mortgage, obtain alternative GFEs, compare them and then make the decision to return to a particular originator, particularly without requiring an interest rate lock. More importantly, it does not seem to be sufficient time even to close on the loan for which the GFE is offered.

Industry practice generally assumes that in the purchase-money context a minimum of 30 days is needed to shop for and obtain a binding mortgage commitment.[8] If an interest rate lock is required, such a short time frame might be legitimate to protect lenders from interest rate fluctuations. Without a mandated interest rate lock, however, the short time frame is useless. While interest rates might fluctuate over 30 days significantly, settlement costs are unlikely to fluctuate at all. Certainly, lenders should be able to predict the settlement costs with a high degree of certainty a month in advance. *Accordingly, the GFE should be binding for at least 30 days.*

Moreover, a GFE must include an interest rate lock. Without an interest rate lock, consumers can only shop on the settlement costs of the loan, not the interest rate. The

[7] 73 Fed. Reg. 14030, 14057 (Mar. 14, 2008).

[8] *See, e.g.,* Woodbury Title Goup, The Closing Process, http://www.woodburytitle.com/page/page/2189688.htm (most mortgage contingency clauses in contracts specify 30-45 days to shop for a mortgage).

failure to require an interest rate lock undermines the effectiveness of the early provision of the GFE. Interest is the largest component of the price of a mortgage. If interest rates are allowed to float while settlement costs are fixed, consumers are encouraged to shop on the smallest portion of mortgage costs, the settlement costs, and lenders are encouraged to play bait and switch games with the offered interest. *To be a useful shopping tool, all costs must be fixed at the time the GFE is delivered.*

In order to encourage shopping, HUD permits the charging of only two fees, for the cost of providing the GFE and a credit report.[9] While the intent is good, this provision potentially runs afoul of both federal and state consumer protection provisions. RESPA itself forbids the charging of any fees for the preparation of the final settlement statement.[10] HUD's endorsement of a fee on the GFE, the necessary precursor to the settlement statement, undercuts this prohibition.[11] *Accordingly, we recommend that HUD not mention any fees in relation to the GFE. The cost of providing a GFE is simply a cost of doing business, and there is no reason for HUD to encourage – and sanction – the addition of a new fee.*

Despite the promise of this rulemaking, it remains likely that the requirement that the GFE be delivered early in the mortgage application process will be honored more in the breach than in actuality. Without aggressive enforcement by HUD and a private right of action for consumers, as discussed below, lenders will not have sufficient incentives to make sure that consumers are supplied with shopping tools in a timely fashion. HUD assumes repeatedly that its new rules will change the marketplace and cause unscrupulous originators to become more transparent.[12] However, there are no teeth in the regulation. Currently, many borrowers never receive a GFE, and many of those who do so receive it at closing. Without enforcement by consumers on both the time of delivery and the accuracy of the numbers, GFEs are likely to continue to be used as much as a tool for bait and switch as for honest competition.

B. A Standardized GFE that Focuses Consumer Attention on the Key Price

[9] 73 Fed. Reg. 14030, 14057 (Mar. 14, 2008).

[10] 12 USC §2610.

[11] Implicitly, authorizing the charging of a fee for the preparation of a GFE encourages lenders to pass on to consumers at the GFE stage the costs of preparing the final settlement statement. Moreover, some states prohibit the charging of any nonrefundable application fee before the credit is issued. HUD's proposal could be seen to preempt those state statutes by permitting the charging of a fee. Similarly, the model GFE has a space for the lender to fill out the amount of an application fee.

[12] Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 3-58 (2008) ("[T]his table makes it more likely that . . . originators will [explain loan options] since the failure to do so might result in a bunch of questions on the topic, and a change in the loan requested, and the need to write-up a new GFE.").

Components is Critical

The new GFE is standardized and legible. It does a very good job of letting a consumer do what the GFE was designed to do: choose the cheaper loan when the difference is all in the settlement costs.

Consumers need a standardized and streamlined GFE in order to be able to shop. The current GFE provides too much information and does not point to the most important costs. Most consumers can tolerate no more than three or four decision points.[13] Compare this to the 45 separate fees listed on a single GFE reviewed by HUD in its Economic Analysis.[14] Few, if any, borrowers are able and willing to aggregate so many disparate fees. Only 13% of consumers have the quantitative literacy to add fees in order to compare prices,[15] even if they were willing and could take the time to do so. Aside from the math, borrowers have trouble just identifying fees when presented with a long list.[16] The current

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[13] For example, most consumers in credit card shopping will only look at two pieces of information. Jinkook Lee & Jeanne M. Hogarth, *Relationships among Information Search Activities When Shopping for a Credit Card*, 34 J. Consumer Aff. 330, 340 (2000). Similarly, in reviewing credit card activity, most borrowers only look at three categories of information in evaluating the card and their continued use of the card. Macro International, Inc., Design and Testing of Effective Truth in Lending Disclosures 19 (2007), http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf. The three categories reported were information about payments, the account activity summary, and the transaction list. Most other information was disregarded. Some evidence suggested that even the account activity summary was largely disregarded in favor of the transaction list. *Id.* at 31.

[14] Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 3-154 (2008).

[15] *See Mark Kutner, Elizabeth Greenberg & Justin Baer,* U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, A First Look at the Literacy of America's Adults in the 21st Century 3, 4 (2005), *available at* http://nces.ed.gov/NAAL/PDF/2006470.PDF (only 13% of the adult population has quantitative proficiency; a "sample task "typical of level" is "computing and comparing the cost per ounce of food items").

[16] For example, when reviewing model disclosure forms with focus groups, half of the respondents in a survey conducted for the Federal Reserve missed at least one fee charged on a sample credit card statement. Macro International, Inc., Design and Testing of Effective Truth in Lending Disclosures 12, 40-41 (2007), http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf. Only when the researchers grouped and totaled the fees did the borrowers consistently find the fees. Similarly, in a recent survey conducted for the Federal Trade Commission ("FTC"), consumers reviewing mortgage disclosures were unable to identify or aggregate fees, although the listed fees were fewer than 20.As Herbert Simon points out, the easier it is to discover a satisfactory solution, the higher the standard for an acceptable solution becomes. Herbert A. Simon, *A Behavioral Model of Rational Choice,* 69 Q. J. Econ. 99, 111 (1955). *See also* Yu-Chun.Regina Chang & Sherman Hanna, *Consumer Credit Search Behavior*, 16 J. Consumer Studies and Home Economics 207

marketplace, where fees are listed by hundreds of different names, on a multitude of different lines, does not permit comparison shopping.[17]

Totaling and aggregation of fees is therefore critical. The easier it is to shop the more likely it is that consumers *will* shop, and shop effectively. We must take care, however, to make sure that we focus consumers on the important and relevant totals, not irrelevant subtotals.

The standardization of the GFE will promote consumer shopping and facilitate market transparency. To ensure that the GFE is useful and not misleading to consumers, HUD must make the following further revisions:

- Replace the interest rate disclosure on the GFE with the APR.
- Provide only the earliest date on which the interest rate can rise, not the maximum (while retaining disclosure of the maximum payment—a key price measure for consumers).
- Reduce the focus on settlement costs, by reducing the font size and eliminating the bold for settlement costs.
- Only provide a total for all settlement costs on the first page of the GFE, without breaking out the origination costs.
- Provide guidance to originators as to the calculation of the maximum payment and maximum loan balance.

C. The Proposed GFE Must Include the APR as the Key Loan Term

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(1992) (consumers seek a solution that meets minimum requirements without expending too much energy).

[17] The National Consumer Law Center has collected and analyzed over 981 settlement statements. The settlement statements tend to be more uniform than the GFEs, but even among the settlement statements there is wide disparity. On the 981 settlement statements analyzed, there were 326 different fee names used in the 800 series, 221 different fee names in the 1110 series, and 133 different fee names in the 1300 series. The same fees were reported with different names and on different lines more often than not. Nat'l Consumer Law Ctr., *Lenders' Use of the HUD-1 and HUD-1A Settlement Statements: An Early Analysis of Data from the National Mortgage Data Repository 3-4* (Aug. 2007). HUD's analysis of 3000 settlement statements from five metropolitan areas, shows comparable divergence, with over 130 different fee names in the 800 series and nearly 200 different names in the 1100 series. Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., *RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 3-155 – 3-159* (2008).

HUD is focused on reducing costs for consumers and facilitating shopping. The APR, in the mortgage market, is a necessity to achieve those goals.

The APR is the only apples-to-apples shopping metric in the mortgage market.[18] Its consistent use reduces the cost of consumer credit.[19] Consumers look for and rely on the APR when shopping. In 2000, ninety-one percent of the population was "aware" of the APR.[20] More than seventy percent of the population reports using the APR to shop for closed-end credit.[21] Seventy-eight percent of homeowners who refinanced their homes report comparison shopping on the basis of the APR.[22]

If the goal is to facilitate consumer shopping for mortgages, *HUD must mandate the inclusion of the APR on the GFE*. Interest rates are not as useful and can undermine the disclosure of the APR.

Interest rates, while reflecting the largest cost of credit, do not bundle all costs. Reliance on an interest rate in shopping can result in taking out the more expensive loan overall. Depending on the term of the loan, the fees, and how the rate is stated and calculated, interest rates can be inherently misleading and deceptive and quite often are not comparable with each other.[23] Moreover, interest rates do not control for the term of the loan.

Unlike interest rates, the APR takes the total cost of the loan, including fees and the time cost of money, and scales that cost to the size and term of the loan. The APR bundles the fees with the interest rate and standardizes the rate over an annual term. Thus, a shopper can tell whether a 15 year loan is cheaper than a 30 year loan by looking at just one number, no matter how many fees the lender has piled on at origination.

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[18] *See, e.g.,* Elizabeth Renuart & Diane E. Thompson, *The Truth, the Whole Truth, and Nothing But the Truth: Fulfilling the Promise of Truth in Lending*, 25 Yale J. on Reg. 181 (2008).

[19] *See* Victor Stango & Jonathan Zinman, *How a Cognitive Bias Shapes Competition: Evidence from Consumer Credit Markets* 3-4, Sept. 5, 2006, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=928956 (in markets where TILA disclosures made reliably, consumers who most underestimate APRs given a payment stream do not overpay on credit; in markets where TILA disclosures not made reliably, same consumers pay 200-400 basis points more for interest compared to consumers who underestimate APRs to a lesser degree).

[20] Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes*, *1970-2000*, Fed. Res. Bull., 623, 631 (Sept. 2000), http://www.federalreserve.gov/pubs/bulletin/2000/0900lead.pdf.

[21] Jinkook Lee & Jeanne M. Hogarth, *The Price of Money: Consumers' Understanding of APRs and Contract Interest Rates*, 18 J. Pub. Pol'y & Marketing 66, 74 (1999).

[22] Jinkook Lee & Jean M. Hogarth, *Consumer Information Search for Home Mortgages: Who, What, How Much, and What Else?*, 9 Fin. Services Rev. 277, 286 (2000).

[23] *See generally* Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Slight of Hand: Salience Distortion of American Credit Pricing Limits*, 92 Minn. L. Rev. 1110 (2008).

In recent years, the marketing of payment option ARMs has underscored the need for uniform disclosure of and reliance on the APR and the problems with the use of interest rates in disclosure. Payment option ARMs are typically advertised as, for example, "a 2% fixed rate" even though this rate may be fixed for no more than a day.[24] The APR, while it does not entirely reflect the risk of upwards adjustments in the interest rate, given problems with how it is calculated,[25] at least reduces the distortion, by requiring that the rate disclosed be a composite rate.[26] Composite rates reflect both an initial low rate and the rate that would be in effect but for the initial teaser rate.

Consumers cannot do the math to determine which of two loans is cheaper, given different rates, different fees, and different terms. The APR solves that problem and permits consumers to shop intelligently and efficiently. Failing to include the APR on the GFE obscures the cost of credit and hinders consumer shopping.

It is no answer to suggest that consumers can rely on an early TIL disclosure for the APR. Even when the early TIL disclosure is provided, there is no penalty for providing an inaccurate TIL disclosure, whether accidentally or intentionally. As a result, many of the early TIL disclosures actually provided in the current marketplace are misleading.

Moreover, if the GFE is to have its maximum effect, it should be the single shopping tool for the mortgage. If consumers have to use multiple sheets to shop, the usefulness of the GFE is considerably diluted. Permitting multiple summary sources of critical information virtually guarantees that some consumers will ignore one or the other source. Ignoring the settlement costs and key loan terms reflected on the GFE would be undesirable. Ignoring the APR would be disastrous in most cases. Thus, if the GFE is to be used for shopping, disclosure of the actual APR must be mandated by HUD.

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[24] *See, e.g.,* Andrews v. Chevy Chase, 240 F.R.D. 612 (E.D. Wis. 2007) (describing payment option ARM sold as having a fixed rate, when interest varied monthly; fixed rate is the payment rate); Complaint at 4, Fed'l Trade Comm'n v. Chase Financial Funding, Inc., No. SACV04-549 (C.D. Ca. 2004), *available at* http://www.ftc.gov/os/caselist/0223287/040602comp0223287.pdf (adjustable rate mortgage with initial minimum payment, based on interest at 3.5% amortized over 30 years, which results in negative amortization, since actual interest rate is much higher, advertised as "3.5% fixed payment 30 year loan."); Gov't Accountability Office, GAO No. 06-1021, Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved 22 (2006), *available at* http://www.gao.gov/new.items/d061021.pdf (describing advertisement for payment option ARM that promised 45% reduction in monthly mortgage payments and interest rate of 1.25%; interest rate of 1.25% only applied for first month, and this fact disclosed in "much smaller print" on second page).

[25] Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 Harv. J. on Legis. 123, 143-44 (2007) (discussing limitations of variable rate disclosures in detail).

[26] 12 C.F.R. §226.17, Official Staff Commentary, §226.17(c)(1)-(10).

D. Explanation of NCLC's Recommended GFE Form

Following is our recommended summary GFE form. The key elements of a standard summary GFE should include:

- The APR
- The maximum payment, in dollars
- The maximum loan balance, in dollars
- The total closing costs, in dollars
- Information regarding whether the rate can rise, and the earliest date on which the rate can rise

A second page could have a tradeoff box and detailed information about mortgage broker compensation. (This should not be on the first page of the GFE).

The summary GFE should NOT have:

- The interest rate
- Subtotals of costs or fees

Appendix 1 provides an example of NCLC's model summary GFE form. As discussed above, absent statutory and regulatory changes creating a fee-inclusive TIL finance charge, the final settlement statement provided must contain a detailed itemization of all charges. Any detail provided on the GFE should match that provided on the final settlement statement, but should follow on separate pages, in order not to detract from the summary.

5. <u>The Potential Challenges with Implementing the Proposed "Closing Script"</u>

As demonstrated by HUD's consumer testing, consumers like and benefit from an oral explanation of their loan terms at closing.[27] Such information is seldom forthcoming at current closings. If the requirement were taken seriously by closing agents, it could impede the rushed closings that many consumers, particularly in the subprime market, experience and facilitate a better opportunity for consumers to understand some of the important features of their loans.[28]

However, the closing script has two critical omissions: the APR and notice of the consumer's three-day right of rescission for non-purchase money mortgage transactions.

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[27] U.S. Dep't of Housing and Urban Dev., Office of Pol'y Dev.& Research, RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs 3-46 (2008).

[28] *Sprague v. Household Intern.*, 473 F. Supp. 2d 966, 972 (W.D. Mo. 2005) (describing closings of real estate loans in less than ten minutes at fast food restaurants and delis).

The failure to mention and correctly explain the right of rescission in the closing script will undermine the clear and conspicuous disclosure of the right of rescission as required by TILA. Again, this is another area where coordination with the Federal Reserve Board regulation of TILA is essential.

Moreover, given the wide history of fraud by closing agents,[29] HUD should take care when providing a seal of approval to the oral statements of any closing agents. HUD may be able to prescribe the words, but it is unlikely to be able to monitor the tone in which they are delivered, or whether those exact words actually were used. Two alternative scenarios are possible. In one case, a closing agent may rush through the script and downplay its importance: "This is just something the government makes me say." In another case, a closing agent could say, "You can trust me. What I am telling you has been approved by HUD. This is a government approved loan." Neither scenario results in the transparency envisioned by HUD. Both could exacerbate existing problems of misplaced trust in the settlement process.

It is not clear how delivery of the closing script would be enforced. Consumers might have a private right of action for deception under state law, but settlement agents routinely have consumers sign an acknowledgment that the settlement agent is not the borrower's agent and that the borrower agrees to indemnify the settlement agent for any misstatements. HUD should clarify that both the lender and the closing agent are responsible for ensuring the good faith delivery of the closing script and that borrowers have a right to rely on the accuracy of the closing script. Absent enforceability and clear direction from HUD, the closing script may be abused or not delivered as often as it is given in a helpful manner to borrowers. Current RESPA compliance failures make this possibility likely.

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[29] *See, e.g.,* Nationwide v. Echeverria, 725 N.W.2d 659 (Iowa App. 2006) (title company disbursed loan proceeds to seller although seller did not have title to property and outstanding mortgage lien on property); Matter of Harris, 2006 NY Slip Op 9317 (N.Y. App. Div. 2006) (attorney disbarred after being sentenced to 18 years in prison and restitution of $100,000 in property flipping scheme); United States v. Lutz, 2006 WL 3716581 (4th Cir. Dec. 14, 2006) (upholding "willful blindness" instruction to jury when evidence showed that closer concealed the property flip from lenders by disguising loan disbursements and concealing rapid transfers of property); United States v. Wilkins, 2007 WL 896147 (E.D.Tenn. March 22, 2007) (title company explained two HUD-1s to buyer, including fact that buyer was making a false statement);American Title Co. of Houston v. Bomac Mortg. Holdings, L.P., 196 S.W.3d 903 (Tex.App. 2006), *review granted, judgment vacated, and remanded by agreement* (Mar. 16, 2007) (discussing title company alteration of HUD-1 and title report to conceal source of down payment and flip of property); David Cho, *Housing Boom Tied to Sham Mortgages, Lax Lending Aided Real Estate Fraud,* Wash. Post., Apr. 10, 2007, at A1 (closing attorneys convicted as accomplices in large property flipping scheme) United States. v. Sloan, 505 F.3d 685 (7th Cir. 2007) (reviewing restitution order entered against paralegal who participated in property flipping scheme with attorney-employer).

In addition, the closing script could be used by both closing agents and lenders to absolve themselves of responsibility for misrepresentation. In this respect the acknowledgment is particularly troubling. Unscrupulous or simply harried closing agents may be tempted to add the acknowledgment page to the stack of documents a borrower signs at closing with no more than a hurried, "sign here." Regardless of whether there were inconsistencies or whether or not they were explained, lenders and closing agents are likely to use the acknowledgment as a safe harbor, absolving them from all responsibility for abusive practices. The acknowledgment of the closing script could be used against borrowers.

For the closing script to function as envisioned by HUD, at a minimum make the following changes must be made:

- *Delete the acknowledgment.*
- *Require the APR to be disclosed.*
- *Require the notice of the right to cancel be disclosed, where applicable.*
- *Clarify that lenders are responsible for the accurate delivery of the closing script.*
- *Clarify that settlement agents also are responsible to the borrower for the accurate delivery of the closing script.*

6. The Benefits and Limitations of the Disclosure of Yield-Spread Premiums to Consumers

Lender-paid broker compensation, as HUD describes, leads to higher settlement costs and higher broker costs, as well as higher interest rate costs.[30] In most circumstances, borrowers receive little, if any, benefit from lender-paid broker compensation. Even worse, lender-paid broker compensation appears to drive racially disparate pricing. Only where the fees are either all in or all out of the rate are consumers able to shop successfully for the cheapest loan. When consumers can compare loans with the fees all *in* or all *out,* they are comparing loans with a limited number of variables. On the one hand is a loan with a particular rate and all fees required to be paid by the borrower – which would have to come from either cash or the home equity (meaning that the fees would be paid for in the loan, and more would be borrowed). On the other hand is the same loan with all of the fees paid through the interest rate – so no additional cash would required from the borrower and the loan amount would not have to be increased to cover the closing costs – yet the interest rate would be slightly higher. The latter loan is often called in the industry a "no-cost loan." This is somewhat of a misnomer because there are fees charged on these loans, and paid for by the consumer, only through a higher rate.

There are multiple benefits for "no-cost loans." These include the obvious – the retention of precious cash and equity by the borrower – as well as the lesser known finding

[30] Office of Pol'y & Dev., Dep't. of Hous. & Urban Dev., RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis, FR-5180-P-01: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs, 2-24 - 2-43 (2008).

that "no-cost" loans can result in a significant reduction of all closing costs as compared to other loans.[31] *However, the key to achieving this reduction is that the lender pays ALL of the fees.* The use of a combination of methods of payments – cash or home equity from the borrower plus lender paid broker compensation – has just the opposite effect: an increase in the closing costs and loan costs. Disclosure, by itself, does not overcome the cognitive dissonance caused by splitting the fees.

Disclosing lender-paid broker compensation is difficult. Most disclosures of lender-paid broker compensation are likely to confuse consumers, both because the tradeoffs are inherently complex and because borrowers are led to believe erroneously by both brokers and originators that brokers act as the borrowers' agents.[32] We concur with HUD that the yield spread premium should not be disclosed on a separate agreement. We share HUD's concerns that a separate agreement is likely to cause confusion to borrowers. We agree that the impact of any permissible yield spread premium must be clearly disclosed on the GFE. However, HUD's use of the term "credit" to describe the lender-paid broker compensation, in the absence of substantive regulation that limits total fees, is misleading. Empirically, when there is a mix of both borrower-paid and lender-paid broker compensation, the total of all fees *increases*. When there is this combination of methods of payments, there is not a one-for-one reduction in the borrower's costs, as the common understanding of the word "credit" would convey.

Lender paid broker compensation, when combined with borrower paid closing costs, is particularly troubling because it contributes to the widespread disparities in the pricing of home mortgage loans between whites and African Americans and Latinos. These disparities exist at every income and credit level and increase as income and credit levels increase.[33] In

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[31] Borrowers who use "no-cost" loans and so can shop on interest rate alone pay $1,200 less than borrowers who pay some lender or broker fees in cash. This suggests that consumers have a tougher time comparing alternatives when trade-offs are involved and that mortgage loan markets are not fully transparent or competitive. Susan Woodward, *A Study of Closing Costs on FHA Mortgages,* U.S. Department of Housing and Urban Development, Office of Policy Development and Research. (2008.), available at http://www.urban.org/UploadedPDF/411682_fha_mortgages.pdf.

[32] The Federal Reserve Board recently withdraw its proposed regulation of mortgage broker disclosure after consumer testing revealed that even when the disclosure included an explicit disavowal of the broker's agency, most consumers, even in a testing situation, without active misrepresentation by a broker, continued to believe that the broker, paid for by the consumer, was acting in the consumer's best interests. 73 Fed. Reg. 44,522, 44,564 (July 30, 2008).

[33] *See, e.g.,* Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *The 2006 HMDA Data,* Fed. Reserve Bull. A73, A97 (2007), *available at* http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf (in 2006 and 2005, African Americans and Hispanics who received higher cost loans, on average, after accounting for borrower characteristics and lender, paid 20 and 10 basis points more, respectively, than white borrowers also in the subprime market); *see also* Marsha J. Courchane, *The Pricing of Home*

other words, the wealthiest and most credit worthy African Americans and Latinos are, compared to their white counterparts, the most likely to end up with a subprime loan. The origination channel – whether or not a loan is brokered – accounts for most of the difference in pricing.[34]

Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?, 29 J. Real Est. Res. 399, 417 (2007) (in 2005, African Americans and Hispanics who received subprime loans paid, on average, 50 and 17 basis points more, respectively, than whites in the subprime market); Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. For Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 11 (May 31, 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf *see also* Jim Campen, *Borrowing Trouble VII: Higher-Cost Mortgage Lending in Boston, Greater Boston and Massachusetts, 2005* at 8 (Mass. Community & Banking Council, Jan. 2007), *available at* www.masscommunityandbanking.org (highest income Latinos received high-cost home purchase loans at 6 times the rate of the highest income whites; highest income African Americans 7.6 times to receive a high-cost home purchase loan than highest income whites); Geoff Smith, Woodstock Institute, Key Trends in Chicago Area Mortgage Lending: Analysis of Data from the 2004 Chicago Area Community Lending Fact Book 10 (2006) (African-Americans and Hispanics more likely to receive high-cost loan than white borrowers, disparity increases as income increases); Elvin K. Wyly, Mona Atia, Holly Foxcroft, Daniel J. Hamme, Kelly Phillips-Watts, *American Home: Predatory Mortgage Capital and Neighbourhood Spaces of Race and Class Exploitation in the United States*, 88 Geografiska Annaler, Series B: Human Geography 105 (2006) (finding geographic racial disparities in lending in Baltimore that cannot be explained by income); Stephanie Casey Pierce, Racial Disparities in Subprime Home Mortgage Lending: Can the Difference Be Explained by Economic Factors? (2006) (unpublished M. Pub. Pol'y thesis, Georgetown University), *available at* http://www.dspace.wrlc.org/bitstream/1961/3612/1/etd_smc54.pdf (a survey of 2004 HMDA data from Louisiana found that blacks were 13.82% more likely than whites to receive a high cost, first lien purchase loan); *cf.* Robert B. Avery, Kenneth P. Brevoort, & Glenn B. Canner, *Higher Priced Home Lending and the 2005 HMDA Data*, Fed. Reserve Bull. A123, A138 (2006) (piggyback loans more common in minority census tracts, even holding income constant), *available at* http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf.

[34] *See* Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *The 2006 HMDA Data,* Fed. Reserve Bull. A73, A96 (2007), *available at* http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf (pricing disparities between whites and minorities highest for broker originated loans); Robert B. Avery, Kenneth P. Brevoort, & Glenn B. Canner, *Higher Priced Home Lending and the 2005 HMDA Data*, Fed. Reserve Bull. A123, A157-58 (2006), *available at* *http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf* (same); Robert B. Avery & Glenn B. Canner, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, Fed. Reserve Bulletin 344, 380, 394 (Summer 2005), *available at* http://www.federalreserve.gov/pubs/bulletin/2005/3-05/hmda.pdf (same); *cf.* Marsha J. Courchane, *The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?*, 29 J. Real Est. Res. 399, 400 (2007) ([M]uch of the explanation for why minority borrowers tend to have higher APRs than non-minority borrowers

Lender-paid broker compensation creates the incentives that drive much of the racially disparate pricing.[35] By encouraging brokers to overprice loans where and when they can, lenders implicitly encourage brokers to target the vulnerable and gullible and those perceived as vulnerable and gullible. Most borrowers naively believe that their lenders will give them the loan they qualify for, and are insufficiently on their guard in dealing with brokers. African Americans and Latinos are particularly likely to believe that lenders are required to give them the best rate for which they qualify.[36]

The mechanics and extent of lender-paid broker compensation reach beyond simply overcharging African-American and Latino borrowers. Lenders use broker compensation to lock African-Americans and Latinos into downwardly mobile borrowing and destructive products. For example, lender payments to brokers are often conditioned on the borrower's acceptance of a prepayment penalty.[37] Thus, brokers have an incentive not only to put borrowers into a high cost loan in order to receive additional compensation from the lender, but to make sure the borrower is locked into the high cost loan. Prepayment penalties in these circumstances are seldom chosen by the borrower or in the borrowers' interest.[38]

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is because minority borrowers disproportionately take out subprime loans."); William Apgar, Amal Bendimerad & Ren S. Essene, Joint Ctr. for Housing Studies, Harvard Univ., Mortgage Market Channels and Fair Lending: An Analysis of the HMDA Data 27, 37 (2007), *available at* http://www.jchs.harvard.edu/publications/finance/mm07-2_mortgage_market_channels.pdf (white borrowers 50% more likely than African American borrowers to get a loan from a CRA-regulated entity within its CRA assessment area; failure to get a loan from a regulated institution within its catchment area increases the cost of the loan).

[35] Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. For Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 21-23 (May 31, 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (discussing evidence and analysis that links pricing disparities with broker activity and incentives); *see also* Press Release, Office of the New York State Attorney General, Countrywide Agrees to New Measures to Combat Racial and Ethnic Disparities in Mortgage Loan Pricing (Dec. 5, 2006), *available at* http://www.oag.state.ny.us/press/2006/dec/dec05a_06.html (pricing disparities between whites and minorities highest for broker originated loans).

[36] Mortgage Foreclosure Filings in Pennsylvania: A Study by The Reinvestment Fund for the Pennsylvania Department of Banking 74 (Mar. 2005), *available at* http://www.trfund.com/policy/pa_foreclosures.htm , *citing* Fannie Mae's 2002 National Housing Survey.

[37] *See* Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. For Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 21 (May 31, 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (noting that payment of yield spread premiums is often conditioned on the imposition of a prepayment penalty).

[38] Loans with prepayment penalties attached have higher rates of foreclosure, and in brokered loans, borrowers generally receive no interest rate reduction in exchange for the imposition of the prepayment penalty. *See, e.g.,* Morgan J. Rose, Predatory Lending Practices

The key point here is – *Disclosure by itself is unlikely to remedy the systematic abuses of lender paid broker compensation HUD identifies.*

A. Lender Payments to Brokers Should Not Be Characterized As a Credit

HUD's proposal to describe lender-paid broker compensation as a *credit* used to reduce settlement costs is inherently misleading. There is no requirement that the lender payment will actually be used in that manner. Nothing in the proposed rule requires that brokers only be compensated through a yield spread premium or that the lender payment to the broker be offset against the total broker price charged to the borrower. Merely having the lender payment shown as a borrower credit to reduce the settlement costs will not make it function that way: Brokers can still charge borrowers a separate or increased fee.

It is simply not true, as HUD proposes to emblazon on the GFE, that a lender-paid broker payment reduces upfront costs. In most cases, according to studies HUD cites, lender-paid broker payments actually increase upfront costs.[39]

The treatment of the lender payment to the broker as a credit also potentially

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and Subprime Foreclosures – Distinguishing Impacts by Loan Category 45 (Dec. 2006), *available at* http://www.chicagofed.org/cedric/2007_res_con_papers/car_62_morgan_j_rose_foreclosures_draft.pdf (prepayment penalties and balloon notes combined on a fixed rate refinance subprime loan increase the rate of foreclosure 227%); Ellen Schloemer, Wei Li, Keith Ernst & Kathleen Keest, Ctr. For Responsible Lending, Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners 21 (Dec. 2006), *available at* http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf (higher risk for foreclosure for adjustable rate loans, loans with balloon payments, loans with prepayment penalties, and limited documentation); Gregory Elliehausen, Michael E. Staten & Jevgenijs Steinbuks, *The Effect of Prepayment Penalties on the Pricing of Subprime Mortgages* 15 (Sept. 2006), *available at* http://www.chicagofed.org/cedric/2007_res_con_papers/car_79_elliehausen_staten_steinbuks_preliminary.pdf (finding that prepayment penalties were associated with higher interest rates unless they controlled for "borrower income, property value, loan amount, whether the loan was originated by a broker, and type of interest rate," in which case the difference shrank); s*ee also* Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, Ctr. For Responsible Lending, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages 3-4 (May 31, 2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (the presence of a prepayment penalty increased the likelihood that African Americans had a higher cost subprime loan as compared to whites).

[39] U.S. Dep't of Housing and Urban Dev., Office of Pol'y Dev.& Research, RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs 2-25 - 2-48 (2008).

complicates TIL review. Without guidance from the Federal Reserve Board, it is not entirely clear what effect treating the lender paid broker compensation as a borrower credit will have on the central TIL disclosures, the finance charge and the APR. The credit should be treated as an additional down-payment that reduces the principal loan amount but is otherwise neutral as to the calculation of these central disclosures. Yet without guidance from the Federal Reserve Board, the use of the word "credit" opens up a litigation minefield and likely increases costs for all parties.

A more honest and transparent disclosure about the effect of the yield spread premium is illustrated in Appendix 2 of this Testimony.

The problem is not that brokers are paid out of the interest rate: the problem is that brokers are paid *both* out of the interest rate and out of pocket (or equity). HUD recognizes the costs borrowers incur when borrowers must shop both on fees and rate.[40] Yet the proposal would substitute *disclosure* for substantive regulation. If HUD were to require – as part of its regulation under RESPA's section 8 (12 U.S.C. Section 2607) – that lender paid fees be actually credited to borrower's previously enumerated costs, then this mechanism might work as HUD envisions. But simply requiring a disclosure would not make the lender paid fee provide a reduction dollar for dollar to the borrower.

B. Lender-Paid Broker Compensation Should Only Be Permitted for No-Cost Loans

Given the extensive evidence HUD cites that fees and borrower confusion are at their highest when brokers are paid both by the borrower and the lender,[41] lender-paid broker compensation should only be permitted for no-cost loans.[42]

True no-cost loans, where all fees are pushed into the rate, can offer significant benefits for consumers and the market. Consumers appear to maximize their shopping return with no-cost loans. Racial disparity in pricing appears to vanish in no-cost loans.[43]

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[40] *Id.*

[41] *E.g.,* U.S. Dep't of Housing and Urban Dev., Office of Pol'y Dev.& Research, RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs 2-26, 2-34 (2008).

[42] In this situation, lenders must list all charges incurred in the transaction on the settlement statement but show them as P.O.C., paid outside of closing. *See* HUD Instructions in Regulation Z, 24 C.F.R. 3500 Appendix A. If the lender provides a credit to the consumer to cover closing costs, the credit must appear on lines 204-209 of the settlement statement. *See* HUD Letter Regarding Disclosures on Good Faith Estimate and HUD-1 Settlement Statement, Q 12, attached to OCC Advisory Letter AL 2000-5.

[43] U.S. Dep't of Housing and Urban Dev., Office of Pol'y Dev.& Research, RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs 2-43 (2008).

No-cost loans provide the proper incentives for originators and the secondary market. In a no-cost loan, the only money to be made is if the loan performs over time. Thus, no-cost loans give originators and the secondary market an increased incentive to make sure that underwriting is done at the time of origination. No-cost loans also reduce the incentive to strip equity by increasing the loan amount with junk fees. Such equity stripping does the consumer permanent harm and cannot be refinanced away, unlike a higher interest rate.

HUD should, under RESPA, define the payment of a yield spread premium, which increases the interest rate, at the same time as the borrower is being charged other up-front fees that purport to reduce the rate, as a kickback. There is substantial evidence that in these circumstances the yield spread premium increases total broker compensation and increases the borrower's cost, without providing any additional benefit to the borrower.[44] In these circumstances, the yield spread premium cannot reasonably be seen as a payment for other than the increased rate.

Yield spread premiums should be prohibited unless all other fees (other than escrow fees imposed in accordance with RESPA, actual government fees, and title insurance and title examination fees, if paid to an unrelated party and if bona fide and reasonable) are folded into the interest rate and no discount points are charged. Additionally, no other lender-paid broker compensation should be permitted if the borrower is making any direct payments to the broker.

7. Other Needed Legislative and Regulatory Changes to RESPA.

RESPA, although enacted with the noblest of intentions, lacks built in incentives to ensure compliance. **There is much that Congress can do to improve the settlement process in this nation by passing statutory changes to RESPA that would beef up enforcement.**

A. Civil Liability under RESPA and a Uniform Statute of Limitations Would Greatly Enhance Compliance

Without a private right of action to enforce the timing and content of both the GFE and the HUD-1 under sections 4 and 5 of RESPA, a borrower's leverage to negotiate loan terms and ensure fairness in the marketplace is severely limited. Civil enforcement of each element under the new rule, especially the GFE and HUD-1 requirements, is essential in order to raise levels of compliance and thus ensure a better functioning market.

We support HUD's intention to seek statutory modifications including authority for imposition of civil penalties for sections 4, 5, 6, 8, 9, and 10 of RESPA, as well as authority for the Secretary and state regulators to obtain injunctive and equitable relief under RESPA. Better enforcement mechanisms should result in some better compliance with these

[44] *E.g.,* U.S. Dep't of Housing and Urban Dev., Office of Pol'y Dev.& Research, RESPA Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs 3-4 (2008).

requirements and the ability of state regulators to supplement the work of HUD is important.

Increased government enforcement, however, still leaves borrowers who were victims of "bait and switch" or other abusive lending with no recourse under RESPA sections 4 and 5 to directly challenge some of the main loan disclosures used to deceive them about loan terms. This is especially a concern in light of the new proposed GFE cover page. Without proper consequences for significant changes between the GFE cover page and the final loan disclosures, the GFE could be used as a tool to promote bait and switch regarding loan terms, as well as settlement costs, rather than for shopping. It could affirmatively aid in borrower deception because any misrepresentations would not be able to be stopped or challenged by the borrower. While undoubtedly some lenders would be deterred or punished through regulatory enforcement, the reach of regulatory measures is inevitably limited. As HUD itself points out in the proposed rule, without enforcement authority and clear remedies, consumers are less protected and the statute is much less effective. The remedy most likely to result in compliance is a private action by the borrower. Civil enforcement is a compliance incentive.

B. Section 8(b) Should Prohibit Overcharges, Not Only Markups.

Section 8(b)'s prohibition should apply to overcharges as well as markups. HUD has rightly indicated in its 2001 Statement of Policy[45] that unreasonable fees, even where a markup of a third-party fee is not involved, are prohibited under Section 8. We applaud HUD's inclusion of this approach in the Policy Statement, but unfortunately compliance with this provision has been limited. Every year, there are significant numbers of reported cases under Truth in Lending discussing unreasonable closing costs. We recommend that Congress clarify this by statutory language. While TILA requires the overcharges to be correctly disclosed as part of the finance charge and APR, TILA does not limit the amount of the overcharge.[46] RESPA could and should.

C. Escrow Collection Should Be Limited to the Amount Owed and Should Continue Even Where the Borrower Is 30 Days Late

Currently, servicers administering escrow accounts are permitted to collect payments so that the total paid on one year includes two extra months of funds. This practice has a particularly negative effect on homeowners who live on tight budgets, and the practice is not grounded in any reasonable expectation that such a cushion is necessary. Problems in escrow payments too often result in borrowers falling behind in their mortgage payments because the additional cost of taxes and insurance may not have been properly included in the underwriting, or because the cost of escrow has increased over time. For these homeowners,

[45] Real Estate Settlement Procedures Act Statement of Policy, 2001-1, 66 FR 53052 (Oct. 18, 2001).

[46] 12 C.F.R. 226.4(c)(7).

the requirement of paying more than what is required to cover the month's payments is onerous and unwarranted. *We recommend that Congress change the rule so that only amounts owed can be collected through escrow.*

Moreover, *we recommend that either HUD or Congress clarify that a servicer must make escrow payments even where a homeowner is 30 days late on a payment.* We believe that the statute clearly requires that escrow payments must always be made by the servicer. The regulatory exception to this rule is unwarranted and causes substantial hurdles for borrowers seeking to straighten out their payments. Specifically, one payment made 30 days late is enough to jeopardize the borrower's homeownership if taxes go unpaid, fees and costs are then added to the tax bill, potentially doubling the tax bill. At that point, a small default—a late payment—may become insurmountable. This is especially a concern where one unpaid late fee could result in a borrower being categorized as 30 days late, even where all the relevant monthly payments for that month were paid on time and in full and where the late fee itself was incurred for paying late but substantially before the 30 day mark. This occurs because a borrower who owes a late fee but only sends in the usual monthly payment generally will have the payment applied first to the late fee and then to principal and interest, thus leaving insufficient funds to cover the regular payment. As a result, the monthly payment is not paid in full and is considered late. Borrowers who are 30 days late generally are not on their way to default. Interrupting escrow makes returning to on-time status harder to achieve – an unnecessary result.

D. RESPA's Servicing Rules Must Be Updated

Recent litigation challenging abusive mortgage servicing[47] and the challenges faced by

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[47] *Islam v. Option One Mortg. Corp.*, 432 F. Supp. 2d 181 (D. Mass. 2006)(servicer continued to report borrower delinquent even after receiving the full payoff amount for the loan); *Hukic v. Aurora Loan Servicing, et al*, 2006 WL 1457787 (N.D. Ill. May 22, 2006)(servicer=s clerical error in recording amount of payment left homeowner battling with subsequent servicers and fending off foreclosure for nearly five years); *Rawlings v. Dovenmuehle Mortgage, Inc., 64 F. Supp. 2d 1156* (M.D. Ala. 1999)(servicer failed for over 7 months to correct account error despite borrowers' twice sending copies of canceled checks evidencing payments); *Choi v. Chase Manhattan Mortg. Co.*, 63 F. Supp. 2d 874 (N.D. Ill. 1999)(home lost to tax foreclosure after servicer failed to make tax payment from borrowers escrow account and then failed to take corrective action to redeem the property); *Monahan v. GMAC Mortg. Co.,* 893 A.2d 298 (Vt. 2005)(affirming $43,380 jury award based on servicer's failure to renew flood insurance policy and subsequent uninsured property damage); *Norwest Mortgage, Inc. v. Superior Court,* 85 Cal. Rptr. 2d 18 (Cal. Ct. App. 1999)(kickbacks available in force-placed insurance encourage placement); *Vician v. Wells Fargo Home Mortg.*, 2006 WL 694740 (N.D. Ind. Mar. 16, 2006) (servicers have forced-placed insurance in cases where the borrowers already had it and provided evidence of it); *Dowling V. Select Portfolio Servicing, Inc.*, 2006 WL 571895 (S.D. Ohio Mar. 7, 2006) (servicers have forced-placed insurance in cases where the borrowers already had it and provided evidence of it); *accord, Barbera v. WMC Mortgage Corp.*, 2006 WL 167632 (N.D. Cal. Jan. 19, 2006).

borrowers in the current foreclosure crisis make it clear that RESPA's servicing provisions need to be enhanced and updated. While HUD's current proposed rule focuses primarily on loan origination issues, some of the legislative changes HUD seeks look toward the post-origination phase. Escrow and servicing issues are essential to maintenance of a functioning mortgage market and to foreclosure prevention. In the current crisis, it is the servicing issues that have become paramount, yet the right to get a fair deal from a servicer is not uniformly enforceable and too often is out of reach for homeowners.[48]

- *First, RESPA must include a duty to provide reasonable loss mitigation prior to any foreclosure that prioritizes "home-saving" loss mitigation options over those that result in loss of the home.* Any loss mitigation must be based on an affordability analysis that considers the borrowers debt to income ratio and residual income—to ensure enough actual dollars for non-housing expenses—as well inclusion of the borrower's full debt profile, including junior liens on the property.

- Additionally, loan modification or forbearance agreements often contain a waiver of claims provision that purports to release the servicer and holder from any past or future claims that the borrower may have. Broad release language potentially cuts off all claims the borrower may have related to the origination or servicing of the loan; it must be banned. *RESPA also should prohibit the equally abusive practice of forcing borrowers to arbitrate any disputes with the lender or servicer.*

- Further, the current rules for responding to Qualified Written Requests do not allow a borrower to receive timely, useful information, nor do they prevent against foreclosures occurring before a response arrives. While RESPA currently requires servicers to respond to borrowers' request for information and disputes within 60 days, in practice many such inquires go unanswered. *RESPA should require that servicers respond to borrowers inquiries and disputes within 14 calendar days.* With a shorter timeline, a corresponding statutory change could then be made to remove the requirement for servicers to acknowledge receipt of QWRs. This timeline also would make it less likely that foreclosures would occur while QWRs are outstanding. *RESPA also should be amended to provide transparency to the servicing process by allowing the homeowner to obtain key information about the loan and its servicing history.* Such information should include:

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[48] These recommendations are incorporated in detail in H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, introduced by Representative Waters. NCLC has directly endorsed this legislation; it is a clear roadmap of some needed changes to RESPA's servicing rules. *See also* Written Testimony of Tara Twomey, National Consumer Law Center, also on behalf of National Association of Consumer Advocates, Before the Unites States House of Representatives Subcommittee on Housing and Community Opportunity, H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 (Apr. 16, 2008), *available at* http://www.nclc.org/issues/predatory_mortgage/content/TwomeyHR5679Testimony.pdf

- whether the account is current, or if not, the date the account went into default;

- the current balance due on the loan, including the principal due, an itemization of all fees due, an explanation of the escrow balance, and whether there is any escrow deficiency or shortage;

- a full payment history showing in a clear and easily understandable manner all the activity on the home loan since the origination of the loan, including the escrow account, and the application of payments;

- the initial terms of the loan; a copy of the original note and security instrument;

- identification of the owner of the mortgage note and any investors;

- any documents that limit, explain or modify the loss mitigation activities offered by the servicer; and

- any other information requested by the homeowner reasonably related to loss mitigation activities.

Finally, homeowners often have difficulty determining which address of the servicer is the correct one for sending QWRs. *RESPA should provide that any QWR received by the mortgagee or servicer is considered valid,* even where sent to an address other than one designated by the mortgagee or servicer for receipt and handling of such requests.

Conclusion

HUD has done an excellent job in moving the ball toward greater protection for consumers in the settlement process. The tweaks and adjustments that we recommend are important to ensure that the goal becomes the reality.

Appendix 1

NCLC MODEL SUMMARY GFE

Name of originator: ______________________________ Borrower: ______________________________

Originator Address: ______________________________ Property address: ______________________________

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Originator Phone number: ________________________ Date of GFE: ______________________________

These loan terms are available until _________. After that date, the loan terms and closing amounts can change.

<table>
<tr><td rowspan="17">Summary of loan terms</td><td colspan="3">Cost of loan</td></tr>
<tr><td>APR*</td><td colspan="2">%</td></tr>
<tr><td>Beginning monthly payment, including principal, interest, and mortgage insurance</td><td colspan="2">$</td></tr>
<tr><td>Maximum monthly payment</td><td colspan="2">$</td></tr>
<tr><td></td><td colspan="2"></td></tr>
<tr><td colspan="3">Other important loan terms</td></tr>
<tr><td>Beginning loan balance</td><td colspan="2">$</td></tr>
<tr><td>Maximum loan balance</td><td colspan="2">$</td></tr>
<tr><td>Length of loan</td><td colspan="2">years</td></tr>
<tr><td>Amount due at end of loan</td><td colspan="2">$</td></tr>
<tr><td>Interest rate can rise as early as</td><td colspan="2"></td></tr>
<tr><td>Prepayment penalty: Maximum fee you pay if you pay off the loan early</td><td colspan="2">$</td></tr>
<tr><td>Monthly escrow for taxes and insurance?</td><td>__ No</td><td>__ Yes</td></tr>
<tr><td>Total settlement costs</td><td colspan="2">$</td></tr>
</table>

* The APR is the annual rate your credit will cost you. It combines the interest rate and fees charged. You should shop on the APR instead of the interest rate. The interest rate does not include the fees.

Appendix 2

NCLC MODEL GFE DETAILS FOR BROKER COMPENSATION

MORTGAGE BROKER COMPENSATION	
Mortgage Broker Fees paid by borrower directly (included in settlement charges):	$ ___________
+additional fee received by broker from lender and paid by borrower through increased loan interest rate:	$ ___________
Total Broker Fees:	**$ ___________**

You could ask us for other loans. This loan was based on our payment of some fees to your broker or other closing costs. The table below shows how this loan compares to loans where we pay your broker more or less money.

	This loan	If we don't pay the broker	If we pay the broker more money
Loan amount	$	$	$
APR	%	%	%
Monthly payment	$	$	$
Maximum payment	$	$	$
How soon the interest rate can rise			
Maximum prepayment penalty	$	$	$
Maximum loan balance	$	$	$
Total settlement costs	$	$	$