Prepared Testimony of

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On

"HUD's Proposed RESPA Rule"

Before the

Committee on Financial Services,

Subcommittee on Oversight & Investigations

United States House of Representatives

Tuesday, September 16, 2008

Good morning Chairman Watt, Ranking Member Miller, and Members of the Subcommittee, I am Marc Savitt, CRMS, President of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on the Department of Housing & Urban Development's ("HUD") Proposed Real Estate Settlement Procedures Act ("RESPA") Rule. We appreciate the opportunity to discuss this issue, which is of vital importance both to consumers and to our members.

NAMB is the only national trade association exclusively devoted to representing the mortgage broker industry, and NAMB represents mortgage brokers in all 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. The business relationships that our

[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

members maintain with various lenders allow NAMB brokers to provide consumers with numerous financing options and to offer consumers some of the most competitive mortgage products available in the marketplace.

Once again, we would like to thank Chairman Watt and the members of the Subcommittee for their leadership and interest in HUD's Proposed RESPA Rule ("Proposed Rule"). NAMB commends this subcommittee for taking time to examine the Proposed Rule and its potential impact on consumers and our mortgage market.

I. Mortgage Brokers & the Current Market

A. The Role of Mortgage Brokers

A mortgage broker is a real estate financing professional or entity that works with both borrowers and lenders, while representing neither, to obtain a mortgage loan. A mortgage broker works with consumers throughout the complex mortgage origination process. Accordingly, a mortgage broker's role may include taking an 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 provides varies widely, depending on the nature of the transaction, the requirements of the customer, lender, or loan purchaser, and other factors.

A mortgage broker may have a working relationship with one or more banks or 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.

Mortgage brokers also facilitate competition in the marketplace and help drive costs down for borrowers. In fact, 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 constant."[2] Similarly, a study by Richard Todd of the Federal Reserve Bank of Minneapolis and Professor Morris Kleiner of the University of Minnesota stated, "[b]rokers have helped to shorten the loan process and made it cheaper."[3] This 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 experienced "higher foreclosure rates, and a greater percentage of high-interest-rate mortgages."[4]

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background check; 3) minimum of six (6) hours of professional education annually; minimum of two (2) hours of ethics training biennially; 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] 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.

[3] 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") at 7.

[4] Broker Regulations Analysis at 1.

B. Evolving Markets & The Converging Roles of Mortgage Originators

Mortgage markets have evolved rapidly in recent years, as have the roles of mortgage professionals and the entities with whom they are employed. Today, it is not uncommon for these individuals or entities to work in multiple capacities or to assume different roles in mortgage transactions.

In an analysis of mortgage broker regulations, Richard Todd and Professor Morris Kleiner noted, "the actual roles of brokers, loan officers, lenders, and others are not rigidly bound and often blur."[5] The Mortgage Bankers Association of America has also acknowledged this fact, stating recently that "Mortgage bankers sometimes function as mortgage brokers, offering the loan products of other, larger mortgage bankers."[6]

Accordingly, some state laws now expressly acknowledge that a single entity may be acting in multiple capacities – as both a lender and a broker. However, despite this shift in market realities and regulation in some states, the rules promulgated under RESPA have gone virtually unchanged since 1992.

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 (where lenders promptly repackage and sell the loans they originate) has become commonplace.

In fact, it is now common for mortgage companies to act in multiple capacities. 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.

Increasingly, mortgage bankers or lenders are functionally acting as a brokers because they often (i) enter into multiple contracts with various banks and lenders to offer an array of loan products, (ii) know at the time of closing that they have pre-sold or will quickly sell the loan, and (iii) generally know how much they will make off the loan when it is sold. Similarly, mortgage bankers and lenders sometimes operate as correspondent lenders by simply fronting mortgage funds for another bank, lender or the secondary market. As correspondent lenders, these entities are then compensated by the market, in addition to the consumer, for the temporary fronting of funds.

Conversely, we also see some brokers that act as mortgage bankers or lenders. For example, a broker may fund a loan by accessing a warehouse line of credit, and then promptly sell that loan to a purchaser who has previously committed to buy the loan.

Dramatic advances in technology have served to accelerate this 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 between historically different functions. In fact, originators today tend to use the same software regardless of whether they are acting as broker or funding the loans they originate. The distinctions that still exist between mortgage originators are largely being determined by the click of a mouse.

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[5] Broker Regulations Analysis, at 5, n.4.

[6] *Mortgage Bankers and Mortgage Brokers: Distinct Businesses Warranting Distinct Regulation,* Mortgage Bankers Association (May 2008), fn 9, at 13.

To the consumer, none of this is readily apparent. As the aforementioned 2005 university study observed, today "[b]orrowers may canvass mortgage originators without taking into account or even knowing whether an originator is a broker or lender."[7] Because consumers are largely unaware of, and indifferent to, the technical distinctions drawn between the originators with whom they are dealing, it is imperative that consumers be given the same information about the mortgage transaction regardless of the type of originator involved.

To serve consumers' interests effectively, regulatory initiatives relating to mortgage originators must address the mortgage market as it is today, not as it existed a generation ago. This means acknowledging the convergence of the roles of brokers, banks, and lenders; and applying rules equally to all of these originators.

Still, 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. These distinctions create market dysfunction which the Proposed Rule should seek to remedy, not exacerbate. Yet, in the Proposed Rule, lenders, unlike brokers, do not need to disclose what they are paid for originating loans that they do not retain for their own portfolios.

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 RESPA, and consequently, to protect consumers from unnecessarily high settlement costs. Accordingly, the Proposed Rule would, among other things, 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 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 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 put forth in the Proposed Rule, including provisions which are beyond the jurisdiction of HUD and within the purview of other federal agencies or state regulators – including Title V of H.R. 3221 (Housing & Economic Recovery Act of 2008) implementing the new mortgage originator licensing and registration law, the Secure & Fair Enforcement Mortgage Licensing (S.A.F.E. Mortgage Licensing Act). All consumers deserve the same standard of professionalism, information and protection against fraud and abusive lending practices regardless of where they obtain their mortgage. To ensure all mortgage originators are well educated and knowledgeable about the loan products they offer, NAMB has long advocated for uniform licensure, education (including ethics training) and criminal background checks for each and every individual.

NAMB objects, however, to those components of the Proposed Rule that would not best serve the consumer and instead would move away from simplifying the settlement process for consumers and further confuse consumers. NAMB has concerns with numerous aspects of the Proposed Rule either because they would impede competition, treat direct competitors differently, fail to reflect the most authoritative research, or fail to consider the most effective and least burdensome alternatives.

[7] Mortgage Pricing Study at 8.

HUD proposes to make bold changes in the marketplace through implementation of the Proposed Rule. However, in light of the current market situation – rising home foreclosures, the credit crunch, the day-to -day changes to the marketplace and rapid Congressional and regulator response, 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 have been implemented by the Federal Reserve Board. In addition, Congress continues to consider sweeping changes to how loans are originated in the United States. Before implementing sweeping changes to the settlement process, a thorough analysis should be undertaken to ensure any changes made to RESPA are done so with a positive impact on consumers and the industry that serves those consumers, not a negative impact.

At this time, NAMB believes HUD's efforts, and the mortgage market in general, may be better served by focusing on the many issues facing homeowners today and providing support for those consumers currently at risk of losing their home to foreclosure. NAMB believes HUD should continue to move forward in its RESPA reform process, but should do so in conjunction with the Federal Reserve Board in its review of Regulation Z and issue a new Proposed Rule. As regulators, Congress, and industry focus on the issues at-hand we must be cautious and ensure that the market has an opportunity to stabilize, accommodate changes, and provide the necessary assistance to borrowers facing foreclosure and in need of help from various refinancing programs administered by HUD.

III. Principles that should Guide Proposed Reforms

Any policy initiatives to be implemented by HUD or any other governmental entity must, above all else, meet two criteria.

First, the governmental entity must identify and articulate the proper policy goals. Those goals should be identified through a careful analysis of how consumers are currently served by mortgage markets, and by positing what systemic traits those markets should have to ensure that consumers' are best protected.

Second, the governmental entity must consider a full range of alternative means to achieve the articulated policy goals, and subject each of those possible alternatives to rigorous scrutiny to determine, based on all available studies and the most thorough empirical research, which alternative best achieves the policy objectives. In particular, the agency should carefully consider data and quantifiable evidence produced by other government agencies with particular expertise in the subject area or independent academic researches whose backgrounds permit them to make an informed and disinterested assessment of the relevant facts

As discussed herein, NAMB believes that the Proposed Rule implementing RESPA meets these two criteria in certain respects, but fails to do so in a number of other areas.

IV. Specific Proposals Negatively Impacting Mortgage Brokers & Consumers

A. Inequitable Disclosure of Yield Spread Premiums ("YSP")

YSP constitutes some portion of the compensation owed to a mortgage broker for the goods, services, and facilities provided when originating a loan transaction. 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 invites gamesmanship by competing originators,

which may exacerbate rather than eliminate confusion among consumers when shopping for a mortgage loan. The Proposed Rule also would at times require the reported credit to be negative, a result which almost certainly would increase confusion among borrowers.

The Proposed Rule perpetuates the inequity between broker and lender transactions, as regulated under RESPA. Despite the fact that our mortgage market has evolved and originators' roles have converged under the "originate to distribute"[8] model, the Proposed Rule maintains, and even accentuates, an artificial difference between broker transactions (disclosure of YSP) and lender transactions (no disclosure of similar indirect compensation). As we have outlined in detail above, the era of clear differentiation between competitors in the mortgage market is over. The fact that this arbitrary distinction is perpetuated in the new GFE represents a fatal flaw in the Proposed Rule.

B. Proposal to Require Use of New GFE

The Proposed Rule states that, "[I]n order for the GFE to serve its intended purpose, which is to apprise borrowers of the charges that they are likely to incur at settlement, a number of specific changes to the GFE requirements are required to make it firmer and more useable. Accordingly, [the] proposed rule would establish a new required GFE form to be provided to borrowers by loan originators in all RESPA covered transactions." [9]

The Proposed Rule presents those changes in ten subcategories, each corresponding to different aspect of the revised GFE. Those subcategories, and NAMB's comments on each, are addressed below. As noted, NAMB supports the goals which the revised GFE is meant to serve. Also, NAMB supports certain elements of the revised GFE. However, NAMB does not support the revised GFE as set forth in the Proposed Rule.

Replacing a one page form with four pages does not facilitate consumer understanding. Moreover, some of the information included in the form, such as the unwarranted distinctions among mortgage originators, serves, as the Federal Trade Commission (FTC) has concluded, to confuse consumers and impede competition. Finally, some of the most crucial information for consumers is either not given sufficient emphasis, as with the explanation of the role of mortgage originators and importance of comparative shopping, or is not addressed at all, as with information about service release premiums (SRP) and payments created by AfBA relationships.

1. <u>Changes to Facilitate Shopping</u>

The Proposed Rule would bifurcate the application process by establishing a new definition for a "GFE application" and a separate new definition for "mortgage application."

The "GFE application" would be comprised of those items of information a borrower would submit to receive a GFE, including name, Social Security number, property address, gross monthly income, borrower's information on the house price or best estimate of the property value, and the amount of loan sought. The GFE application would provide the "trigger for initial RESPA disclosures," which, HUD asserts, could then be used to facilitate comparative shopping. The "mortgage application" would be submitted after the GFE application, once the borrower chooses to proceed with a particular loan originator. The mortgage application would ordinarily expand upon GFE application by providing such

[8] Broker Regulations Analysis at 5, n.4.

[9] HUD, *Real Estate Settlement Procedures Act (RESPA): Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs under the Real Estate Settlement Procedures Act*, 73 Fed. Reg. 14.030 (March 14, 2008)

information as bank and security accounts and asset and liability information. The credit decision would then be based on the more expansive information from the borrower. Nonetheless, the Proposed Rule expressly states that "borrowers may not be rejected unless the originator determines that there is a change in the borrower's eligibility based on final underwriting …[or by] "unforeseeable circumstances."[10]

NAMB objects to the Proposed Rule's bifurcation of the application process. The new GFE application, as currently proposed, is unworkable.

Because the Proposed Rule does not present a GFE application form, parties seeking to comply with the Proposed Rule would have to rely solely on the text to determine what the GFE application would include and how it would be processed. The Proposed Rule specifies certain information that would be listed on the form, such as Social Security numbers and property addresses, but does not include certain key information, such as borrower assets and property appraisals, that would be critical to the lender's response. Also, the Proposed Rule does not provide needed guidance on such points as whether a GFE application would be required in all instances, whether it would be signed, and what would constitute "unforeseeable circumstances" sufficient to justify revising the terms specified in the GFE. Further, the Proposed Rule fails to explain how the GFE application and revised GFE would be coordinated with such other provisions of applicable law, such as Federal Reserve Board Regulations B, C, and Z. Nor does the Proposed Rule explain when redisclosure of a GFE application may be required or how that might work.

Perhaps most troubling, without a proposed form, there also has not been any of the testing which, as the Proposed Rule notes at great length elsewhere, is essential to development of sound policies and effective forms.

2. Addressing Up-Front Fees that Impede Shopping

The Proposed Rule would limit the fees that could be charged by a loan originator to provide a GFE to "the cost of providing the GFE, including the cost of an initial credit report."[11]

NAMB does not object to limiting the fees that could be charged to provide a GFE to the loan originator's costs in doing so. NAMB believes that, so long as regulatory impediments do not impede competition, the marketplace will tend to reduce those fees in most cases, perhaps even to zero. However, until the Proposed Rule is implemented, it is impossible to predict how burdensome this provision would prove to be, and how substantial the costs loan originators would be required to bear as a result. In view of that uncertainty, the Proposed Rule must provide loan originators with needed flexibility, particularly since GFEs—unlike, for example, the credit reports which applicable law requires be made available to consumers at no cost at least annually—may not be provided through automated means, and involve a very real commitment of time and resources to prepare.

3. Introductory Language

The Proposed Rule would add introductory language to the GFE that explains the interest rate, settlement charges, settlement date, and the timing required to lock in the interest rate. In addition, the Proposed Rule would add language at the end of the GFE (though it is discussed in the subsection of the Proposed Rule relating to "Introductory Language"), which advises consumers that "Only you can shop for the best loan for you. Compare this GFE with other loan offers, so you can find the best loan."[12]

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[10] Id. at 14,035-36.
[11] Id. at 14,036.
[12] Id. at 14,036, 14,095-97.

NAMB believes that the introductory language set forth by the Proposed Rule, as well as the language encouraging comparative shopping proposed at the end of the revised GFE, is either inaccurate or inadequate and should be improved.

The Proposed Rule would revise the introductory language of the GFE to read, "The interest rate for this GFE will be available until ____." Yet it is potentially misleading to suggest that a borrower will receive a specific interest rate prior to final application. A more accurate alternative would be to state, "The interest rate quoted on this GFE is ___. This rate is not guaranteed. Until it is locked, this rate will float with the market and can change without notice." It is very important that the consumer understand that fact. Failure to do so will lead to confusion about what is, in many cases, the single most important economic attribute of the loan—the interest rate. NAMB strongly supports revising the GFE to encourage comparative shopping. In general, NAMB believes that the better informed consumers are, the more likely they are to make a more sound financial decision. However, as currently drafted, the revised GFE appended to the Proposed Rule would foster less understanding of the loan origination process, not more.

The language encouraging comparative shopping is also inaccurate in that it incorrectly characterizes the GFE as a "loan offer." That is misleading. The proscribed text leaves borrowers with the impression that they have been approved; they have not. As the Proposed Rule itself notes, a credit decision, and thus a loan offer, cannot be made until a mortgage application is received and processed. Thus, that reference should be changed to "other estimates."

In addition, the language encouraging comparative shopping should be made even more conspicuous, more emphatic, and more informative. Specifically, NAMB strongly encourages HUD to adapt language developed by the FTC based on extensive testing on consumers.

As noted, over the course of several years, the FTC conducted research into the efficacy of proposed disclosures and their effect on consumer decisions and market outcomes. The FTC has presented its findings in two separate reports totaling over 400 pages. In addition, those reports specifically address the asymmetrical disclosure obligations imposed upon brokers, but not other originators performing similar functions and being paid similar compensation. The prototype disclosure forms developed by the FTC include prominent legends in large typeface which expressly advise borrowers that mortgage originators, including both brokers and lenders, do not represent borrowers, and thus the "lender or broker providing this loan is not necessarily shopping on your behalf or providing you with the lowest cost loan." The legend also encourages borrowers, in all caps, to "COMPARISON SHOP TO FIND THE BEST DEAL."[13] FTC testing showed that consumers got the message.

NAMB strongly urges HUD to adopt the FTC prototype disclosure forms instead of implementing the Proposed Rule's provisions on broker compensation. If the FTC forms are not adopted in their entirety, NAMB also suggests that the FTC language be incorporated earlier in the form, and in a more prominent typeface, than the language at the end of the proposed GFE addressing comparative shopping. The FTC forms have been thoroughly tested, and they are more effective means of addressing the policy concerns raised by the Proposed Rule. Also, as the FTC has explained, the prototype forms do not create anti-broker bias that can impede competition and lead consumers to make choices that are not in their best interests.

4. Terms of the GFE (Summary of Loan Details)

[13] 2007 FTC Study at H-13.

The Proposed Rule would provide that the revised GFE include a summary of the key terms of the loan, including the initial loan amount, the loan term, the initial interest rate, the initial monthly payment, and the rate lock period.[14]

NAMB supports inclusion of the loan details identified by the Proposed Rule in the GFE. In addition, NAMB believes that consumers would be well served by the inclusion of certain additional monthly expenses specific to the property, such as homeowners' association dues, if applicable.

5. Period During Which the GFE Terms are Available to the Borrower

The Proposed Rule would provide that the interest rate stated on the GFE would be available until a date set by the loan originator. The estimate of the charges for all other settlement services would be available for at least ten business days. [15]

As noted, NAMB believes that it is meaningless, and potentially misleading, to suggest that a borrower would receive a specific interest rate prior to final application. As a consequence, NAMB suggests more specific language making it clear that the quoted rate may change until locked.

The "ten business day" period during which estimated settlement charges would be available is too long. Ten "calendar days" would be more reasonable, and would conform more closely to market realities.

6. Consolidating Major Categories on the GFE

Under current RESPA rules, the GFE simply lists estimated charges or ranges of charges for settlement services. The Proposed Rule would group and consolidate all fees and charges into major settlement cost categories, with a single total amount estimated for each category. [16]

NAMB objects to consolidating major categories of the GFE. Such categories tend to lead to confusion, not clarity, as components are not evident to consumers until presented with the HUD-1, in which they are disclosed separately.

RESPA now requires, under Part 3500, Appendix D, a special form for payments by a referring party to a settlement service provider involved with an Affiliated Business Arrangement. This disclosure statement must be made in writing at or before the time of the referral and must be acknowledged by the mortgage applicant. This disclosure includes the name of the provider of the settlement service and the charge or range of charges. It also delineates between those items that may not be required by the originator and those that may be required. This form contemplates the name and amount of charges the applicant will pay. This existing form is in direct conflict with the new GFE as proposed. By eliminating the disclosure of the name of the provider on the GFE, it renders this important consumer protection form useless. By grouping certain charges into categories, some of the charges on this document are now combined with other amounts that are not covered under the AfBA disclosure. Only confusion can be the result of creating cost groupings and not amending the required disclosure under Part 3500, Appendix D. It will also make it impossible for the consumer to shop settlement service providers who are not affiliated. NAMB believes that consumers will lose this important consumer protection (choice of provider and prohibiting required use) and will be confused by such a change. At the very least, HUD should formally address this issue and consumer test the combination of the new GFE with the existing AfBA form to determine what such a change will bring to the marketplace.

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[14] 73 Fed. Reg. at 14,036.
[15] Id. at 14,037.
[16] Id.

Regulation X under RESPA, Section 3500.7 also requires a disclosure if a particular provider is required (Section 3500.2) by the lender (other than the lender's own employees). This disclosure must state that the provider is required to give the name, address, and phone number of each provider, and describe the nature of any relationship between such provider and the lender. NAMB believes that this is an important consumer protection that should be maintained. Required use, in any form, gives rise to the possibility of higher prices to the consumer and eliminates the possibility of the consumer shopping for such service or rejecting the lender's loan offer. By eliminating the detail on the GFE as proposed, the requirements under this section of RESPA are rendered confusing at best and harmful at worst. Some of these charges will naturally be grouped under the new GFE as proposed, thereby eliminating the detail on that form, only to have a different form executed by the consumer which includes certain items but not others. How is a consumer to determine the appropriateness of a charge when it is grouped on one form and itemized on another? How is a consumer to determine the nature of the relationship? Additionally, the consumer has no way to compare the detailed costs on this form versus the grouped costs on the proposed GFE. NAMB believes that consumers will lose this important consumer protection and will be confused by such a change. At the very least, HUD should formally address this issue and consumer test the combination of the new GFE with the existing 'Particular Providers' form to determine what such a change will bring to the marketplace.

NAMB recommends that the reference to charges for "services" not be used on the proposed GFE with respect to originators. Use of that term presents a potential conflict with state law, as some states expressly prohibit originators from imposing a "service charge," and presents state tax concerns due to current and contemplated state taxes on "services." Use of the term also presents a concern relating to federal tax code provisions that allow consumers to deduct broker origination fees. Characterizing such fees as a "service charge" could affect their deductibility under Internal Revenue Service ("IRS") regulations. A possible alternative could be "origination charges," which would also correspond to the reference to "Adjusted Origination Charges."

NAMB also recommends that the GFE include the names of service providers selected by the loan originator to facilitate comparative shopping.

In addition, NAMB notes that the RESPA statute expressly provides for the disclosure of a "range" of settlement charges and fees.[17] Accordingly, NAMB questions whether HUD, whose regulations must be consistent with the authorizing statute, has the authority to pronounce that loan originators who disclose a range of charges and fees do not comply with RESPA.

7. Option to Pay Settlement Costs

The revised GFE appended to the Proposed Rule would include a statement advising the borrower how the interest rate of the loan affects the borrower's settlement costs, and include actual available options in that regard on the GFE form.

NAMB strongly supports inclusion of information regarding the relationship between closing costs and interest rates on the proposed GFE. Understanding of that relationship is central to understanding loan pricing, originator compensation, and other basic economic elements of the mortgage process.

8. Establishing Meaningful Standards for GFEs

[17] 12 U.S.C. § 2601.

The Proposed Rule would prohibit costs for originators' service charges, adjusted origination charges, locked interest rates, and government recording and transfer charges that are charged at closing from exceeding the estimates for those costs listed on the GFE "absent unforeseeable circumstances." In addition, the Proposed Rule would prohibit the sum of all other services from increasing at settlement more than ten percent "absent unforeseeable circumstances."

NAMB supports the proposal to limit increases in costs disclosed on the GFE that are later assessed at closing. However, further guidance is needed as to what constitutes "unforeseeable circumstances," including specific and detailed examples so that parties seeking to comply have reasonable assurance that they do so.

9. Important Information for Borrowers

The Proposed Rule would include in the revised GFE information for borrowers that, HUD asserts, would enhance their understanding about the process of obtaining a mortgage loan. That information, which would be listed on the fourth and final page of the GFE, would address: the financial responsibilities of homeowners, how to apply for the loan described on the GFE, how to obtain more information, how to use the shopping chart, and the consequences of any sale of the mortgage loan.

NAMB generally supports the inclusion of the information listed on page four of the proposed GFE. However, NAMB believes that the information relating to the consequences of any sale of the mortgage loan, which are described in small print at the very end of the form, merits greater emphasis and more detail. Specifically, NAMB proposes that the description of the additional compensation to lenders which would occur upon sale of the loan should be moved to block two on page two of the proposed form, where it should appear beneath the check box stating "The credit or charge for the interest rate you have chosen is included in our 'service charge'." SRPs are, like YSPs, a form of compensation, and should be identified as such to the borrower in a place and in a manner which facilitates the consumer's understanding of the similarities between the two.

More fundamentally, as discussed in detail below, NAMB strongly advocates ensuring that the GFE, HUD-1, and any other documents developed by HUD under RESPA impose symmetrical disclosure obligations on all mortgage loan originators. Failure to do so would deprive consumers of important information, and compromise their economic interests by impeding competition among originators.

10. Enforcement

The Proposed Rule provides that charging a fee in excess of the tolerance, or any other failure to follow the GFE requirements, constitutes a violation of Section 5 of RESPA.

NAMB supports the Proposed Rule's enforcement provisions, provided both that NAMB's suggested changes to the GFE form are implemented, and that HUD adopt a provision currently under consideration that would allow loan originators a limited period of time to remedy any potential violations of the tolerances set forth in the Proposed Rule.

C. Lack of Authority

The Proposed Rule fails to cite any authority in support of its characterizations of broker conduct, and fails to propose policies which would address that conduct if it existed.

In rationalizing HUD's position with respect to the disclosure of YSPs, the Proposed Rule states,

> [M]any brokers hold themselves out as shopping among the various funding sources for the best loan for the borrower, and do not explain to the borrower that the payment they receive from the lender is derived from the borrower's interest rate. Some may even assert that the YSP is not a payment the borrower needs to be concerned with.[18]

Not a single citation is offered in support of these accusations. In the recent case of AmeriDream v. Jackson, the Federal District Court for the District of Columbia took the extraordinary step of voiding a HUD regulation because, among other grounds, the regulation was based on "flimsy anecdotal evidence."[19] The assertion in the Proposed Rule about the conduct of mortgage brokers is worse: it is based on no evidence at all.

Rather than impugning brokers, a more constructive approach would be for HUD to examine current law and industry practice to determine what provisions are currently in place to ensure that borrowers fully understand the relationship of loan originators to the borrower, the importance of comparative shopping, and the interplay between mortgage rates, originator compensation, and closing costs, and assess how those provisions might be strengthened.

In fact, federal and state law, as well as NAMB policies, already direct that mortgage brokers make it very clear that the broker is acting as an independent agent and not necessarily acting to obtain the best loan for the borrower.

For example, when a prospective homebuyer applies for a loan, they are provided with a document drafted by HUD, Buying Your Home: Settlement Costs and Helpful Information.[20] That pamphlet advises borrowers, in bold-face type, that "A mortgage broker may operate as an independent business and may not be operating as your 'agent' or representative."[21] Accordingly, HUD further advises borrowers, "Your mortgage broker may be paid by the lender, you as the borrower or both."[22] The Proposed Rule makes no mention of this information which HUD already provides to every prospective borrower, does not explain why the current disclosure is inadequate, and does not identify any basis for concluding that borrowers will pay more heed to that information if simply presented in another form. To the contrary, the Proposed Rule presumes, without citing any source as a basis for that presumption, that borrowers mistakenly view brokers as acting in a capacity which HUD already advises borrowers is not the case.

In addition to current HUD disclosures, NAMB itself has developed a more detailed disclosure document describing the role of mortgage originators, the use of which has been mandated by several states and the District of Columbia. NAMB believes this form should be required nationally.

In the late 1990s, NAMB developed that disclosure form, or Mortgage Loan Origination Agreement ("Agreement), to be given to a prospective borrower before application. That form, which is very widely used today as a supplement to the GFE and HUD-1 disclosure forms, expressly states that the broker does not represent the borrower and is not obligated to obtain the best deal.

The Agreement is simple and direct, consisting of only two short paragraphs, one describing the nature of the broker relationship and one explaining how brokers are compensated. Furthermore, the Agreement is typically presented to the consumer for review even before making the loan application; a signed copy of

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[18] Id. at 14,042. (Emphasis added.)
[19] *AmeriDream v. Jackson*, Civil Action No. 07-1752 (PLF)(D.D.C. 2008) at 18.
[20] U.S. Dep't of Hous. & Urban Dev., *Buying Your Home: Settlement Costs and Helpful Information* (June 1997)
[21] Id. at 4.
[22] Id. at 4.

the Agreement is among the materials required to initiate the application process. The operative portion of the Agreement paragraph states in its entirety:

> **Section 1. Nature of Relationship**
> In connection with this mortgage loan we are acting as an independent contractor and not as your agent. We will enter into separate independent contractor agreements with various lenders. While we seek to assist you in meeting your financial needs, we do not distribute the products of all lenders or investors in the market and cannot guarantee the lowest price or best terms available in the market.
>
> **Section 2. Our Compensation**
> The lenders whose loan products we distribute generally provide their loan products to us at a wholesale rate. The retail price we offer you—your interest rate, total points, and fees—will include our compensation. In some cases, we may be paid all of our compensation by either you or the lender. Alternatively, we may be paid a portion of our compensation by both you and the lender. For example, in some cases, if you would rather pay less up-front, you may be able to pay some or all of our compensation indirectly through a higher interest rate in which case we will be paid directly by the lender. We may also be paid by the lender based on (i) the value of the loan or related servicing rights in the market place or (ii) other services, goods or facilities performed or provided by us to the lender.[23]

In addition to the disclosures currently mandated by applicable law or industry practice, NAMB strongly supports still more disclosures to that effect, such as that proposed by the FTC, which describe the relationship of loan originators to the borrower, highlight the importance of comparative shopping, notify the borrowers that they are the only ones who can conduct that comparative shopping on their own behalf, and explain the interplay between mortgage rates, originator compensation, and closing costs.

For example, NAMB supports enhancing the language noted in small type at the top of page three of the proposed GFE regarding comparative shopping, as well as the language in small type at the very end of the proposed GFE regarding the fees that may be received by a mortgage originator upon a subsequent sale of the loan. Specifically, NAMB supports addressing the issues of comparative shopping and originator compensation together. Highlighting the sources of originator compensation – that is, that it may come in whole or in part from lenders – underscores the importance of a borrower comparison shopping on his or her own behalf. In addition, because that point is so critical for a consumer to understand, NAMB supports making it much more prominently and emphatically in the document.

Towards that end, NAMB strongly recommends that HUD adapt the text of the disclosure that the FTC developed based on extensive testing of how to promote informed decision making among prospective borrowers.

Like most good ideas, the FTC's proposal is simple. In essence, it would mandate disclosure of the Agreement in a more condensed and emphatic form. The FTC proposal would include a legend in the disclosure form that states, in large block letters, "HOW TO PROTECT YOURSELF." Beneath that is the statement "COMPARISON SHOP TO FIND THE BEST DEAL—The lender or broker providing this loan is not necessarily shopping on your behalf or providing you with the lowest cost loan."[24] The FTC found that consumers got the message: the efficacy of that alternative solution was confirmed by

[23] Id.
[24] 2007 FTC Study at H-13.

empirical testing. In addition, because the FTC language acknowledged the similar roles of all mortgage originators, it did not impede the competition among originators that serves consumers well.

Although the Proposed Rule, without citing any authority for the statement, singles out mortgage brokers and claims they hold themselves out as shopping for the best loan for the borrower, the leading study on that point demonstrated that borrowers view both brokers and lenders as providing such assistance. As a consequence, any policy initiative meant to dispel that misconception should address all originators.

D. Inadequate Consideration of Empirical Data & Flawed Methodology

Exhaustive studies of mortgage disclosures by the FTC, the government's principal consumer protection agency, in 2004 and 2007[25] show that additional disclosures of mortgage broker compensation create confusion, cause consumers to choose more expensive loans, lead to a bias against mortgage broker transactions, and impede competition, thus hurting consumers.

Similarly, a 2008 study commissioned by the Board of Governors of the Federal Reserve concluded that upfront disclosures which single-out mortgage broker compensation may bias consumers against working with mortgage brokers and lead consumers to believe they will always pay less commission when working with a direct lender.[26]

Finally, in April 2007, the Joint Center for Housing Study at Harvard University released a 75 page report ("Harvard Mortgage Markets Study") which detailed the similarities between different loan originators, including the way both brokers and loan officers are compensated, along with the common consumer protection concerns each origination channel presents. Among the key recommendations presented in this report was a call for federal regulators to "establish minimum standards and apply rules equally to the marketplace," and to "create effective and adequately funded enforcement strategies to ensure that all mortgage brokers, loan officers, and mortgage originators play by the same rules."[27]

One of the Harvard Mortgage Markets Study's two authors, Ren Essene, echoed these points at a June 14, 2007 Federal Reserve Board hearing on the Home Equity Lending Market, 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.[28]

Neither the Harvard Mortgage Markets Study nor Ren Essene's testimony is discussed, or cited, by the Proposed Rule. Moreover the Proposed Rule fails to give proper consideration to much of the other

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[25] 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").

[26] *See attached,* Macro International, Consumer Testing of Mortgage Broker Disclosures (July, 2008)("Broker Disclosure Study").

[27] Ren Essene & William Apgar, Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans, Joint Center for Housing Studies, Harvard University (2007)("Harvard Mortgage Markets Study")at vi.

[28] 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.

relevant and authoritative research conducted by the FTC, the Federal Reserve Board, and university scholars at a number of institutions.

Instead, the Proposed Rule relies exclusively on flawed methodology to assess the efficacy of revised disclosures relating to mortgage broker compensation. The HUD contractor that conducted the studies cited in the Proposed Rule failed to test the disclosures in actual transactions involving competing originators. The HUD contractor also failed to test consumer understanding of loan terms and consumers' ability to effectively comparison shop when YSP was not disclosed. Instead, the HUD contractor *assumed* the answer to the most fundamental question, which is, whether YSP disclosure aides consumer understand and comparison shopping.

Without empirical evidence to support the hypothesis, HUD conducted tests under the assumption that it is beneficial to consumers if YSP is disclosed. Therefore HUD's tests focused only on how, not whether, to disclose YSP. Similarly, HUD concluded, *without testing*, that there would not be a benefit to consumers if indirect lender compensation were to be disclosed in the same manner as YSP. As a result, HUD tested only the disclosure of indirect broker compensation.

E. Proposal to Modify the HUD-1 Settlement Statement.

The Proposed Rule would modify the current HUD-1/1A Settlement Statements to allow the borrower to compare easily specific charges at closing with the estimated charges listed on the GFE. In addition, an addendum would be added to the HUD-1/1A that would compare the loan terms and settlement charges estimated on the GFE to the final charges on the HUD-1 and would describe in detail the loan terms for the specific mortgage loan and related settlement information. The settlement agent would be required to read the addendum aloud to the borrower at settlement and provide a copy of it at settlement.

NAMB believes that the HUD-1 and GFE should mirror each other and promote clarity, understanding, and ease of use for consumers. However, because the proposed GFE, at four pages, is less user-friendly than the current version, mirroring the HUD-1 after the proposed document will not make it easier for consumers to understand and use.

F. The Closing Script

NAMB opposes the closing script. The closing script is certain to increase costs for consumers and lower the number of loans that can be closed in a day. NAMB estimates that the additional time and resources which would be consumed by implementing the closing script would average approximately $500 per loan, with no commensurate, or even discernible, benefit to consumers in light of disclosures already mandated. The closing script also presents practical and legal concerns. As a practical matter, loan closings would be further delayed, which in turn would make locking in loan terms more problematic. Also, the closing script would require the closing agent to assume an advisory role, particularly when the borrower asks questions, which may trigger state regulatory and licensing requirements. Also, the closing script would present issues relating to allocating responsibilities—and liabilities—among professionals involved with the loan.

G. Harmonization of HUD's Proposed RESPA Rule with the Federal Reserve's Truth In Lending (TILA) Rule

As the Proposed Rule notes, the Federal Reserve Board proposed new regulations under TILA relating to disclosure. Those proposed regulations were issued on January 8, 2008[29] and finalized on July 30, 2008.[30]

The Federal Reserve Board's (Board) Proposed Rule addressed the YSP in a manner that was, admittedly so, confusing to the consumer and reduced competition in the marketplace. In our comment letter, NAMB stated that the manner in which the Board was requiring such disclosure of the YSP was confusing to the consumer. NAMB explained that by applying such disclosures to mortgage brokers but not to creditors' employees who originate loans, would reduce competition in the market and harm consumers. NAMB explained that disclosing a broker's compensation would cause consumers to believe, erroneously, that a loan arranged by a broker would cost more than a loan originated by a loan officer. The FTC commented and cited its published report of consumer testing on mortgage broker compensation disclosures, and stated that focusing consumers' attention on the amount of the broker's compensation could confuse consumers and, under some circumstances, lead them to select a more expensive loan. The Board considered these comments, conducted consumer testing and withdrew the proposal relating to YSP. In its final rule, the Board stated it is "concerned that the proposed agreement and disclosures would confuse consumers and undermine their decision-making rather than improve it." [31] The Board recognized that such disclosure of the YSP, as proposed, would not serve in the consumers' interest and in fact, would further confuse the consumer. HUD's Proposed RESPA rule requires disclosure of the YSP that will produce the same or a similar result as the Board's proposed YSP disclosure.

The Board stated that they will "continue to explore available options to address potential unfairness associated with originator compensation arrangements such as YSP. As the Board comprehensively reviews Regulation Z, it will continue to consider whether disclosures or other approaches could effectively remedy this potential unfairness without imposing unintended consequences."[32] NAMB believes HUD, at a minimum, should take the same approach with its RESPA rule.

HUD's Proposed Rule states, "As HUD moves forward to finalize this rule, it will continue to work with the Board to make the respective rules consistent, comprehensive, and complementary."[33] Noting that intention, however, is of no consequence. Just as the Proposed Rule must explain how it relates to existing law, it must explain how it relates to the Board's amendments to Regulation Z. The Administrative Procedures Act (APA) requires as much, as does sound rulemaking.

The Proposed Rule also does not address the Risk-Based Pricing regulations[34] the Federal Reserve Board and FTC recently proposed pursuant to the "Fair and Accurate Credit Transactions Act of 2003," or "FACT Act."[35]

The FACT Act, which amended the Fair Credit Reporting Act ("FCRA"), created a new disclosure requirement – the Risk-Based Pricing Notice ("RBP"). The RBP must be given to the consumer when the credit report affects pricing or other terms of the credit product. Specifically, the statute says that the RBP must be given to a consumer when credit is extended on "material terms that are materially less favorable than the most favorable terms available" to a "substantial proportion" of that creditor's other

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[29] Federal Reserve, Proposed Rule Amending Regulation Z, Implementing the Truth In Lending Act and Home Ownership and Equity Protection Act 73 Fed. Reg. 1,672.
[30] Federal Reserve, Final Rule Amending Regulation Z, Implementing the Truth In Lending Act and Home Ownership and Equity Protection Act, 73 Fed, Reg. 44,522.
[31] 73 Fed. Reg. at 44,563.
[32] 73 Fed. Reg. at 44,565.
[33] 73 Fed. Reg. at 14,034.
[34] Federal Reserve Board and FTC, *Fair Credit Reporting Risk-Based Pricing Regulations*, 73 Fed. Reg. 28,966 (May 19, 2008).
[35] Public Law 108-159.

customers. The notice may generally be provided at application, communication of an offer of credit, or when the credit is granted (closing for real estate transactions), which would allow lenders and brokers to provide a generic notice to all applicants at the time of application. But the FACT Act allows the Federal Reserve Board and FTC to specify the timing of providing the notice after the credit report has been used to set the rates and terms of the offer, thereby making the notice much more consumer-specific. Those requirements could affect RESPA regulations in numerous ways, none of which are addressed by the Proposed Rule. It is essential that the Proposed Rule assess their impact before finalizing still more mandated disclosures.

HUD should seek public comments on the interaction between its proposal, the final amendments to Regulation Z and the pending RBP regulations. HUD should also work with the Board as it considers additional disclosures pursuant to Regulation Z. Further, input from the parties who must comply with, and hope to benefit from, HUD's Proposed Rule is certain to improve any final regulation.

H. Administrative Procedures Act Compliance

The rulemaking process by federal agencies, including HUD, is governed by the APA, which sets forth clear standards which 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. As the U.S. Circuit Court for the District of Columbia made clear in Association of Data Processing Service Organizations, Inc. v. Board of Governors of the Federal Reserve System, Section 706(2)(A) of the APA "enable[s] the courts to strike down, as arbitrary, agency action that is devoid of needed factual support."[36]

V. Recommendations

NAMB urges HUD to adopted recommended changes stated herein. NAMB urges HUD to conduct further research into the operation of modern mortgage markets and the efficacy of proposed disclosures, taking into account not only how YSP should be disclosed, but whether it should be disclosed, along with whether and how other forms of indirect originator compensation might be effectively disclosed. In

[36] *Ass'n of Data Processing Svc. Orgs., Inc. v. Bd. of Govs. of Fed. Reserve System*, 745 F.2d 677, 683 (D.C. Cir. 1984).

conducting this research, NAMB strongly encourages HUD to give proper consideration to key studies in the field, such as those mentioned above.

HUD should also undertake new testing of any proposed disclosures, which both assesses how the forms would be used by actual mortgage originators, and how they would be received by actual borrowers in real transactions. Ultimately, we believe that new and comprehensive testing will further illustrate the need to amend the Proposed Rule and modify the GFE so there is equal disclosure of YSP and the similar compensation that lenders pay to their own sales staff.

Policies and promulgated rules that accentuate and perpetuate an artificial distinction between mortgage brokers and their direct competitors will only serve to impede competition, limit consumer choice, increase retail pricing, and ultimately hurt consumers.

VI. Conclusion

NAMB has strongly and repeatedly urged HUD to modify the GFE so that consumers understand the disclosures they are reading, to ensure that direct competitors are treated the same and that the artificial distinctions which still exit in mortgage transactions covered by RESPA disappear.

Today, we ask the members of this subcommittee to join us in calling upon HUD to: (1) refrain from publishing a final rule until the market has had ample opportunity to absorb and adjust to the changes and turmoil it has already endured; (2) focus immediate attention on helping borrowers in distress refinance through HUD-administered programs and avoid foreclosure; (3) revise the GFE, giving proper consideration and weight to the numerous studies calling for clarification of the disclosures and uniformity of disclosure across all distributions channels; (4) field test any prototype disclosure, with real consumers, prior to implementation; and (5) work in conjunction with the Federal Reserve to harmonize HUD's RESPA Proposal with the disclosures pursuant to Regulation Z.

NAMB strongly supports measures which empower consumers to make informed decisions to select a mortgage product based upon their own assessment of the comparative price, most appropriate product, and highest quality of service.

Again, thank you for the opportunity to appear before this subcommittee today to discuss this important issue. I am happy to answer any questions that you may have.