Written Statement

of

Arne Rovick
Vice Chairman and General Counsel
Edina Realty Home Services

On Behalf of

The Real Estate Services Providers Council, Inc. (RESPRO®)

Before the
U.S. House of Representatives
Subcommittee on Housing and Community Opportunity
of the
Committee on Financial Services

On

"Simplifying the Home Buying Process:
HUD's Proposal to Reform RESPA"

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Good afternoon, Mr. Chairman and members of the Subcommittee. My name is Arne Rovick and I am Vice Chairman and General Counsel of Edina Realty Home Services, a full service real estate brokerage company headquartered in Edina, Minnesota.

Edina Realty Home Services is the parent company of Edina Realty, Inc., which participated in over 33,000 residential real estate sales transactions in the year 2002 for a total volume of $7 billion, through 70 residential real estate brokerage offices and 2900 real estate sales associates in Minnesota and western Wisconsin.

Edina also is the co-owner along with Wells Fargo Home Mortgage of a joint venture called Edina Realty Mortgage, LLC, which originated over 6300 residential mortgages in the year 2002 for approximately $1 billion, and the parent of Edina Realty Title, Inc., which issued over 10,000 title insurance policies and performed 20,000 closings in the year 2002.

Today, I represent the Real Estate Services Providers Council, Inc. (RESPRO®), of which I was past Chairman and currently serve as a member of the Board of Directors.

RESPRO® is a national non-profit trade association of approximately 220 leading companies in the home buying and financing industry (see attached membership list). Our members represent a cross section of the industry, including real estate brokerage companies, mortgage lenders/brokers, title insurers/agencies, vendor management companies, and other settlement service providers.

RESPRO® members united in 1992 to promote an environment that allows providers from all industries to offer home buyers and owners the benefits of diversified services, known as "one-stop shopping."

Because RESPA's referral fee provision (Section 8) regulates the flow of funds to gain access to the consumer, any attempts to change it by either Congress or the

Department of Housing and Urban Development (HUD) inevitably create “turf battles” among industries that compete for that access.

RESPRO®, however, believes that our cross-industry membership gives us a broader perspective on RESPA issues than that of a single-industry association. RESPRO® members began to review “packaging” proposals similar to that proposed by HUD in its pending RESPA rulemaking as early as 1996. Despite our members’ different industry perspectives and interests, we were able to agree on a “consensus” position on a packaging that is based upon the fundamental premise that consumers are better served if *all* providers, regardless of their industry or affiliation, can offer their products and services in an open and competitive marketplace. It is that premise that forms the basis of my testimony today.

I. **Overview**

RESPRO® supports HUD’s goals of providing consumers (1) settlement cost information early in the process, (2) the ability to shop for the mortgage product and settlement services that best meet their needs, and firm disclosed costs that would avoid surprises at settlement; (3) the benefit of new products, competition and technological innovations that could lower settlement costs; (4) access to better borrower education and simplified disclosure; and (5) vigorous RESPA enforcement and a level playing field for all industry providers. [1]

However, RESPRO® believes that HUD’s specific proposal to give lenders a RESPA safe harbor for guaranteeing an entire loan “package” at the time of application would not accomplish these goals because (1) virtually all lenders and certainly all non-lenders are unable to guarantee the interest rate as HUD’s proposal would require them to do; (2) non-lenders such as real estate brokers, home builders and title or other settlement

[1] “Martinez announces ‘Homebuyer Bill of Rights’— Part of Bush Administration Effort to Expand Homeownership”, HUD Press Release (June 26, 2002).

service companies would as a practical matter be excluded from competing in the packaging marketplace; and (3) consumers could not effectively shop among packages because the services included in the package would not be required to be itemized and consumers would have no way of comparing the contents of each package.

To correct these deficiencies, RESPRO® has proposed to HUD a "Two-Package Concept" that would (1) make it more viable for lenders and non-lenders to package by eliminating the guarantee of the interest rate; (2) increasing competition in the packaging marketplace by allowing non-lenders like real estate brokers, home builders, and title or settlement service companies to offer settlement service packages directly to consumers; (3) allowing consumers to compare packages by itemizing the services in each package; and (4) preventing unscrupulous lenders from engaging in "bait and switch" techniques that involve increasing an interest rate at the last minute to make up for price concessions on a settlement service package.

RESPRO® also believes that HUD's proposed "binding Good Faith Estimate (GFE)" – the only alternative to "packaging" -- would significantly disrupt the marketplace by increasing liability risks for lenders, creating consumer confusion, and increasing administrative burdens for providers in all industries. Therefore, RESPRO® recommends that HUD leave the current regulatory environment in place as the packaging option is being tested in the marketplace.

II. <u>The Guaranteed Mortgage "Package"</u>

HUD's proposed rule would attempt to encourage mortgage lenders to offer a "Guaranteed Mortgage Package" three days after application, which would include a guaranteed interest rate subject to changes in a verifiable market index yet to be established and a total lump-sum cost for all settlement services the lender requires to close the loan (e.g., underwriting fee, appraisal, credit report, pest inspection, title insurance, closing services). The guarantee would be good for 30 days or until the consumer accepts the package.

Lenders who offer a "Guaranteed Mortgage Package" would be provided a safe harbor under RESPA's anti-kickback prohibition (Section 8) for transactions involving services within a loan "package". This would allow them to negotiate volume discounts with providers of services to be included in the package, be paid by third party providers for including their settlement services within the package, require the use of affiliated settlement services, and offer affiliated settlement services without providing the RESPA-required affiliated business disclosure.

While RESPRO® supports HUD's goal of promoting consumer shopping, we do not believe that its proposed Guaranteed Mortgage Package (which we will refer to as "HUD's packaging proposal") would achieve this goal for several reasons.

A. The Interest Rate Guarantee Would Not Be Viable for Lenders

Under HUD's packaging proposal, lenders would only get a RESPA safe harbor if they offer a guaranteed interest rate for 30 days to virtually anyone who inquires about a loan, provides basic income information about himself, and estimates the property's value. They would be expected to guarantee the rate with the knowledge that a large majority of potential borrowers would not in fact close their loans with them, although they could if interest rates rise above the guaranteed rate.

While HUD proposes to allow the interest rate to vary according to a verifiable index or other appropriate measure (which to date no one has been able to establish), lenders set prices according to the present cost of funds, which change hourly, if not more frequently, according to a long list of market factors and perceptions about such factors.

Given this environment, it is no sooner possible to guarantee an interest rate against an index than it is to guarantee a stock's movement or a stock or interest rate option against an index. While interest rates, stocks, and options may sometimes move consistent with the prime rate, the federal funds index, the Dow Jones, or Wilshire 5000, the rate of any one loan product can change numerous times before an index even blips and may change more or less than the rates of other similar loan products. Lenders would not be able to hedge that kind of risk in a volatile secondary market.

B. HUD Would Severely Limit Competition in the Marketplace by Not Allowing Non-Lenders (Real Estate Brokers, Home Builders, and Title/Settlement Service Providers) To Offer Guaranteed Packages

Even if it was possible to for lenders to guarantee the interest rate, HUD's "Single Package" approach as a practical matter would bar non-lenders such as real estate brokers, home builders, title underwriters and agents, vendor management companies and other settlement service providers from competing with lenders in the packaging marketplace because they do not offer and therefore could not guarantee the interest rate or the loan origination services that HUD requires to be included in the package. Instead, they would be forced to partner with a lender if they want to offer a guaranteed settlement service package.

As a result, competition that is supposed to pass on cost savings to consumers will be diminished, not promoted.

Let me give you an example, from the perspective of Edina Realty Home Services. Thirty percent (30%) of Edina's real estate customers choose Edina Realty Mortgage as their mortgage lender, but seventy percent (70%) choose their mortgage loan from over 100 other national, regional, or local mortgage lenders or brokers in any given year. Our title company, Edina Realty Title, Inc., currently issues title policies and performs closings on behalf of Edina Realty Mortgage *and* these 100 other mortgage lenders or brokers for seventy percent (70%) of Edina's real estate customers.

Edina Realty Title would like to offer guaranteed settlement service packages directly to our real estate customers that could be used not only with mortgages provided by Edina Realty Mortgage, but by any of the more than 100 mortgage originators in our marketplace. RESPA's referral fee prohibition would prevent Edina Realty Title from paying our real estate agents for referrals to our package, and it would mandate that we would disclose the affiliation to the consumer.

HUD's proposal, however, would prevent Edina Realty Title from offering these packages because it could not guarantee the interest rate and points, even though it could offer superior service and pricing with respect to all the services needed to close the transaction. Not only would this allow Edina to offer our real estate customers the potential benefits of packaging, but it would also provide small, local mortgage originators in our marketplace a means to compete against the large national lenders who package.

Edina is not alone in our willingness to compete in the new packaging marketplace. According to a 1997 study by Weston Edwards and Associates, 31% of the nation's 250 largest residential real estate brokerage firms offered title, closing, escrow or personal insurance in 1996 through wholly-owned subsidiaries or joint ventures. RESPRO® believes that this percentage has significantly increased over the last six years. In addition, a significant and increasing number of home builders offer these services.

The exclusion of these and other non-lender competitors (such as independent title companies) from the packaging marketplace would effectively put control over the distribution and marketing of settlement service packages in the hands of mortgage lenders. This would give lenders the ability to use the RESPA safe harbor to obtain lower prices and/or referral fees from non-lenders who provide settlement services to be included in the package without any assurance that competition in the packaging marketplace would be sufficient to ensure that any discount or lower price is passed on to the consumer.

In addition, the exclusion of non-lender competitors from the packaging marketplace could deprive consumers of potential benefits of one-stop shopping programs.

In fact, a 2002 survey of over 2000 current and future home buyers by Harris Interactive, the parent of Harris Poll, found[2]:

- That 82% of home buyers would "strongly" or "somewhat" strongly consider using a realty-based one stop shopping service for their home purchase;

- That 64% of home buyers who recently used realty-based one stop shopping programs had a much better overall experience with their home purchase transaction; and

- That over 90% of home buyers who did not use realty-based one stop shopping programs believed that if they had used one, they would have had a better overall home purchase experience.

A 1994 economic study commissioned by RESPRO® and conducted by Lexecon, Inc., a national economic consulting firm, also found that realty-based one stop shopping programs potentially offer lower costs. The study compared title and closing costs between realty-owned title companies and independent title companies in over 1000 home purchase transactions throughout seven states -- Florida, Minnesota, Tennessee, Wisconsin, Mississippi, Pennsylvania and California—and concluded that title and closing costs for realty-owned title companies were not only competitive with those of independent title companies, but actually resulted in a 2% cost savings.[3]

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2 "Consumer Perspectives on Realty-Based One Stop Shopping", by Harris Interactive and Murray Consulting, Inc., March 2002.

3 "Economic Analysis of Restrictions on Diversified Real Estate Services Providers", by Lexecon, Inc., January 3, 1995. In a 1996 Economic Analysis accompanying a final RESPA regulation, the Department of Housing and Urban Development (HUD) offered its independent analysis of both the Lexecon, Inc. study and the Edwards study. It concluded that "…referral activity among affiliates might still benefit consumers because

C. Consumers Would Not Be Able to Effectively Shop Among Packages Because Services in the Package Are Not Itemized

Many proponents of packaging believe that consumers do not care about specific settlement services associated with a mortgage loan; instead, they believe consumers only care about price. RESPRO® disagrees with this premise, especially in purchase money transactions.

HUD's packaging proposal partially recognizes that this premise is flawed, and therefore suggests in its packaging proposal that consumers at least be informed about whether particular services -- pest inspections, lenders title insurance, and appraisals -- are expected to be excluded from the package.

However, RESPRO® does not believe HUD's packaging proposal goes far enough to promote consumer shopping, and believes that all services included in the package should be disclosed to the consumer.

Consumers often are directly affected by the type of settlement services provided by the lender (e.g., automated valuation from statistical models, drive by, or appraisal based on an in-home inspection, pest inspection). In particular, in purchase money transactions, consumers often take solace that the lender has had a full appraisal or has performed a full title search, rather than simply assuming the statistical risk that its overall losses from loans will be acceptable.

Likewise, in certain geographic areas, special settlement services may be of great interest to consumers. For example, in some areas a consumer may want to know that lenders have specifically had the house inspected for mold, radon or stucco problems and if such inspections were not done he/she may want to pay for them directly or go with another packager who utilizes them.

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of the possibility of immediate savings in shopping time and hassle and future reductions in prices due to lower marketing and other costs. Taking these benefits into account, referrals among affiliated firms are probably neutral and possibly beneficial to consumers."

In addition, if services included in the package are disclosed, non-lenders such as real estate brokers and home builders – who in purchase money transactions work closely with the consumer and are the likely point of contact when future problems arise due to the omission of a settlement service – would be able to compete in the packaging marketplace on service as well as price.

D. RESPRO®'s Proposed "Two Package" Concept

Despite our concerns, we believe that HUD's goals of promoting consumer shopping may still be achieved if it restructures its packaging proposal.

As we understand it, HUD's proposal to include the interest rate in its proposed Guaranteed Mortgage Package is based upon a concern that a lender could engage in a "bait and switch" technique by offering a low-cost settlement service package and then making up for the price concession through a higher interest rate loan.

But we believe that HUD could significantly deter the use of "bait and switch" techniques – and at the same time inject competition into the packaging marketplace by ensuring that consumers can choose among guaranteed settlement service packages offered by *both* lenders and non-lenders -- by providing a RESPA safe harbor for transactions involving settlement services in two separate packages:

- **A "Lender Services" Package:** A package of itemized lender services required for the loan [the "800" series of the HUD-1 Settlement Statement), excluding the interest rate, that lenders could offer at a lump sum guaranteed price; and

- **An "Ancillary Services" Package:** A package of itemized non-lender services required for the loan (the "1100, 1200, and 1300" series of the HUD-1 Settlement Statement) that lenders *or* non-lenders could offer at a lump sum guaranteed price.[4]

Under RESPRO®'s proposed Two-Package Concept, a home buyer could choose among national, regional, or local mortgage originators for a "Lenders Services" package. At the same time, he/she could choose among a variety of "Ancillary Services" packages offered either directly or online by the mortgage lender or broker whose loan they choose, an affiliated title company of the real estate broker or home builder that is working with them on the purchase of their home, or an independent title company or other "packager".

This would help ensure that consumers could effectively shop for the lowest package of settlement services from a broad array of competitors.

RESPRO® recognizes that a mortgage lender should not have to accept an Ancillary Service package that utilize settlement service providers with a record of poor service or reliability, who cannot financially stand behind their products, or who have other documentable deficiencies. In other words, a lender should be able to reject an Ancillary Service package for legitimate business reasons.

In fact, we would anticipate that most Ancillary Service packages would be pre-approved by lenders and marketed by Ancillary Service packagers as acceptable by designated lenders.

However, it is also important to prevent lenders from raising the interest rate of a loan to offset price concessions given on a low-cost Ancillary Services package that it may offer. Therefore, RESPRO® proposes that lenders be prohibited from "tying" their loan or Lenders Services Package to the use of a particular Ancillary Service package; similarly, the Ancillary Service packager

[4] Under RESPRO®'s proposal, referrals between a real estate broker, homebuilder, or non-settlement service packager and the Ancillary Services package would still be subject to RESPA, so that they could not accept payments for referrals to the package, they must disclose the nature of the affiliation to the consumer, and they could not require the use of an affiliated package.

should not be permitted to tie or condition the use of its package on the use of a specific loan or interest rate.

In summary, RESPRO® believes that its proposed Two Package Concept would address HUD's concern that prompted it to require a virtually impossible guarantee of interest rates, which would threaten the viability of packaging. It also would inject greater competition into the packaging market for ancillary services to the loan than HUD's packaging proposal.

III. <u>The Binding Good Faith Estimate (GFE)</u>

A. HUD Should Allow Packaging a Chance to Be Tested Without Marketplace Disruption By Leaving the Current Regulatory Environment as the Alternative to Packaging

RESPRO® opposes HUD's proposal to make the Good Faith Estimate (GFE) binding at this time, and recommends that HUD leave the current regulatory environment as the alternative to "packaging".

1. <u>Packaging Should Be Tested in the Marketplace Before the Alternative Regulatory Environment is Significantly Altered</u>

In the opening statement of its proposed RESPA rule, HUD says, "The American mortgage finance system is justifiably the envy of the world. It has offered unparalleled financing opportunities under virtually all economic conditions to a very wide range of borrowers that, in no small part, have led to the highest homeownership rate in the Nation's history. "

HUD clearly recognizes in this statement that our residential mortgage industry has functioned well. In addition, the residential real estate industry has been one of the strongest sectors of our nation's economy for the past three years.

This is not to say, however, that the mortgage process cannot be improved. We welcome the opportunity to test the economic theories supporting RESPRO®'s Two Package approach. However, we believe that HUD should be cautious about dramatically changing the pricing and delivery system for such a crucial sector of our economy until it has tested the theories of the packaging system and can predict with certainty that the GFE proposal is viable.

2. HUD's Proposed Binding GFE Would Significantly Increase Liability Risks for Mortgage Lenders

HUD's proposed binding GFE would dramatically increase liability risks for lenders who do not package by requiring them to control costs that are outside of their ability to control, without the incentives HUD provides for packagers.

Mortgage lenders do not have control over and often cannot estimate within a "ten percent" or "zero" tolerance the charges of many third party services, such as state and local government charges, which are totally in the control of the government; reserves for the cost of hazard insurance, mortgage insurance, and/or property taxes, each of which are very difficult to predict and may in part depend on when a closing will be held; title charges, which are dependent on many factors not known at the time of application (e.g., in some states the preliminary title report is based upon abstract entries which depend on what the seller has done which means you need an examination of the property, likewise, certain inspections may be triggered by an appraisal).

These significant liability risks are compounded by HUD's proposed remedy for non-compliance with its binding GFE requirements – a rescission of the loan agreement, or, in HUD's words, allowing the borrower to withdraw the application and receive a full refund of all loan related fees and charges if the cost at settlement exceeds the estimate and permissible tolerances on the GFE (absent "unforeseeable and extraordinary" circumstances).

Rescission of the loan is an extreme and excessive penalty, especially if the violation is technical and/or unintentional. For example, under HUD's proposal, a lender in a refinancing transaction whose closing costs in a particular category exceed the GFE estimate by a minor amount would be vulnerable to a borrower's decision to walk away from the transaction at the last minute and collect all loan-related fees paid if he/she finds a better interest rate, with no opportunity to correct the mistake and refund the difference between the GFE estimate and the actual closing cost.

HUD's rescission penalty also is unclear as to when the consumer could withdraw the application and receive the refund of all loan related fees and charges. Presumably, this could occur at closing; although it is doubtful that a buyer of a home will choose to withdraw his/her loan application in a purchase money transaction and possibly forfeit the home of his/her dreams. If HUD allows a rescission and refund of all loan-related fees after closing, it would create considerable confusion in the secondary mortgage market.

3. HUD's Proposed Binding GFE Is Confusing to the Consumer

HUD's proposed binding GFE is seven pages long. While the estimated charges are presented on the first page, the proposed form uses terms that are not familiar to the average consumer (e.g., "lender-required and selected third party services", "shoppable lender required third party services") that require several pages of attachments to explain. In addition, the tolerances for each category of charge are explained in several pages of attachments. Finally, since both HUD's packaging and GFE proposals presume incorrectly that consumers only care about price and not service or convenience, and because the GFE has no description of the particular service and what's included in it, it would be extremely difficult for a consumer to make "apples to apples" comparisons of packages offered by different settlement service providers.

4. HUD's Proposed Binding GFE Would Create Significant Administrative Burdens on Providers Across Industry Lines That Are Not Anticipated in Its Economic Analysis

RESPRO® believes that this resulting consumer confusion over the terms, format, and tolerances in new binding GFE would generate consumer questions that will necessitate extensive consultations with providers, resulting in considerable education and training costs to providers across industry lines.

For example, most home buyers would consult with their real estate agent to help guide them through the new terms, format, and tolerances in the new binding GFE, as they do today with their questions about the GFE. We believe that HUD has severely underestimated the significant education and training costs that would be incurred by the real estate brokerage industry in purchase money transactions if the binding GFE were implemented.

Moreover, mortgage originators and loan closers have invested in software that helps prepare GFE's and HUD-1's, and that material changes to either form will cause further substantial expense to both of these industries.

Finally, between the application and the closing, there are usually loan term changes in the loan, the loan amount, and even property type that often trigger additional services and costs that could not be foreseen at the time the binding GFE is provided. As a result, mortgage lenders in a significant number of loan transactions would need to reissue the binding GFE every time there is a change in the loan terms, resulting in more consumer confusion and significant administrative costs for providers across industry lines.

5. HUD Does Not Have The Statutory Authority To Implement The Proposed GFE With Tolerances And Rescission Rights For Borrowers Through Regulation

RESPA requires that a mortgage lender, within three days of receipt of a loan application, provide the applicant with a "good faith estimate of the amount of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary." There is no private remedy or private right of action for a lender's failure to comply with this requirement.

Indeed, Congress had once provided in RESPA for an advanced and itemized disclosure of charges arising in connection with the settlement, as well as for lender liability for failure to comply. Congress later repealed this part of RESPA, deciding not to impose any sanctions for violation of the new good faith estimate provision even though other parts of RESPA did provide for private remedies and rights of action.

HUD's proposed regulation rewrites RESPA. It converts an estimate of settlement charges with no penalties into a provision where lenders would have to itemize with complete accuracy certain charges in advance and predict others within a ten percent tolerance subject to the right of a borrower to withdraw, or in effect rescind, their loan application if the lender's estimate was faulty. We do not believe that HUD does not have this authority.

Mr. Chairman, RESPRO® appreciates this opportunity to testify, and I would be glad to answer any questions.