Testimony of the

Consumer Bankers Association

on

Simplifying the Home Buying Process:

HUD's Proposal to Reform RESPA

before the

Subcommittee on Housing and Community Opportunity

of the

Committee on Financial Services

of the

United States House of Representatives

on

February 25, 2003

The Consumer Bankers Association (CBA) appreciates this opportunity to submit our views regarding the efforts of the U.S. Department of Housing and Urban Development (HUD) to reform the regulation implementing the Real Estate Settlement Procedures Act (RESPA). We have attached to this brief statement our more complete comments that were provided to HUD during the rulemaking process, and we appreciate your including them in the record along with this testimony.

The Consumer Bankers Association is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including real estate-secured lending covered by RESPA. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

Today we wish to restate our support for simplification and reform of the RESPA mortgage lending process. In particular, we support HUD's bold and innovative proposal to permit lenders to offer a Guaranteed Mortgage Package (GMP) within three days of an inquiry (in place of the Good Faith Estimate of closing costs). A GMP would include a guaranteed lump-sum amount of settlement costs (including all lender required settlement services except per diem interest, hazard insurance, and escrow/reserves). Those lenders who offer a GMP would be entitled to an exemption from RESPA's section 8 prohibitions on referral fees for settlement service costs within the GMP package. If the customer accepts the offer, the lender would be contractually bound not to charge more than the GMP Agreement (GMPA).

We agree with HUD that the GMP concept is an appealing option for many lenders, since it will permit them to negotiate packages at favorable costs. Consumers will also benefit because they will be provided a "guaranteed" price upon which to shop for the best terms. In fact, CBA was an early supporter of this concept, because we believe it will reduce the complexity of disclosures, provide useful shopping information at a more advantageous time for consumers, allow market forces to keep costs down, and reduce the chance of the consumer being surprised by settlement costs at closing.

Notwithstanding our general support, we must also state some concerns regarding HUD's proposal. First, we believe it is a mistake for the proposal to prohibit HOEPA (or "high-cost mortgage") lenders from using the GMP option. If HUD is correct that this proposal will be beneficial to consumers, it should be available for use with HOEPA loans as well. Creating a competitive marketplace where consumers can shop for credit would go a long way toward eliminating predatory lending practices in the high-cost mortgage market. Why make a proposal that would benefit all except the borrowers who most need it?

Second, we recommend against including an interest rate in the GMP. Including it in a "guaranteed mortgage package" and calling it a "guaranteed rate" (even with qualifications) would lead to terrible misunderstandings. It is simply not guaranteed. The reason it is not guaranteed is because (1) it is expected to float, unless locked in by the consumer; and (2) it is provided too early in the loan shopping process to be reliable.

Many lenders report that the information they have at the early date when the inquiry is taken is not accurate enough—particularly about the price of the property—to give any certainty about the rate they can offer the consumer. Therefore, even if the consumer is able to track the rate between the application and closing, the consumer cannot know with any confidence that the rate will not change for reasons that can only be known to the lender. Because the disclosure must be given before an application is taken and before any fee is paid, the loan has not been underwritten and the rate will often be subject to change, as the lender obtains a property appraisal and more thoroughly underwrites the loan. Although we recognize that the rate is a valuable disclosure for the consumer to receive, and can be useful when the consumer shops for credit, it is inappropriate as part of the GMP.

Third, we would oppose any approach that called for lenders to adjust their rates based only on an external index (such as LIBOR). The pricing of products is a proprietary business, and each lender does it in its own way based on many factors, including the fluctuations in the secondary market, the need to hedge, the desire to attract customers to certain products, and so forth. But there is no reason for the lender to rely exclusively on some external index. If HUD were to impose such a requirement, it would dramatically change the economics of mortgage lending and the pricing of mortgage loans, in ways that we cannot yet determine. Ultimately, we believe it would create a safety and soundness concern for lenders and could drive up the cost of credit for consumers.

Under the proposal, lenders who do not wish to offer GMPs could continue to provide the Good Faith Estimate of Closing Costs (GFE)—but HUD is proposing significant changes here as well. The GFE would be grouped differently by categories, and, although it would continue to comprise estimates of settlement costs, the estimates would be required to be accurate—or in some cases within a 10% tolerance. Lenders who choose the enhanced GFE option would not get the benefit of a safe harbor from section 8 of RESPA. Under the GFE Option, mortgage brokers would also provide a new disclosure that explains their role in the transaction. Yield spread premiums would be disclosed on the GFE as an amount paid by the lender to the borrower. This is intended to ensure that borrowers receive the full benefit of a higher price paid by wholesale lenders for a loan with an above-par interest rate.

We support improved disclosure of broker's fees, but HUD's proposed approach appears more likely to confuse consumers. There are better alternatives. If the goal is to clarify the treatment of broker fees and the relationship of the parties, we recommend employing something akin to the Broker Disclosure Fee Agreement, previously recommended by many in the industry.

Beyond new disclosures of mortgage broker fees, however, changes to the GFE ought to be deferred at this time. The new GMP option is more than enough for lenders and consumers to absorb, without making dramatic changes to the status quo at the same time. As HUD conceives the proposal, lenders would be forced to choose between two significant changes in the way they do business. In our comments, we urged HUD to wait

until the GMP option has been introduced and had a chance to be accepted. Until then, we will not have a good understanding of what changes to the GFE, if any, are necessary.

We have many other comments regarding HUD's proposal, which we address in greater detail in our comment letter to the agency. In general, however, we remain committed to the idea of reform, and will be happy to work with the agency and this subcommittee toward that end.

Thank you again for the opportunity to share our views.

October 28, 2002

Rules Docket Clerk
Office of General Counsel, Room 10276
Department of Housing and Urban Development
451 Seventh Street, SW.
Washington, DC 20410-0500

RE: Docket No. (FR-4727-P-01); Proposed Rule on Real Estate Settlement Procedures Act (RESPA)

To the Office of General Counsel:

The Consumer Bankers Association (CBA)[1] is submitting this letter in response to the Department of Housing and Urban Development's (HUD) request for comment on a proposal to modify its Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA). This proposal (Proposal) intends to simplify and improve the process of obtaining home mortgages and reduce settlement costs for consumers. It includes provisions for a new Guaranteed Mortgage Package (GMP) and revises the Good Faith Estimate (GFE) to assist consumers in shopping and comparing costs in home mortgage transactions.

The Proposal would create two parallel approaches to offering closed-end mortgage loans—both considerably different than the current scheme—that could be employed at the option of the originator.

Under one option, lenders would offer, at no cost to the consumer, a guaranteed package price to anyone who inquired about a loan and provided certain basic information. The offer, called a "guaranteed mortgage package", would have to be provided within 3 days of the inquiry, and must be kept open for 30 days.

[1] The Consumer Bankers Association is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits and delivery. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

A GMP would include (1) an early interest rate disclosure that the consumer could keep track of prior to lock in (called a "guaranteed" interest rate), and (2) a guaranteed lump-sum amount of settlement costs (including all lender required settlement services except per diem interest, hazard insurance, and escrow/reserves). Some additional TILA-type disclosures (including the APR) would be provided as well.

Those lenders who offer a GMP would be entitled to an exemption from RESPA's section 8 prohibitions on referral fees for settlement service costs within the GMP package. If the customer accepts the offer, the lender would be contractually bound not to charge more than the GMP Agreement (GMPA).

HUD believes that the GMPA concept will be an appealing option for many lenders, since it will permit them to negotiate packages at favorable costs. Consumers will benefit because the market forces will drive down the prices of settlement services, and because they will be provided a "guaranteed" price upon which to shop for the best terms. However, this GMP option would not be available to consumers obtaining HOEPA loans.

Under the Proposal, lenders who do not wish to offer GMPs could continue to provide the Good Faith Estimate of Closing Costs (GFE)—but HUD is proposing significant changes here as well. The GFE would be grouped differently by categories, and, although it would continue to comprise estimates of settlement costs, the estimates would be required to be accurate—or in some cases within a 10% tolerance. (Under the current GFE, there is no requirement that the final costs be the same as the GFE, and generally no liability if they are inaccurate.) The APR and other TILA disclosures would be given with the GFE as well. Lenders who choose the enhanced GFE option would not get the benefit of a safe harbor from section 8 of RESPA.

Under the GFE Option, mortgage brokers would also provide a new disclosure that explains their role in the transaction. Yield spread premiums would be disclosed on the GFE as an amount paid by the lender to the borrower. This is intended to ensure that borrowers receive the full benefit of a higher price paid by wholesale lenders for a loan with an above-par interest rate.

We greatly appreciate the opportunity to comment on the Proposal and we look forward to working with HUD in the future as final changes are made to Regulation X.

CBA Comments

CBA has for years been actively engaged in the discussions about RESPA/TILA Reform. We have long endorsed a position that would permit lenders to offer some guaranteed settlement service cost package, with section 8 exemption. Therefore, we strongly support HUD's initiative.

However, there are many details to be worked out, since this calls for a significant change in the mortgage and home equity lending businesses.

Because of the difficulty of presenting our comments as responses to the questions posed, we have chosen to offer our comments in a different format, but indicate, when such is the case, the questions upon which they bear.

I. CBA is supportive of the concept of a guaranteed settlement cost package in return for a safe harbor from section 8 of RESPA.

First and foremost, we wish to indicate our support for HUD's overall efforts. We have long been active in the efforts on the part of the industry, consumer groups and the regulatory agencies to solve the problem of the complex regulatory regime to which mortgage lending is subject.

When a 1996 statutory requirement[2] called for the Federal Reserve Board (FRB) and HUD to recommend ways to simplify and improve the disclosures required by the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA), we participated in regular discussions between industry and consumer organizations to seek workable solutions that might be proposed to the agencies. The group that met, loosely known as the Mortgage Reform Working Group (MRWG), although unable to reach a formal consensus of opinion, brought forth ideas that were the direct precursor to HUD's Proposal—including the concept of an optional guaranteed settlement services package in lieu of the GFE. Ultimately, the idea was endorsed by both agencies in the HUD/FRB Report to Congress on the reform RESPA and TILA.

We were early supporters of the idea, because we believed it would have multiple advantages: It would reduce the complexity of disclosures; it would provide useful shopping information at a more advantageous time for the consumer; it would allow market forces to keep costs down; and it would reduce the likelihood that the consumer would be surprised by the dollar amount needed at the settlement table. In order to make the guaranteed package work, HUD would need to exempt the elements of the package from the restrictions of Section 8 of RESPA; otherwise, lenders would avoid packaging out of concern about liability risk. In our testimony to Congress on September 16, 1998, we stated: "We support the idea of guaranteed closing cost packages coupled with section 8 relief because we believe there may be potential marketing benefits to lenders, increased simplicity of disclosures, and cost savings to consumers."

However, we believe it is incorrect and potentially misleading to call it a Guaranteed Mortgage Package or to state that the interest rate is part of the guarantee. By using this term and including references to a guaranteed rate, HUD is putting lenders (and other packagers) in the position of implying that they are offering a loan commitment. We recommend the use of a phrase that more accurately reflects

[2] Section 2101 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

the situation, such as Guaranteed Settlement Cost Package. As noted below, we also suggest that the interest rate should be removed from the package; or that the package more clearly state the qualified nature of the rate disclosure.

II. HUD should defer any changes to the existing GFE system (except regarding the treatment of broker fees), while the new GMP is introduced.

We recommend deferring changes to the GFE until a later date, when a more informed decision can be made about what changes are appropriate and what is within HUD's legal authority to accomplish. HUD's proposal creates a dramatic change in the way mortgage lending will be done in this country for the foreseeable future. The bold concept of a GMP, permitting consumers to shop more easily for mortgage credit will change the face of lending, putting everyone whose business touches on mortgages in a new world, requiring new systems, training, and forms. But even more significantly, the introduction of the GMP option will force a realignment of business and a reassessment of pricing that we cannot really foresee at this time. These are changes that need to be entered into with care. The fact that HUD is presenting them as an option suggests a recognition of the need to allow lenders and other service providers to come into this in their own way.

Yet introducing changes in the GFE at the same time would make it more of a false option. There would be no *status quo*. Lenders would have to choose between one significant change and another. Many lenders are also quite wary of the GMP option. They wish to take a wait and see approach. We believe it will be successful and beneficial to consumers and industry alike; but it is an experiment that must be allowed a fair chance to work. Lenders will come around to it given an opportunity. Right now, their support for the Proposal may depend on their not believing that they are being railroaded into making changes.

Even the imposition of tolerances on the GFE would be an unacceptable change at this time. Although it may not be apparent on the face of it, numerical tolerances will call for significant changes in the behavior of lenders and brokers. They would operate as a kind of quasi-guaranty, that would force lenders and brokers to factor changes into their pricing structure, to explain changes that are due to unforeseen circumstances, and to run the risk of harming customer relations. Indeed, there would be little reason to choose the GFE option, since the tolerances force lenders to essentially guarantee the settlement service costs, but without the benefit of the section 8 exemption.

2. Treatment of broker fees. Regarding the treatment of mortgage broker fees (such as "yield spread premium"), the Proposal would require that any payments from a lender based on a borrower's transaction, other than a payment to the broker for the par value of the loan, including payments based upon an above par interest rate on the loan, *be reported on the GFE and HUD-1 as a lender payment to the borrower*. The approach suggested in the Proposal has the advantage of simplicity; but we believe it is outweighed

by the potential for confusion. We are concerned that consumers will not understand the nature of the disclosure.

If the goal is to clarify the treatment of broker fees and the relationship of the parties, we recommend, in the alternative, requiring brokers to offer a disclosure such as the Broker Disclosure Fee Agreement, previously recommended by many in the industry. A copy of the form that was recommended by a number of trade groups is attached as an addendum to this comment letter. Should this approach be taken, we would recommend that it be republished prior to final issuance, so that everyone affected can have an opportunity to comment.

III. Interest rate should be separated from guaranteed settlement service package and –if disclosed—more accurately described as conditional

We have serious reservations about the inclusion of the interest rate in the GMP. Including it in the package, and calling it a guaranteed rate, will lead to terrible misunderstandings. It is simply not guaranteed. The reason it is not guaranteed is because (1) it is expected to float, unless locked in by the consumer; and (2) it is provided too early in the loan shopping process to be reliable. Although we recognize that the rate is a valuable disclosure for the consumer to receive, and can be useful when the consumer shops for credit, it is inappropriate as part of the GMP.

The fact that the rate can float between the time of the disclosure and the closing (unless it is locked) is reason enough to avoid calling it a guaranteed rate. But as an added concern, many lenders report that the information they have at the early date when the inquiry is taken is not accurate enough—particularly about the price of the property—to give any certainty about the rate they can offer the consumer. Therefore, even if the consumer is able to track the rate between the application and closing, the consumer cannot know with any confidence that the rate will not change for reasons that can only be known to the lender. Because the disclosure must be given so early in the "application" (really before an application is taken) and before any fee is paid, the loan has not been underwritten and the rate will often be subject to change, as the lender obtains a property appraisal and more thoroughly underwrites the loan.

The GMPA states, in the introductory paragraph, "This Agreement is subject to verification of your credit rating, final property appraisal, and other appropriate underwriting criteria." But this phrase is hidden in a document that otherwise states, on numerous occasions that the rate is guaranteed. For example, all of Paragraph I is called, in bold-face type, an "**Interest Rate Guarantee**." The same paragraph states, "…we guarantee that the interest rate will not exceed __% [over][under] the [prime][index] rate for __ days [30 days or greater]." The entire document, which includes the rate

disclosure, is called a "Guaranteed Mortgage Package Agreement." While the ability of the rate to float is explained, it does not adequately explain the many ways in which the price of the property, the consumer's credit history, and the other factors that play into risk-based pricing may effect the cost of the credit, and the "subject to" language is totally inadequate to counter the impression that the form will leave the consumer.

Misunderstandings are a virtual certainty. Consumers who are aggrieved will blame the lenders, resulting in bad customer relations and significantly increased litigation risk. Inevitably the cost of credit will rise, as lenders seek to protect themselves against the risk of understatement and cover the increased costs of "guaranteeing" a rate.

Clearly HUD contemplated the problems that might arise if lenders were forced to guarantee rates, and proposed, in the alternative, that there be some mechanism in place that would permit the rates to float, while allowing consumers to track their rate. The ability to track the rate is designed to protect the consumer from rate manipulation by unscrupulous lenders. Two possible approaches to this have been suggested. One would force lenders to identify an external index to which they would tie their rates, and the other would call for lenders to make their rate changes known according to a publication that can be monitored by the applicant. We believe that neither would be workable.

We would strongly oppose any approach that called for lenders to adjust their rates based only on an external index (such as LIBOR). The pricing of products is a proprietary business, and each lender does it in its own way based on many factors, including the fluctuations in the secondary market, the need to hedge, the desire to attract customers to certain products, and so forth. But there is no reason for the lender to rely exclusively on some external index. If HUD were to impose such a requirement, it would dramatically change the economics of mortgage lending and the pricing of mortgage loans, in ways that we cannot yet determine.

Ultimately, we believe it would create a safety and soundness concern for lenders *and could drive up the cost of credit for consumers.* If lenders are required to guarantee interest rates within three days after receipt of an application and are only permitted to change the rate because of an increase in the cost of funds (i.e., as measured by outside index movements), risk-based pricing may no longer be possible, resulting in very significant changes in the way housing financed is priced today. These changes are more than likely to result in higher interest rates to borrowers as a lender hedge against the forced absence of pricing flexibility and the inability to price according to risk.

Certainly permitting the use of the lender's published rates (such as posted rates on the lender's web site) is preferable to mandating the use of external indices, but this approach is problematic as well. If, due to the subsequent underwriting, some consumers cannot be offered the precise rate they were initially disclosed, *they would be mistakenly following the wrong rate on the lender's chart*. Other complications can also interfere with the consumer's ability to track the rate changes. One common one might be if the consumer wishes to add or subtract discount points from his or her original application—something consumers routinely do. Discount points are almost formulaic in their

relationship to the rate, but most consumers would still require an elaborate rate spread sheet to see what happens to each rate based on changes in the amount of the discount points.

We recommend that several steps be taken to address these concerns. **First, as noted above, to prevent problems between consumers and packagers or lenders, we recommend that the term "Guaranteed Mortgage Package" be eliminated.** The entire package, after all, is not guaranteed. Instead, it should be called a Guaranteed Settlement Cost Package (or something similar).

Second, we recommend that the interest rate should be eliminated from the package. Rates would continue to be handled the same as they are currently; i.e. disclosed according to Regulation Z and floating unless locked in by the consumer after paying a lock-in fee.

If the interest rate does remain, however, we believe the disclosure should clearly state, in large type, easy to understand, that the rate is NOT guaranteed, and that it IS SUBJECT TO CHANGE.

If the rate is not locked, it is essential that it be permitted to float according to whatever mechanism is most appropriate to that lender's pricing, and not according to some index outside of the lender's control.

IV. APR and other TILA disclosures should be excluded from the reform package.

All the TILA requirements, including the APR, are inappropriate for inclusion in the RESPA disclosures. If one of the goals of this reform effort is "to simplify…the mortgage loan process," as HUD has stated, this would do just the opposite. All the TILA disclosures are redundant and would only complicate the mortgage disclosure process.

In particular, requiring the inclusion of the APR in the early RESPA forms raises a number of serious problems. The APR is a figure that is defined with great precision by the Federal Reserve Board. HUD's definition would need to track the Federal Reserve Board's or risk confusion. Yet, because RESPA's timing precedes TILA's, lenders (or other packagers) would need to provide the APR before enough information is available to provide for an accurate figure. For example, an accurate APR cannot be provided at the early time required by RESPA, without knowing whether mortgage insurance will be included in the loan. HUD should avoid confusing the two regulations.

V. HOEPA loans should not be excluded from the GMP Option.

HUD, with little supporting commentary, has proposed excluding HOEPA loans from the GMP option. We do not agree.

HUD's Question 15 states: "As proposed in Section III.C(6), under the rule, mortgages with total fees or a rate covered by the Home Ownership and Equity Protection Act (HOEPA) would be subject to the new GFE disclosure requirements; however, HOEPA loans would not qualify for the guaranteed package safe harbor. Is this exclusion appropriate considering, on the one hand, that packaging promises borrowers a simpler way to shop and make transactions more transparent? On the other hand, the safe harbor could be provided for a loan that has very high rate and/or fees and may be predatory. The proposal also says that during the rulemaking other limitations may be established to exclude high cost and/or loans with predatory features from the packaging provisions. HUD invites comments on whether HOEPA loans, any other loans, or features of loans should be included or excluded from the safe harbor and why." 67 FR 49156.

We are strong proponents of legitimate efforts to prevent abusive lending practices, and we agree with most thoughtful observers that one of the best antidotes to predatory lending is a competitive market and an informed consumer. We can understand HUD's reluctance to extend the protections of the GMP to high cost loans that might be predatory. But HOEPA loans are not, by virtue of being subject to HOEPA, predatory. They merely have costs that are higher than average and that trigger the HOEPA requirements. HOEPA's requirements are imposed precisely in order to reduce the likelihood that they will be abusive. It is often said that consumers who are in the subprime market do not shop for credit. We believe that they fail to shop in part because the existing mortgage lending process makes it so difficult to do so, and aids the unscrupulous lender, broker or service provider in imposing unreasonable terms and conditions on their customers. The Proposal is an effort to remedy this by providing by simplifying and clarifying the disclosures of the costs of lending, and enhancing the opportunity for consumers to shop for the best mortgage and refinancing.

As Secretary Martinez noted in his testimony before the U.S. House Financial Services Committee, October 3, 2002, "Injecting greater competition into the mortgage lending process and among settlement services is an important reason for reforming RESPA. When consumers are empowered to shop for the best loan to meet their needs, the market will respond to the competition by lowering costs. When closing costs are reduced, home loans will become less expensive and more families will become homeowners."

The Secretary also stated, "We believe that our proposed reforms, and the greater transparency they ensure, will make it more difficult for unscrupulous lenders to abuse borrowers." HUD is sending a mixed message if it withholds these benefits from the very consumers who need them most. If HOEPA lenders cannot take advantage of it, there will be a two-tiered lending world, with some consumers paying more, because HUD will not permit them to take advantage of the competitive market.

From an operational perspective, there is another reason not to exclude HOEPA loans from the GMP. The GMP is provided so early in the application (or inquiry) process, that

lenders cannot know with any degree of certainty if the loan will prove to be subject to HOEPA. They could start by assuming that, based on the information provided, the loan is not a HOEPA loan and offer a GMP, only to discover after subsequent underwriting that the GMP should never have been provided. The inability for lenders to know, early enough in the application process, whether the consumer is going to only qualify for a HOEPA loan, will make it difficult for lenders who even *offer* HOEPA loans ever to use the GMP option.[3]

VI. Issues of compatibility with other federal laws must be resolved.

Inconsistencies with FRB-issued regulations, such as Z, B and C must be carefully resolved. Although they may appear to be small matters in the overall scheme, these inconsistencies could undermine the effort to reform RESPA by making the use of the GMP, for example, so difficult as to be undesirable. We do not have solutions to all these problems, but we urge you to put your resources to work, jointly with the Federal Reserve Board where necessary, to minimize these problems. Those that have come to light are the following:

A. Regulation Z. Use of the GMP and revised HUD-1 can result in Regulation Z compliance problems. This is caused specifically by the elimination of an itemized list of prepaid charges, which are currently required in the GFE and HUD-1. Under the Proposal, lenders cannot know which components of the prepaid items are prepaid finance charges under TILA and which are not. In addition, those lenders who need to determine whether their loans meet the HOEPA threshold will be unable to do so without being able to itemize the components that apply to the threshold determination and the components that do not.

Even if the prepaid charges needed to compute the finance charge for TILA are itemized with the HUD-1 when lenders employ the GMP,[4] problems arise. Lenders cannot itemize individual charges if the amounts of the various services have been negotiated as a package. Inevitably, they will be challenged on the amounts that they attribute to each individual transaction. Furthermore, the information at closing is offered too late to be entirely helpful. TILA requires early disclosures to be given for purchase money mortgages, but lenders will not have the complete breakdown of charges needed to calculate the APR accurately.

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[3] Generally speaking, we recommend that GMP should be available as widely as possible. As a purely technical matter, it is useful for lenders not to have to distinguish between covered loans and those that are not. Since the GMP is entirely optional, allowing it to be employed does not require lenders to use it for any particular product or loan.

[4] The Proposal states, "[B]ecause the amounts of certain individual charges needed to compute the finance charge and the APR under TILA and HOEPA [sic], the packager must list the finance charges needed to calculate the APR on an addendum to the HUD-1 or HUD-1A." 67 FR at 49153.

If HOEPA loans are not given the safe harbor from section 8 under the GMP option (as HUD has proposed), lenders will want to avoid offering the GMP on HOEPA loans. However, because they will not have an accurate breakdown of the charges that apply to the threshold under HOEPA, they will need to err on the high side and avoid offering the GMP to any loan that is even close to being covered by HOEPA.

If, instead, lenders are told to include the full amount of all prepaids as if they are covered by TILA and apply toward the HOEPA threshold, the result will raise APRs (and, incidentally, increase the number of HOEPA loans) for all loans that are subject to RESPA. Of course, the same will not be true of loans that are not subject to RESPA (e.g. home equity loans)—making APRs not comparable between different products.

Timing concerns also arise in regard to Regulation Z. The new timing requirements of the Proposal, i.e. within three days of the "application," as that is defined by the Proposal, is earlier than the Regulation Z timing, as well. Even though early TILA disclosures are required for purchase money mortgages, they are not required for refinancings, which are subject to RESPA. In addition, the early disclosures are not required to be given until three business days after receipt of a "written application." The Proposal would require the GFE or GMP to be provided at an even earlier time, and it is even triggered by an oral inquiry that has the requisite elements.

We urge HUD to resolve these incompatibilities and inconsistencies with Regulation Z by opening a dialogue with the Federal Reserve Board and seeking a solution that is simple and practical for lenders and packagers, and informative for the consumer.

B. <u>"Application."</u> The definition of "application" raises concerns that go to the treatment of loans under Regulation B (ECOA), Regulation C (HMDA). Definitions of applications vary among these regulations, with varying consequences for the lender and consumer. By creating a new definition that is earlier than all the others, HUD is sowing confusion. Under the Proposal, the definition of "application" would be changed to be "whenever a prospective borrower provides a loan originator sufficient information…, whether verbally, in writing or computer generated, to enable the loan originator to make a preliminary credit decision concerning the borrower… ." According the Proposal, sufficient information is "typically a social security number, a property address, basic employment information, the borrower's estimate on the value of the property, and the mortgage loan needed." 67 FR at 49149. These five items alone, particularly if they are taken over the phone, are not usually enough to amount to an application under the other regulations. These are the elements of an inquiry, not an application. Yet by calling the event an application, HUD raises a number of possible concerns: e.g. does a denial of a RESPA application amount to a denial of an application under Regulation C? What is the impact on HMDA reporting? Would the prospective borrower making an inquiry under RESPA that must be treated as an "application" be an "applicant" under Regulation B?

We believe the answers to all these questions are the same: that a RESPA application, as defined by the Proposal, is not an application at all, and would not have any

consequences under these other regulations. **We would urge HUD to avoid confusion by changing the name of the event. Calling it a "pricing inquiry," or a similar phrase would also be more descriptive and understandable to the consumer.** As a statutory matter, this would merely give the same event a new and more descriptive name.

C. Bank Holding Company Act. One critical concern for banks is the relationship of the Proposal to the Bank Holding Company Act (BHC Act). Section 106 of the BHC Act Amendments of 1970 creates potential conflicts for banks using the GMP option. The tie-in rules prohibit banks from requiring the use of an affiliated service provider. This might raise concerns for banks who have affiliated service providers that might be included in a GMP offered by them or by a third party, or who decline to approve a package that may include a service provider affiliated with a competitor; and a differentiation between BHC's and others could result in an uncompetitive environment.

It is important for HUD to work with the Federal Reserve Board to clarify how banks can employ the GMP without running afoul of the BHCA and other banking statutes and regulations.

VII. HUD must explicitly preempt state laws that would conflict with compliance.

Preemption of certain state laws will be necessary if the GMP option is to prove successful. A number of situations may arise that call for preemption of state laws, among others, including:

*State disclosure laws, including laws regarding the itemization of certain charges
*State laws requiring borrower choice of service providers
*State anti-affiliation laws and tie-in restrictions
*State kickback and anti-referral fee laws (mini-RESPA laws)
*State laws requiring the separate disclosure of yield spread premiums

RESPA preempts state laws "to the extent that those laws [concerning settlement practices] are inconsistent with any provision of this Act, and then only to the extent of the inconsistency." Moreover, HUD may not determine that a state law is inconsistent if it affords consumers greater protection than RESPA provides. Section 8(d)(6) of RESPA states, "No provision of State law or regulation that imposes more stringent limitations on affiliated business arrangements shall be construed as being inconsistent with this section."

We recommend that HUD make an express finding in its final rule that all such laws, and any others that it may identify as problematic, are in conflict with the revisions to RESPA, since they frustrate its purpose and provide less consumer protection. It should further determine that the final rule regarding the GMP is more protective of consumers and competition in the marketplace.

VIII. Technical violations of RESPA should not cause excessive liability.

Under the GMP option, any small error in disclosures (including the TILA disclosures, which we have elsewhere recommended to be eliminated from the package) or in the timing or other technical requirements could result in the loss of the safe harbor from section 8. This would be inappropriately severe repercussion. We believe the safe harbor exemption should be available to packagers and service providers as long as the guaranteed settlement cost figure is accurate.

Furthermore, the loss of the safe harbor exemption on one loan runs the risk of significant liability if the safe harbor –involving negotiations for services involving multiple transactions—is threatened. To address this concern, we believe there should be an opportunity to cure honest mistakes without losing the exemption. Permitting a lender to refund an error to cure a good faith error would protect consumers without unduly harsh penalties on lenders and service providers.

IX. Considerable time will be needed for the industry to implement the changes.

We are recommending against most mandated changes to the GFE process. The GMP is entirely optional. We therefore recommend that any mandatory changes that are adopted be given as long as **two years** for lenders to implement. Lenders who are HMDA reporters already have costly and time-consuming implementation requirements between now and January 2004.

Additional Issues

A. Regulation of costs.

The regulation does not permit packagers to charge for the cost of providing the package offer (notwithstanding the fact that lenders can charge a nominal amount when providing a GFE). Subsequently, the prospective borrower can be charged a "minimal" fee when the offer is accepted. We recommend that the packager be permitted to charge the consumer at the time the of the GMP offer, in order to cover the cost of providing the offer. Subsequent charges should not be limited by HUD at all.

We understand that it is HUD's intention to create an environment conducive to shopping, where the prospective borrower has no investment in the transaction before selecting a package or a lender. However, the mortgage lending process is not a matter of choosing an item off a shelf. Someone has to pay for the time and effort that goes into providing the price quote. Ultimately, if the shopper does not cover that cost, it will be passed on to the smaller number of those who do obtain a loan, driving up their cost of credit.

B. The GMP should exclude certain items.

Although we agree that it is useful to have only a limited number of figures to compare when an applicant is shopping for credit, some of the amounts that are included in the GMP are likely to throw it off dramatically if they are wrong and may be too difficult to provide with sufficient degree of accuracy. The concept of a "guarantee" would be totally undermined if these amounts must be included in the GMP, and consumers would be misled.

We recommend the exclusion of the following items from the package. In addition, we recommend the exclusion of costs that are not relevant to the consumer's decision when shopping for credit, that arise from a consumer's change or subsequent request, or that are to satisfy closing conditions rather than to pay for settlement services.

- **Mortgage insurance premiums (MIP).** Although the amount of MIP is to be specifically identified, along with a disclosure that it is subject to change[5], it is still to be included in the total GMP cost figure. Until the appraisal, even whether MIP is needed is not known for sure. If that figure is wrong, it will result in a significant inaccuracy in the total GMP disclosure. We therefore recommend that the GMP price not include mortgage insurance.

- **Discount points.** Discount points are not settlement services at all, but are related to the price of the loan itself. They do not belong in a package of settlement service fees. Borrowers choose to pay points to reduce the rate. Thus, the amount of the points is tied to the rate, and borrowers can make changes after the application as their needs or desires change. As borrowers may often want to change the relationship of the points to the rate during the application process, the changes should not affect the settlement cost figure.

- **Rate lock fees.** HUD should clarify that that rate lock fees are excluded from the package. A separate location for disclosing rate lock fees is required.

- **Flood insurance.** Flood insurance is a service that may not be required to be purchased, depending upon whether or not the property is located in a flood zone, as indicated by the flood search report. The flood search will not be ordered or performed until the applicant accepts the package. Thus, the lender will not know

[5] Mortgage Insurance disclosure needs to reflect potential increase as well as decrease. GMP also includes up-front costs of mortgage insurance, based on the ratio of the loan amount to the value of the property. Since the lender does not have the value of the property with certainty at the time of the disclosure—within 3 days of the initial inquiry—the lender must estimate. According to HUD, the disclosure should reflect the "maximum" possible insurance, and include a disclosure that the amount of mortgage insurance premium "may decrease or become unnecessary" depending on the appraisal. However, the possibility exists that the potential borrower will overestimate the value of the property—resulting in an under-disclosure of the MI, or the mistaken impression that MI is unnecessary. It is important that the disclosure clearly reflect that fact.

whether flood insurance will be required or how much the insurance will cost until the lender receives this report.

- **Charges payable in a comparable cash transaction.** We recommend that the GMP cost amount not include any charge payable in a comparable cash transaction. Thus, while mortgage recording taxes and charges are in the GMP cost amount, transfer taxes paid on the recorded deed in a purchase transaction or property taxes that are apportioned in a purchase transaction should not be. This is consistent with TILA's definition of a finance charge. Under TILA, finance charges exclude any charge "of a type payable in a comparable cash transaction."

C. GMP offer should not have to be open for 30 days from when the document is delivered or mailed to the borrower.

We recommend shortening the time frame for keeping offers open. Thirty days is an unnecessarily long time if the purpose is to permit shopping. While some may take that long to shop for a loan, those who are serious should be able to do so in much less time. Further, the requirement to maintain the offer for 30 days could increase the cost of credit. **We recommend 10 days as the maximum needed for the offer**.

D. HUD should explicitly state that packaging is a primary market activity.

The Proposal states that a packager is any person or other entity that offers and provides GMPs to borrowers. Proposed § 3500.16(b). The Proposal, however, should clarify that packaging is a primary market function, not open to entities whose charter prevents them from primary mortgage market activities.

E. The requirement to provide copies of certain documents (e.g. pest inspection; appraisal; credit report, and lender's title) to consumer on request is unnecessary.

These are new requirements, which will only add to the burden and complexity of the new rules. The pest inspection is done for the benefit of the lender, as is lender's title. The other two documents, appraisal and credit report, are already required to be provided to consumers under other laws.

In regard to Credit Reports, the Fair Credit Reporting Act already gives consumers a right to a free copy of their credit reports, directly from the credit bureau, in certain instances such as when the consumer has been denied credit. Some credit bureaus, as a condition of doing business, require lenders to agree not to directly provide consumers with credit report copies. Also, releasing third-party account experience may arguably make a lender a "credit reporting agency" under the Fair Credit Reporting Act. In the absence of a federal law clearly mandating and authorizing lenders to provide credit report copies to consumers, we ask that HUD not require lenders to offer credit report copies.

Regarding the lender's title policy, it would be extremely misleading to provide a copy to the borrower. Borrowers may take this as an implication that they have some protection or right to rely on the lender's title policy, which is not the case.

The borrower already has a right to a copy of the appraisal under the ECOA and Regulation B. An additional requirement under RESPA is unnecessary and redundant.

F. Clarification of Safe Harbor.
HUD should clarify that the arrangements covered by the GMP safe harbor exemption may not be used to challenge referrals to service providers in connection with loans not covered by the exemption, if the arrangements are separately negotiated and by their terms apply only to referrals made for loans covered by the exemption.

Thank you for your consideration in these matters. If you wish any further information, please do not hesitate to contact me.

Very truly yours,
S/

Steven I. Zeisel
Senior Counsel

Attachment

Mortgage Broker Fee Agreement

In the following: "I" or "me" = applicant; "You" = mortgage broker

Mortgage Broker Service. You are duly authorized and prepared to assist me in arranging mortgage financing for my home, and you agree to provide such assistance, as set forth below.

Amount of Broker Compensation. I understand that, as compensation for the goods, services and facilities you provide, your total mortgage broker compensation from all sources will not exceed:

[$_____]

and / or [*specify which*]

[_____ point(s)] (one point equals 1 percent of the original principal balance of the actual mortgage loan obtained).

Method of Broker Compensation Payment. I understand that I may have a choice as to how your compensation is paid. Depending on such factors as my financial circumstances, whether I qualify for a loan and/or whether a loan program is available:

- I may pay your compensation for the services you provide out of my pocket directly.
- If I want to lower the amount I compensate you out of my pocket directly:

  → I may have the lender pay some or all of your compensation, in which case the lender will charge me a higher interest rate which could result in higher monthly payments; and/or

  → I may use the proceeds of the loan to pay some or all of your compensation, in which case I will be obligated to repay that amount with interest over the term of the loan.

I understand that I should discuss with you in further detail the specific options available to me to pay for your compensation, including the impact of each such option on the amount of cash I must bring to the closing, my interest rate, loan amount and monthly payments.

Nature of the Relationship. [Choose appropriate text][standard][I understand that in connection with this Agreement, you are not acting as my agent. You are also not acting as the lender's agent. Although you seek to assist me in meeting my financial needs, you may not make available the products of all lenders or investors in the market or the lowest prices or best terms available in the market.]

[California/FHA][I understand that in connection with this Agreement and any mortgage loan you arrange for me, you are acting as my agent. You are not acting as the lender's agent. Although you seek to assist me in meeting my financial needs, you 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.]

[lender's agent] In assisting to arrange financing for my home, I understand that you are not my agent and that you are acting as the agent of the lender.]

Termination. This Agreement will continue until one of the following events occurs:

- I fail to receive loan approval;
- My loan closes;
- I terminate this Agreement;
- You and I enter into a new Mortgage Broker Fee Agreement; or
- _____ days expire from the date of this Agreement without any of the foregoing occurring.

Mortgage Broker Fee and Disclosure Acknowledgement

By signing below, I/we understand and agree to the terms of this Agreement. The contractual obligation to comply with this Agreement rests solely with the mortgage broker and the applicants signing below. No other entity shall be liable for any misrepresentation or non-performance of the mortgage broker's obligations under this Agreement, or the mortgage broker's collection of compensation in excess of the maximum compensation amount stated herein.

Signing this Agreement does not obligate me to obtain a mortgage loan through you, nor does it prevent me from shopping for mortgage loans with any other mortgage broker or lender. This Agreement does not constitute a loan commitment or otherwise indicate mortgage loan approval.

I acknowledge that you and any lender that makes a loan to me is relying upon this Agreement and upon my statement that I actually understand your role in the transaction and how you will be paid.

* * Applicant_____ Date_____

* * Applicant_____ Date_____

_____
Mortgage Broker's Signature
Mortgage Broker's License No. (where applicable) _____