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on behalf of

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before the

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Hearing on

HUD's RESPA Reform Proposal

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Good morning Mr. Chairman and members of the Committee. My name is John Courson, and I am President and CEO of Central Pacific Mortgage Company, headquartered in Folsom, CA. I am also Chairman of the Mortgage Bankers Association of America (MBA),[1] and it is in that capacity that I appear before you today.

I thank you for inviting MBA to form part of the important discussions regarding regulatory reform of the Real Estate Settlement Procedures Act ("RESPA"). This regulatory reform initiative, as set forth in HUD's recently issued proposed rule entitled "*Simplifying and Improving the Process of Obtaining Mortgages To Reduce Settlement Costs to Consumers*,"[2] will have far-reaching import for our industry and on the American consumer.

I want to begin my presentation by stating that we strongly support Secretary Martinez in his initiatives to simplify and improve the mortgage process, and we believe that the Proposed Rule is a major step forward for both consumers and the industry. MBA commends the Secretary on issuing this sweeping proposal.

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[1] MBA is the premier trade association representing the real estate finance industry. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership prospects through increased affordability, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,600 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field.

[2] 67 F.R. 49134 ("Proposed Rule").

The issues and controversies implicated by RESPA, a broad-reaching, 29-year old statute, are complex and politically thorny. Undaunted, Secretary Martinez has recognized that the mortgage process has become much too complex and that there currently exists an urgent need to thoroughly reform the process in order to ensure the objectives of clear disclosures and consumer protection in the mortgage shopping process. The sheer scope of HUD's proposal demonstrates a great deal of leadership and courage by the Secretary. This reform initiative also demonstrates foresight on the part of HUD, as it brings real solutions to the table, and challenges us all to come together and reach agreement on fixing a mortgage disclosure system that has become increasingly complex and burdensome for all the parties involved.

MBA Position

MBA has consistently called out for the need to enact fundamental reforms to the bewildering and confusing mortgage shopping process. MBA has been a constant partner in discussions with government and consumer groups to craft workable methods to simplify and improve the mortgage process.

MBA sees HUD's Proposed Rule as a unique opportunity to effectuate large portions of long-discussed improvements to the mortgage process. As can be expected with any far-reaching project to improve and innovate existing systems, we believe that there are a number of technical issues that still require attention and resolution by HUD. Notwithstanding these details, we want to make clear to the Committee that MBA fully embraces the more important concepts of reform advanced by HUD's proposed rule. MBA believes that, if properly structured, HUD's "Guaranteed Mortgage Package" system will improve and simplify disclosures, foster market competition, and strongly enhance protections for all consumers.

The Current System

To properly appreciate the benefits of the reform proposals now advanced by Secretary Martinez, it is fundamental to understand how the current home mortgage disclosure system operates and why it has been criticized as flawed and ineffective in adequately protecting mortgage shoppers.

Disclosures

The Congressional intent in enacting RESPA was to protect consumers from unnecessarily high settlement costs by affording them with greater and more timely information regarding the nature and costs of the settlement process, and by prohibiting certain business practices. The statute sets out to achieve these goals through two principal disclosures—the good faith estimate of settlement costs (GFE) and the settlement statement (HUD-1). The GFE provides consumers with an itemized estimate of the costs the consumer will be required

to pay at closing. This disclosure, containing such items as fees for origination, surveys, appraisal, credit report, etc., must be given to consumers within three days of application for a mortgage loan. The second key disclosure, the HUD-1, is provided to the consumer at closing, and lists all actual costs paid at, or in connection with, the settlement.

From a consumer's perspective, these forms may be effective in alerting them as to the generally anticipated costs they will have to incur at settlement, but the disclosures fall short of providing them with reliable figures that they need to effectively shop the market. As its name implies, the "good faith estimate" requires that cost disclosures to consumers be made in good faith, and that they bear a "reasonable relationship" to actual charges. RESPA does not impose any liability on the creditor for an inaccurate or incomplete estimate, nor for failing to provide one at all. It is important to understand the reality of the current law—the figures disclosed on the GFE, the key disclosure that consumers use to shop for settlement services, are neither firm nor guaranteed. If a consumer discovers that that the cost estimates they received at application differ significantly from the final HUD-1 figures, they have no redress or federal remedy to address the inaccuracies.

MBA believes that this legal structure is entirely inappropriate for both consumers and industry. Consumers that shop the market for the best prices available can never be assured of the actual costs at settlement. This system also provides little incentive for creditors and others to increase accuracy or incur risks in order to ensure such accuracy. In fact, it is the unscrupulous actors that benefit, as bait-and-switch tactics cannot be detected, and the intentional underestimating of costs and fees actually bears rewards in the competitive market place.

A further criticism of current disclosures centers on their complexity. Under existing regulations, the GFE and HUD-1 forms must separately itemize every single charge associated with closing. Though the intent is noble, this requirement creates a massively complex form that hurls disparate and obscure figures at consumers in a way that they cannot comprehend or effectively use to shop.[3]

From the industry's perspective, these disclosures are burdensome and expensive to administer. Not only are the forms costly to produce, but more importantly, they are subject to varying interpretations by different jurisdictions and regulatory entities. Creditors are always uncertain as to what degree of itemization is required, how certain costs are to be disclosed in instances where the services are out-sourced, and what line items to use in instances of non-traditional transactions that require special services. This is exacerbated by the

[3] For example, some of the fees required to be listed on the GFE may constitute costs that are already included and built into the loan's interest rate. Others may be fees that are dependent on the loan amount or price of the property.

fact that closing requirements vary across state lines, thereby causing disclosure requirements to vary in order to accommodate for such differences. Often, local jurisdictions create disclosure requirements that are in direct contradiction to express federal guidelines.

Section 8

Further difficulties arise in connection with the restrictions found under Section 8 of RESPA. This portion of the statute prohibits kickbacks, fee-splitting, fees for referrals of "settlement service business," and unearned fees, and imposes very heavy monetary and criminal penalties. MBA believes that the anti-steering provisions of Section 8 of RESPA serve very legitimate consumer protection purposes, as they shield home shoppers from improper influences that hamper shopping and competition. However, RESPA's Section 8 provisions are vague and subject to varying interpretations that impose barriers to cost-saving arrangements. For example, any attempt by lenders to negotiate for better prices with third-party settlement service providers, or efforts to regularize costs through average-cost pricing, could be deemed to constitute violations of Section 8.

I must note that all of the disclosure and legal complexities I describe here frequently lead to expensive and baseless class action litigation. Conflicting advisory opinions emanating from regulators can create classes of plaintiffs based on one or another of the varying interpretations. Special mortgage products that lower costs and benefit consumers create uncertainties under the ambiguous application of the RESPA statute. The Internet is now growing as the dominant medium for commerce, and yet the anti-kickback provisions of RESPA have not yet been clarified vis-à-vis online transactions. All these legal risks are menacing to industry, and generate massive legal and regulatory costs that can only be passed on to consumers through higher prices.

Need For Change

Although we can all agree that the American home finance system is recognized as the best and most efficient in the world, we cannot ignore the fact that consumer confusion persists and that the mortgage settlement process is bewildering to most home shoppers. The problems outlined above are real and have the effect of raising costs and trumping true competition in the market place. Worse still, in many instances, the confusion created by the current labyrinth of forms and disclosures allows unscrupulous actors to dupe and defraud even the most careful consumer. We believe, and repeat here today, that the scourge of "predatory lending" is in large part caused by the complex disclosure laws that allow dishonest players to perpetrate deception on unwary consumers.

Mr. Chairman, we can do better, and through this proposed rule, HUD has provided us with the blueprint from which to start our reform efforts.

HUD's Proposal

The Department's Proposed Rule, issued on July 19, 2002, contains far-reaching proposals that could fix virtually all the market and consumer problems I have identified above. The central element of HUD's proposal focuses on the creation of a carefully defined safe harbor that produces greater clarity and increased reliability for the shopping consumer. Under HUD's Proposed Rule, lenders and other settlement service providers would be allowed the option of offering applicants a "guaranteed" fee package in lieu of a GFE. This guarantee, dubbed the "Guaranteed Mortgage Package" ("GMP") under the proposal, would require a single lump-sum amount that represents the total of those costs expected to be incurred in connection with the originating, processing, underwriting and funding of that loan. As an important element of the GMP system, HUD is requiring that entities engaging in packaging offer to consumers, within 3 days of a loan application, an "interest rate guarantee," subject to change resulting only from a change in an "observable and verifiable index" or based on other appropriate data or means to ensure the guarantee. To encourage shopping, the proposal would not allow lenders to collect any application fees (prior to consumer acceptance of the GMP offer). Under the proposal, any person who assembles and offers such a package or whose services are included in such a package would be exempt from the restrictions and prohibitions of Section 8 of RESPA relating to referral fees, mark-ups, volume discounts, and fee splitting.

The Concept of "Packaging"

MBA believes, and has long advocated, that the "guaranteed fee package system" of the type set forth by HUD is the most effective way to achieve accurate disclosures for consumers. The effectiveness of this system is premised on the reality that consumers do not generally shop for individual settlement services, such as appraisal and credit reporting services. Rather, consumers shop for the mortgage loan, which is the central element that in turn requires the purchase of the other ancillary services. Since each lender has different loan products, and since each lender has different investors that impose different requirements pertaining to such services, these ancillary services can rarely be purchased independently from the mortgage loan. As they advance through the mortgage shopping process, consumers tend to focus only on the mortgage loan, and are therefore interested in the overall "price" of the loan itself rather than the individual price for those ancillary services performed for the benefit of the creditor or the ultimate investor.

The "packaging" system recognizes this reality, and constructs a system whereby the consumer is presented with a single price that includes all items required to close the loan. The "packaging" system streamlines cost disclosures to consumers by assembling practically all required closing costs under one single figure, thereby allowing consumers to better understand the overall cost of the

loan transaction. Unlike the estimates provided under the GFE, the "package" price offered to consumers would be solid and guaranteed very early in the shopping process. This cost reliability allows consumers to shop the market and effectively compare total settlement service prices among various sources. In short, the "packaging" system engenders market competition by encouraging comparison-shopping, which in turn allows market forces to influence costs and reduce unnecessary fees and charges.

Under a "packaging" system, consumers would receive an up-front disclosure guaranteeing costs relating to settlement. Packaging entities would therefore have an incentive to attain the best prices available in order to ensure the competitiveness of their packages. In a competitive environment, any price reduction achieved by the packager will surely be passed on to consumers.

The "packaging" system envisions a system that is free from unnecessary legal entanglements in terms of deals and activities necessary to arrive at the lowest possible guaranteed fee package. For example, the concept of "packaging" would create market incentives whereby lenders and other entities will seek out third-party settlement service providers in order to enter into volume-based contracts and otherwise secure discounts from providers in order to ultimately produce much lower settlement costs for consumers. It is also envisions that lenders will be able to solidify prices for consumers by "averaging" costs over a large number of transactions. As set forth above, today, these types of activities pose real risks under the hazy rules of Section 8 of RESPA. Average-cost pricing and volume-based compensation could be deemed to constitute improper referral schemes or "overcharges," which some would interpret as being violative of current RESPA rules.

Not only do these current restrictions pose undue complexities and legal risk, but more importantly, they are outdated and unnecessary under a guaranteed cost system. Inside of the package of guaranteed costs, consumers are fully protected because engaging in certain activities prohibited under Section 8 of RESPA would only serve to inflate the total "package" price, which in turn, would lead consumers to reject inflated-priced products for lesser-priced alternatives. The "packaging" system creates, therefore, a self-enforcing disclosure regime that saves government resources, promotes competition, and facilitates market innovation. The protections afforded by Section 8 should, however, remain fully applicable outside of the "package" arrangement, as we believe that improper steering would continue to have deleterious effects on market competition and consumer choice.

The Proposed Rule

HUD's GMP proposal incorporates this competitive "packaging" system, along with all of its benefits, into the current RESPA regulatory structure. As noted above, the Proposed Rule would afford a Section 8 exemption for entities that

are willing to offer simplified disclosures to consumers, which must set forth a guaranteed cost for those services required to close a mortgage loan, along with an assured interest rate quote on the loan.

MBA believes that HUD's proposed guaranteed fee package proposal goes a long way in resolving most of the shortcomings and market failures associated with RESPA's current disclosure system. Under the proposal, HUD would allow "packagers" to replace the current GFE forms with an alternative "Guaranteed Mortgage Package Agreement" disclosure that streamlines the cost disclosures and presents closing costs to consumers as a lump-sum, fixed number that can be easily compared with other packaged products. This disclosure is provided to the mortgage shopper free of charge and very early in the loan application process, thereby encouraging comparison-shopping.

More importantly, HUD's proposal would require that the lump-sum package cost be absolutely guaranteed three days after application. For numerous reasons, this represents a very significant consumer protection provision. First, it allows consumers to shop the market with the confidence that they are comparing actual, final figures. Since the guaranteed mortgage package price incorporates practically all costs required to close the loan, the consumer's comparison shopping will not be clouded or confused with meaningless numbers. In addition, the "Guaranteed Mortgage Package Agreement" empowers the consumer to easily detect misdisclosures and effectively enforce their rights and their benefits in the bargain. Unlike the current system that allows for variances between the GFE and the HUD-1, HUD's proposed system imposes a "zero" tolerance on the initial and final disclosures; a mere inspection and comparison between the initial disclosure and the closing statement will suffice to clearly expose whether the costs were improperly inflated. The streamlining also eases enforcement for government regulators, and will make it much tougher to defraud the public.

MBA also believes that HUD's proposals are a step in the right direction in terms of clarifying confusing legal standards that breed pointless class action litigation. The convoluted rules of Section 8 of RESPA are rendered obsolete by using free market forces to compress prices and allowing firm and reliable disclosures to serve as the consumer's shield of protection. Likewise, disclosure difficulties are resolved through a straightforward lump-sum disclosure that incorporates practically all transaction fees, without the complex distinctions that exist today.

Summary

To summarize, MBA believes that, with some adjustments, the guaranteed cost packaging proposal proposed by HUD is a viable system that is certain to result in broad consumer benefits. The certainty and reliability inherent in this system will provide sound consumer protections while sharply stimulating market competition. In terms of industry benefits, the proposed system will go a long way in clarifying difficult rules and regulations that pose unnecessary legal risks

and serve to trump operational efficiencies that could streamline the mortgage process.

Addendum: Additional Recommendations

Although MBA embraces HUD's Guaranteed Mortgage Package proposals, we believe that HUD must clarify and revisit certain components of the Proposed Rule. MBA has filed lengthy comments with HUD, setting out these recommendations in detail. For the benefit of the subcommittee, I summarize them below—

1. Interest Rate "Guarantee"

In the Proposed Rule, HUD is proposing that entities engaging in packaging offer to consumers, within 3 days of a loan application, an "interest rate guarantee, subject to change (prior to borrower lock-in) resulting only from a change in an observable and verifiable index or based on other appropriate data or means to ensure the guarantee." Through this requirement, HUD seeks to ensure that the rate of the loan does not vary after the borrower commits to a packager for reasons other than an increase in the cost of funds. The objective of the interest rate disclosure proposal, as articulated by HUD, is to protect against an increase in the packager's compensation through changes in the rate portion of the price quote.

Although MBA fully supports the Department's objectives with regards to the "Interest Rate Guarantee," we point out that any such regulatory plan must take into account that interest rate movements are set by open market forces that are not under any one lender's control. It must also be recognized that loan pricing is not exclusively influenced, nor fully measured, solely by the movement of any one index. Indeed, any index, even if applicable to pricing a mortgage product, may be only one in a number of components used to determine the ultimate price of a loan. Factors other than "interest rate index" fluctuations that would affect pricing include internal operating costs, product availability, capped investor commitments on particular loan programs, warehouse-line capacity and general capacity. In light of the unpredictability and shifting nature of the factors that affect loan pricing, our members believe that the protections sought by HUD can be afforded only under very specific conditions that allow financial institutions to effectively protect against financial risk. These carefully circumscribed conditions must be incorporated into any final rule. They are as follows—

- GMP interest rate "guarantee" should be renamed to reflect more accurately the nature of the disclosure.
- Retain the current definition of "application" under the RESPA regulations.
- Limit the post-disclosure shopping period to 5 days (or any additional period as determined only by the individual lender).

- Once the consumer accepts the GMP offer and “locks” the rate, the disclosed interest rate quote (subject to the index) is good only for as long as the duration of the “lock-in” period.
- GMP disclosure must list the specific loan product, and the "guarantee" would be applicable only to the specified product.
- Lenders must have full authority to select the appropriate rate “index”.
- Lenders must have full authority to select different “indices” for different loan products.
- Lenders must have full authority in setting the "spreads" applicable to the interest rate quotes.
- Lenders must be afforded the option of regularly publishing their rates as an alternative means of complying with the GMP rate quote requirement.

2. Modifications to Good Faith Estimate

For numerous reasons, HUD should delay the implementation of the Revised Good Faith Estimate (“GFE”) proposals. As currently drafted these proposals are extremely complex and in our opinion, unnecessary in light of the extraordinary pro-consumer reforms advanced under the GMPA proposal. We are, therefore, asking that changes to the GFE be delayed until after the market has had an opportunity to accommodate the packaging reforms. After a reasonable period of implementation, HUD should revisit the need for any additional changes to the current GFE system

Notwithstanding our position to delay the implementation of the Revised GFE, MBA agrees with HUD that confusion regarding mortgage broker compensation continues to be a vexing issue for consumers and that greater disclosure regarding broker fees may be necessary. MBA therefore recommends that HUD adopt the Mortgage Broker Fee Agreement Disclosure already introduced by a coalition of trade associations to HUD a few months ago, with the attendant exemption for brokers and lenders from Section 8 scrutiny. This additional disclosure would achieve HUD’s goals of full disclosure and greater consumer education.

3. Preemption

HUD should clearly announce its intent to seek preemption of state law that conflicts with the provisions established by any final rule. HUD should also take immediate action to facilitate this preemption of state law.

4. Conflicts With Federal Laws

MBA has recommended that HUD address the conflicts with other Federal laws that will result from this proposed rule. Particularly, HUD should engage the Federal Reserve Board on the implications this Proposed Rule will have with regard to the Truth in Lending Act and Regulation Z. The technical requirements

contained in TILA, give rise to several conflicts between that law and the proposed regulations. In light of certain itemizations and "Finance Charge" calculations mandated by TILA, lenders could potentially lose the flexibility that is necessary to accomplish the goals of the GMPA. Since some of these requirements have a statutory basis, Congressional action may be required to ultimately resolve this matter.