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Statement of

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Committee on Banking, Housing & Urban Affairs
U.S. Senate

Hearing on HUD's RESPA Reform Proposal
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Good morning Chairman Shelby, Senator Sarbanes and members of the Committee, I am Cathy Whatley and I am the 2003 President of the National Association of REALTORS® (NAR). I appreciate the opportunity to present to the Senate Banking Committee our thoughts on HUD's proposed rule to reform the Real Estate Settlement Procedures Act (RESPA). NAR is America's largest trade association, representing more than 860,000 members involved in all aspects of the residential and commercial real estate industries. When it comes to the home purchase transaction, REALTORS® hold the position closest to the consumer. From the very early stages of the home search to closing day, the REALTOR® is involved and acts as an advisor in the process. It is because of this very important role that we feel we can offer valuable insight into how these proposed changes may impact the consumer as well as the industry.

NAR supports efforts to improve RESPA and the home mortgage transaction experience for consumers. We admire Secretary Martinez's dedication to this initiative and we appreciate and agree with the stated goals of reform as set forth by the Department: 1) to simplify and improve the process of obtaining home mortgages, and 2) to reduce settlement costs for consumers. However, I will state up front, we have serious reservations as to whether the proposal as written meets these goals.

As you know, this proposal has generated significant response from all segments of the industry and consumer groups. In fact, only now that the comments are in can we truly appreciate the complexity of this proposal. While some may endorse the concept of the GMP, support is conditioned on the adoption of recommended changes and these changes are as numerous as the number of groups making them. How HUD responds to these recommendations will determine the level of future support or opposition. Unfortunately, the current process does not permit the industry to reassess the proposal relative to any changes HUD might consider upon review of the 45,000 comment letters. Therefore, we think HUD should amend the original proposal based on industry and consumer comments and reissue a revised proposal for additional comment.

NAR Position

I will summarize our overall reaction to this proposal, which we submitted in our comments to HUD

- HUD proposes two new disclosure methods, the Guaranteed Mortgage Package (GMP) and the Enhanced Good Faith Estimate (GFE). We believe the goals of reform can be achieved by improving the current Good Faith Estimate (GFE). While the proposal before us must be more carefully constructed, we support the concept and recommend that further analysis and development of this concept be conducted. It makes more sense to build on a model that we know rather than one that is untested relative to consumer and/or industry benefit.

- The Guaranteed Mortgage Package (GMP) represents a radical departure from today's rules. There is not enough evidence of consumer and industry benefit to move forward with this at this time. Additional data collection, research and analysis need to be conducted to provide evidence of significant benefits. There are risks inherent in this proposal and until more is known about the likely impacts, HUD should postpone advancing this kind of significant regulatory change.

- Congress should address many of the changes to RESPA in this proposal. To propose a repeal of Section 8 or to require providers to fix their fees requires oversight by the body that created RESPA.

The Enhanced Good Faith Estimate (GFE)

The goals of reform, certainty and simplicity, can be achieved without sacrificing the important consumer protections of Section 8. The Enhanced GFE imposes pricing discipline on lenders thus providing borrowers more certainty early in the process enabling them to shop and compare loans. It also clarifies that volume discounts are permissible, thereby encouraging lenders to seek discounts that can be passed on to consumers.

This incremental approach will reduce the potential for any market disruption and will pave the way for future changes as appropriate. Specifics of this approach need to be carefully studied to minimize burdens on the industry, such as the tolerances for those services not within the control of the lender. Clarifying that volume discounts are not a violation under RESPA should go a long way toward providing lenders who otherwise would not be inclined to seek these discounts for their customers. Additional thought on the mortgage broker compensation disclosure should also be more fully analyzed so the consumer is not further confused and the broker is not unfairly placed at a competitive disadvantage to a retail lender. There could also be small business implications that require additional scrutiny. The GFE form should be further reviewed and amended so borrowers can more easily reconcile it with the HUD-1 at closing. Additional thought must be given to the proposed penalties for non-compliance. To simply permit the borrower to walk away at closing is a disservice to everyone in the transaction including the borrower. Penalties must be stiff enough to discourage non-compliance and rational to ensure innocent parties to the transaction are not penalized. These improvements to the GFE will go a long way toward achieving the stated goals of the Department and are consistent with the original purpose of RESPA.

The Guaranteed Mortgage Package (GMP)

While being characterized as an improvement to the process, the GMP could produce unintended consequences for the consumer, the lending and entire settlement service industry. It could also negatively impact the overall economy. The proposal assumes an increase in competition will result from the packaging scheme and this competition will drive down prices and benefit consumers. However, we believe there is also the possibility that this proposal could increase concentration, reduce transparency, reduce the quality of services, and ultimately lead to higher closing costs. This will undoubtedly alter the lending and settlement services industries. We come to this conclusion after carefully weighing the benefits of the available reform options against the potential for negative market consequences due to the loss of RESPA's Section 8 consumer protections. What amounts to broad relief for one segment of the industry without evidence of consumer benefit or continued consumer protections represents a flawed approach to reform and should be revisited.

At first glance, the prospect of creating a simplified disclosure that includes an interest rate and lump sum closing costs at no cost to the consumer is appealing. However, upon further review, we find there are too many unanswered questions and concerns about this approach. The following is a summary of some of these concerns in the proposal.

The GMP will hurt small business- HUD's GMP proposal provides lenders with the very strong incentive of a Section 8 safe harbor for the packaging of settlement services. Therefore, it is likely the market will move in this direction. This proposal thus poses a serious threat to the settlement service industries that may already be offering a form of bundling or one stop shopping to their customers. These companies will not be able to compete with the large lenders who will now be offered a huge incentive to package.

HUD assumes a savings of $1.8 billion dollars in third party settlement costs. NAR believes HUD should conduct additional analysis to more fully quantify and qualify this benefit relative to the loss in the marketplace of third party settlement providers. Ensuring an abundance of providers creates a healthy and competitive market where the consumer has choices and can base their choices on both price and quality. To create incentives that merely encourage consolidation without regard for the quality of services being provided by the small businesses in today's competitive environment should be reviewed more closely.

The GMP limits packaging to lenders-The proposal states, “anyone can package.” This is a misleading statement because HUD’s requirements for the safe harbor under the GMP are that the package must be advertised with a guaranteed interest rate. The only players in the marketplace that can offer a guaranteed interest rate are the lenders. This is confirmed in another provision that requires the GMP to be signed by a lender. Therefore, real estate brokers will only be able to offer packages if they form a relationship with a lender. Even then, the terms of the relationship and the package arrangements will be subject to the specific lender requirements. They will not be able to market their services directly to consumers. Packagers will always be under the control of the lender. Therefore, the rest of my comments will reflect the lender as the intended packager.

Simplification- The proposed GMP disclosure includes the interest rate, APR and a lump sum package price for settlement services. However, there are three other required settlement costs that are not included in the package and disclosed separately. They are per diem interest, reserves/escrow, and hazard insurance. In addition, there is an optional owner’s title insurance disclosure. While it may be easy enough to add these costs to the lump sum GMP, we must not assume how the final rule will reflect these disclosures. In public comments to HUD, several lender groups have advocated the removal of some of the services within HUD’s GMP and to disclose them separately. Some of the services they recommend to exclude from the package are flood insurance, mortgage insurance, government fees and points. If HUD agrees with this assessment, the disclosure becomes very complicated. So the new disclosure would include the cost disclosures for the interest rate, points, the guaranteed package, per diem interest, reserves, hazard insurance, mortgage insurance, and flood insurance. Under this scenario, there may be more services outside than inside the guaranteed package.

Interest Rate Guarantee- The HUD GMP proposal requires an interest rate guarantee, subject to change resulting only from a change in an observable and verifiable index and it must remain open to the potential borrower for thirty days. The reason for linking the two is to prevent a lender from increasing the interest rate to make up for any losses on the guaranteed package. While lenders may find the interest rate guarantee unworkable, to deviate from this requirement will undermine the rationale for the GMP in the first place. To guarantee one piece of the offer and not the other can lead to bait and switch tactics and other abusive practices. Therefore, additional analysis is required to assess the impact of both guaranteeing the interest rate and removing the guaranteed interest rate from the GMP.

Certainty of costs-HUD has indicated one of its goals in this proposal is to protect consumers by providing some cost certainties in the mortgage transaction, hence the “guarantee” in the GMP. The rule, however, appears to have a loopholes that negates the contractual “guarantee,” specifically, the condition of “pending final underwriting and appraisal.” Under this proposal, there is nothing to prevent a lender from trying to lure consumers with a below-market GMP, and then increase the interest rate or costs following final underwriting, which can take place right up to the closing. Therefore, it is questionable as to whether the consumer is truly getting a guarantee. It sounds more like a conditional guarantee of interest rate and costs.

Transparency In the Process- In the HUD proposal there is much emphasis placed on creating a transparent process. However, the GMP will result in quite the opposite. Borrowers will shop for a loan based on an interest rate and a "black box" of settlement costs. To move from a process today where borrowers are fully informed of the various services required to close the transaction to one in which the borrower is assumed to only be interested in the lump price of the package is taking a step backwards in the area of consumer education. Despite claims to the contrary, consumers want to know what they are getting for their money. If services are not disclosed to the borrower, true comparisons cannot be made. Even in the 1998 HUD/Fed Report, they recommended that *"consumers want to know what services they are purchasing…",* and so they suggested the services in the package be itemized.

If nothing else, HUD needs to recognize this flaw in the proposal. Both services and quality of services matter to consumers. While lenders contend that these services are for their use, the borrower pays for them and is directly impacted by the quality of the service providers. For example, a lender may have a contract with a certain pest control company and includes this service in its package. The pest control company may not be very reputable yet meets the minimal needs of the lender. Substandard work could mean problems in the future that may result in thousands of dollars for the homeowner.

In the home purchase market, most borrowers rely on trusted advisors, such as real estate agents in the selection of settlement services. Under today's rules that prohibit settlement providers from paying or accepting fees for the referral of business, the only driving force behind a referral of business from a real estate agent to another provider is continued customer satisfaction from trusted providers in the marketplace. It is widely acknowledged that if a borrower is not satisfied or has a negative experience with a certain provider in the transaction, it is the real estate agent who makes things right. Under HUD's GMP proposal, the ability to guide the borrower through the transaction is restricted by these pre-arranged packages where services are not disclosed and service quality may be at risk. As pressure mounts on settlement providers such as appraisers, title companies, pest inspectors to drastically cut their prices to ensure inclusion in a lender package, quality of service could deteriorate. This scenario further underscores the need for full disclosure of services in a package.

Increased Competition or Increased Concentration

There is the likelihood that HUD's packaging proposal can lead to increased concentration within the industry and reduce competition. Lenders will be provided a financial incentive (Section 8 exemption) to package with no obligation to pass along discounts to borrowers and as a result will control the entire mortgage transaction. This will most likely lead to increased market share of the large lenders who already control the lion's share of the mortgage origination and servicing market. Small service providers including real estate brokerages with ancillary services will be at risk. Today the real estate transaction is still very much locally based. Small and mid-size service providers offer competitive choices to borrowers.

Any regulation that moves an industry toward a more concentrated market structure should be viewed with considerable caution. An increased concentration of powers into the hands of a smaller number of large lenders and service providers could lead to higher closing costs—the exact opposite of HUD's stated goals for reform. Until the impact of this proposal is more fully understood, HUD should conduct the appropriate analysis and postpone any further action.

Alternative to the GMP

We strongly believe there are serious flaws in the GMP proposal and believe they should instead pursue changes to the GFE that will provide some certainty about costs and simplify the process. However, if HUD is committed to moving forward with a Guaranteed Packaging rule as outlined in their proposal, we recommend a restructuring of the GMP. If the intent is to promote competition among non-lender packagers, a mechanism must be designed that will truly allow anyone to package independent of the loan. If designed correctly, it may offer opportunities for non-lender packagers, such as real estate brokers, title companies and others to provide alternative choices for the consumer, which do not exist under this proposal.

To date it appears the only alternative that would meet this objective is to split HUD's GMP into two independent guaranteed packages:

1) Lender Service Package: This package would include the lender services and perhaps the appraisal and credit report (800 series services on the HUD-1), and
2) Closing package: This package would include all of the other services such as title, inspections, surveys, government fees, etc. (1100, 1200, 1300 series services on the HUD-1).

Under the two-package system, a lender could offer a lender package along with a guaranteed interest rate. Anyone, including non-lenders, such as real estate professionals could offer the closing package. The conditions for receiving the Section 8 safe harbor would have to be carefully defined but would be available to both packages. Packagers will be eligible for compensation within the package for services rendered and do not necessarily have to provide a specific settlement service. Some minimal requirements would include:

- A lender could not require a borrower who is obtaining the lender's loan and lender package to also purchase the lender-closing package. In other words, the lender cannot tie their loan to a particular closing package.

- The services within the packages, both the lender and closing cost packages, would be itemized. Upon request of the borrower, the service providers should also be disclosed.

- Lenders should provide copies of all reports to borrowers, i.e. credit report, appraisal, etc. Lenders should also disclose to borrowers the type of appraisal used by the lender, i.e. Automated Valuation Model (AVM), a drive-by, or a full appraisal.

- HUD should move toward adopting and requiring uniform service fee descriptions so borrowers can make apples to apples comparisons.

Under this proposal, large lenders will still have a competitive advantage with the Section 8 exemption. However, it is anticipated the lender tying prohibition of the closing package will provide a non-lender some opportunity to compete in this market by offering these services directly to the consumer. The details of such a proposal requires further development and analysis to ensure it creates adequate opportunity for other market players to compete. Further, if HUD pursues this disclosure track, then it would be appropriate to delay implementation of the Enhanced Good Faith Estimate.

Additional Research and Analysis by HUD is Imperative before Advancing this Proposal

The above issues argue the need for additional study on this proposal, the need for alternative approaches to the GMP, and its impact on the consumer as well as the industry.
Not enough is known about the likely impact of the GMP to support advancing this concept at this time. An incremental approach, such as the improved GFE is a more attractive option for satisfying HUD's stated goals for reform. By simplifying the GFE and clarifying that volume discounts are not violations of RESPA, HUD has created the necessary environment for packaging to occur.

Regardless of which approach to reform HUD endorses, Congress should be consulted before any final action is taken. We are very supportive of these Congressional hearings and would like to serve as a resource as the Committee continues to review this proposal. There is too much at risk to move forward in a less than thoughtful and deliberative manner. While we support the concept of the Enhanced GFE, we question whether HUD has the authority to require lenders to guarantee their fees. Similarly, repealing Section 8, a core provision of RESPA, should receive considerable debate on Capitol Hill by the body that created it in the first place. What Congress deemed a prohibited practice, HUD recommends looking the other way as long as the prices are guaranteed.

As you know, the Small Business Administration (SBA) Office of Advocacy submitted comments to HUD. They encouraged HUD to issue a revised initial regulatory flexibility analysis (IFRA) that takes into consideration the comments of affected small entities and develops regulatory alternatives to achieve HUD's objectives while minimizing the impact on small business. They are of the opinion that further economic analysis prepared by HUD, in a revised IRFA, would improve the Final Rule. This is consistent with our belief that additional analysis is needed before moving forward with this proposal.

Conclusion

Let me conclude by calling to your attention HUD's statements in the proposed rule under the Supplementary Information Section

"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"

This statement should serve as a reminder that before HUD moves forward with an untested model, it must be sure it does not jeopardize a system that despite its flaws is still working well for most Americans.

In light of this, we encourage further development of the Enhanced GFE concept as a means to make incremental changes to a system that we know and understand. If this were not a viable option, then we would strongly recommend further analysis and development of a two-package approach to the GMP. Unless there is a real opportunity for providers other than lenders to offer packaged settlement services to consumers, the negative consequences of HUD's proposed GMP will far outweigh any potential benefits to consumers.

I thank you for the opportunity to express the views of the National Association of REALTORS® and stand eager to work with Congress to further address these issues.