



Prepared Testimony of Neill Fendly, Government Affairs Chair & Past President

National Association of Mortgage Brokers

on

The Impact of the Proposed RESPA Rule on Small Businesses and Consumers

before the

Senate Committee on Banking, Housing and Urban Affairs

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Chairman Shelby, Senator Sarbanes, and members of the Committee, I am Neill Fendly, Government Affairs Committee Chair and Past President of the National Association of Mortgage Brokers (NAMB). I appreciate the opportunity to present to you today NAMB's views on the impact the Department of Housing and Urban Development's (HUD) proposed rule (the Proposed Rule) amending the implementing regulations of the Real Estate Settlement Procedures Act (RESPA) will have on small businesses, particularly mortgage brokers, as well as consumers.¹ NAMB² is the nation's largest organization exclusively representing the interests of the mortgage brokerage industry and has more than 15,000 members. NAMB also represents mortgage brokers in all 50 states as well as the District of Columbia. NAMB provides education, certification, industry representation, and publications for the mortgage broker industry. NAMB has also created an education program for consumers on the homebuying process. NAMB members subscribe to a strict code of ethics and a set of best business practices that promote integrity, confidentiality, and above all, the highest levels of professional service to the consumer.

A mortgage broker is an independent real estate financing professional who specializes in the origination of residential and/or commercial mortgages. A mortgage broker is also an independent contractor who markets and originates loans offered by multiple wholesale lenders. As a result, mortgage brokers offer consumers more choices in loan programs and products than a traditional mortgage lender. Mortgage brokers offer consumers

¹ "Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, Docket Number: FR-4727-P-01, July 29, 2002.

² NAMB is a member of the National Federation of Independent Business.

superior expertise and assistance in getting through the complicated loan process. Mortgage brokers also provide lenders a nationwide product distribution channel that is much less expensive than traditional lender retail branch operations (bricks and mortar).

Today, mortgage brokers originate more than 60% of all residential mortgages.³ They are vital members of their communities, often operating in areas where traditional mortgage lenders do not, such as rural communities. The average mortgage broker shop consists of only one office and five employees, including the owner.⁴ Mortgage broker shops are typically small businesses, which remain a vibrant part of our nation's economy.

Mortgage brokers are the key to bridging the gap in minority homeownership. A recent study performed by Wholesale Access, a research, advisory and publishing company, on minority lending stated that two of the key findings of this research are: "(i) brokers reach more minorities than lenders; and (ii) the explanation for this is found in their locations, products and staffing."⁵

HUD's Proposed Rule

NAMB believes HUD's Proposed Rule will adversely impact homeownership and the economy. NAMB has serious concerns regarding this impact. NAMB finds the economic analysis HUD used to formulate the Proposed Rule and the regulatory burden documents prepared by HUD to be flawed, inconsistent and dubious at best.⁶ NAMB believes the Proposed Rule creates an unlevel playing field in the marketplace for small businesses (particularly mortgage brokers), limits consumer choice and access to credit, and is unworkable in the real world. HUD's Proposed Rule would significantly reduce small business revenue while substantially increasing the regulatory burden on small business. If the Proposed Rule is finalized in its current form, many small businesses involved in the mortgage industry, will no longer be in business, including mortgage brokers. NAMB believes HUD's Proposed Rule will further confuse consumers while placing a disproportionate burden on small business - a fact that HUD even admits in their Economic Analysis.⁷ The burden on small business will not be without consequences - the impact will likely result in an increase in costs to consumers and limit consumer access to the range of mortgage products and choices available to them today.

While HUD continues to assert that their Proposed Rule will simplify and improve the mortgage process, many market participants disagree. In fact, HUD received over 40,000 comment letters expressing concern about the merits of HUD's Proposed Rule - the most comment letters HUD has ever received on a proposed rule. Concerns about HUD's Proposed Rule are warranted considering the effect the Proposed Rule will have on small businesses and consumers.

³ "Economic Analysis and Initial Regulatory Flexibility Analysis for RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, Office of Policy Development and Research, July 2002, p. 12.

⁴ *Id.*

⁵ Press Release, Wholesale Access, Study of Minority Lending Completed, (Sept. 24, 2002) (www.wholesaleaccess.com).

⁶ *See Attachment 1*, "Discrepancies with HUD's Economic Analysis."

⁷ "Economic Analysis" at p. vii.

NAMB's Concerns With HUD's Proposed Rule: Enhanced Good Faith Estimate

HUD's Proposed Rule recharacterizes a yield spread premium as a "lender payment to the borrower for a higher interest rate." This characterization creates unintended consequences and provides less clarity to consumers than as presently disclosed. The recharacterization is also inconsistent with HUD's Statements of Policy 1999-1 and 2001-1. In HUD's Statement of Policy 1999-1, HUD stated, "the Department recognized that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are 'for' **the lender** [emphasis added] and other goods or facilities actually furnished or services actually performed are 'for' the borrower."⁸ HUD reemphasized these statements in its Statement of Policy 2001-1.⁹ Further, in the Proposed Rule, HUD stated that "as retailers, brokers also provide the borrower **and lender** [emphasis added] with goods and facilities such as reports, equipment, and office space to carry out retail functions."¹⁰

Yield spread premiums are used to pay the costs incurred in connection with a mortgage broker's business. Mortgage lenders save millions of dollars in facilities and employee costs by originating loans through mortgage brokers. However, these costs do not entirely disappear for the mortgage broker – a mortgage broker must pay for its employees, office facilities, and basic operations. By characterizing the yield spread premium as a "lender payment to the borrower," HUD has discounted any payment to the broker by the lender for goods or facilities actually furnished or services actually performed for the lender and in effect, artificially trying to redefine a market reality.

NAMB believes that HUD has provided no evidence that their recharacterization of a yield spread premium will benefit the consumer by simplifying the mortgage process. Rather, this recharacterization will further confuse consumers and potentially lead them to choose mortgage products because they "appear" less expensive. The Federal Trade Commission has expressed similar concerns. In their comment letter to HUD, the FTC states that the "approach to the disclosure of broker compensation" contained in the proposal could "confuse consumers and lead them to misinterpret the overall cost of a transaction."¹¹ Further, the FTC states in its comment letter that "if the additional information or revised formats confuse consumers, the proposed changes may not increase consumer welfare as much as HUD intends and, in the worst case, may actually result in consumer harm."¹² Consumers should not suffer the consequences of a proposal that will steer them to loans that appear less expensive but in reality are more expensive, thus increasing the costs for consumers for homeownership. If the homebuying process is complicated further, which will be the effect of HUD's Proposed Rule, families may be

⁸ Real Estate Settlement Procedures Act, Statement of Policy 1999-1, 64 Fed. Reg. 10,080, 10,086 (March 1, 1999).

⁹ Real Estate Settlement Procedures Act, Statement of Policy 2001-1, 66 Fed. Reg. 53,052, 53,055 (October 18, 2001).

¹⁰ Real Estate Settlement Procedures Act, 67 Fed. Reg., 49,134, 49,140 (July 29, 2002).

¹¹ Federal Trade Commission Press Release on their Comment Letter.

¹² Comment Letter submitted by the Federal Trade Commission, on the "Real Estate Settlement Procedures Act, Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, FR-4727-P-01 (July 29, 2002), at p. 1.

deterred from seeking the goal of homeownership – an outcome neither the mortgage industry or consumers want.

NAMB has a long history of supporting the reform of mortgage laws, as the laws are often complex for both consumers and industry. As such, NAMB has spent countless hours and resources to strengthen, simplify and clarify the disclosure of costs provided to consumers in advance of settlement. NAMB submitted an alternative disclosure form set forth in its comment letter that satisfies HUD's objectives to simplify and clarify the disclosure of settlement costs, but not at the expense of small business or to the detriment of consumers.¹³ It will allow the consumer to perform a true “apples to apples” comparison of the cost of the mortgage while maintaining a more level playing field for mortgage originators.

The Proposed Rule is Anti-Competitive

NAMB does not believe RESPA reform should create an unlevel playing field among originators or, in essence, pick winners or losers. Unfortunately, the Proposed Rule does just that. HUD even acknowledges that the Proposed Rule “results in different treatment of compensation in loans originated by lenders and those originated by mortgage brokers.”¹⁴ HUD's Proposed Rule requires that only mortgage brokers must include their indirect compensation in the *calculation* of Net Loan Origination Charge, but does not require the same of all originators. This will complicate a consumer's ability to shop because the consumer will be unable to perform a true “apples to apples” comparison of the cost of the mortgage. FTC also expressed concern about this disparity. In their comment letter, FTC states that HUD's prominent emphasis of the yield spread premium and the “asymmetric disclosure” of compensation for mortgage brokers might “inadvertently burden consumers and competition.”¹⁵ Competition fosters choice for consumers and helps to keep prices down for consumers. NAMB believes HUD's Proposed Rule will instead decrease competition, thereby forcing small businesses to close, leaving fewer choices, if any, for consumers.

The effect of the Proposed Rule prevents mortgage brokers from appearing competitive (such as no longer being able to advertise a “no point” loan).¹⁶ In addition, by including a mortgage broker's indirect compensation in the calculation of the Net Loan Origination Charge, consumers will suffer a loss of available credit as many mortgage brokers will no

¹³ See *Attachment 2*, Alternative Disclosure Form submitted by the National Association of Mortgage Brokers, on the “Real Estate Settlement Procedures Act, Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers,” U.S. Department of Housing and Urban Development, FR-4727-P-01 (July 29, 2002).

¹⁴ Real Estate Settlement Procedures Act, 67 Fed. Reg. 49,134, 49,148 (July 29, 2002).

¹⁵ FTC Comment Letter at p. 10.

¹⁶ If the proposed characterization of yield spread premiums is implemented, mortgage brokers will be placed at a competitive disadvantage. One example of this is that mortgage brokers will not be able to advertise certain mortgage loans and remain competitive. For example, a mortgage *broker* who makes a “no point” mortgage loan at 7% interest rate on a \$100,000 loan, but collects a \$1,000 yield spread premium, must advertise that this is a one-point mortgage loan. A mortgage *lender*, who originates a \$100,000 mortgage loan at a 7% interest rate, but collects \$1,000 in compensation when the loan is sold, can advertise a “no-point” mortgage loan. These are the exact same loans with the exact same costs to the consumer. However, due to a federally regulated mandate (*i.e.* artificial) the mortgage broker appears more expensive as he or she must advertise that this is a one-point mortgage loan.

longer be able to originate FHA and VA-insured mortgage loans. This is because direct originator compensation on these loans is limited to 1% of the loan amount (cap) in connection with FHA-insured loans, and direct originator compensation on VA-insured mortgage loans is limited to 1% of the total loan amount or closing costs (cap). In characterizing yield spread premiums as a “lender payment to the borrower,” indirect compensation to a mortgage broker is artificially transformed into direct compensation and thus subject to the cap. This will impact many first time homebuyers who rely on FHA and VA-insured mortgage loans as a viable financing alternative. Mortgage brokers will no longer be able to provide homebuyers with FHA and VA-insured loans. This is significant as approximately 31% of all FHA-insured loans are originated by mortgage brokers.¹⁷

Further, under the Proposed Rule, HUD would no longer require a good faith estimate of costs associated with the mortgage loan but rather a guarantee of many of the costs, including many third party costs, associated with the mortgage loan. Many times during the processing of a mortgage loan, unforeseen costs arise. A good example of this is when the wholesale lender, after the review of the appraisal, requires additional comparables for the property in question. Another example is when, after an appraisal or inspection, damage to the property is discovered and a termite inspection or structural analysis is required. A mortgage broker cannot foresee every cost associated with a mortgage loan. While large lenders might be able to absorb these losses, small businesses like mortgage brokers cannot. Losses such as these can be enough to put mortgage brokers out of business.

¹⁷ Letter from Engram A. Lloyd, Director, Philadelphia Homeownership Center, Department of Housing and Urban Development, to Paul H. Scheiber, Blank Rome Comiskey & McCauley LLP on 8/12/2002.

NAMB's Concerns With HUD's Proposed Rule: Guaranteed Mortgage Packages

The Proposed Rule also sets up a new process for originating mortgages called the Guaranteed Mortgage Package Agreement (GMPA). Created by regulatory fiat, this regime requires an originator to offer a guaranteed mortgage package (mortgage, third party settlement services and closing costs) for a set price. Mortgage brokers, and other small settlement service providers, as small businesses, do not have the bargaining power to enter into volume-based discounts with third party settlement service providers, as do larger entities. The end result will be additional consolidation in the mortgage industry at the expense of small business and ultimately, the consumer.

The economic burden associated with packaging, will fall disproportionately on small business, and although they understate the costs associated with this burden, even HUD concedes that - "\$3.5 billion of the \$6.3 billion in transfers to borrowers comes from small originators (\$2.2 billion) such as small brokers and small settlement service providers (\$1.3 billion)."¹⁸ Since the Proposed Rule significantly increases the regulatory burden for mortgage brokers, a burden that many will not be able to absorb, mortgage brokers will be forced out of the business of placing people in homes - a perverse, but very real effect of a proposal intended to actually help put people in homes. Given the mortgage broker's significant involvement in originating mortgages, we firmly believe this Proposed Rule cannot be finalized in its current form.

Under the Proposed Rule, many mortgage brokers will not be able to compete with the larger entities and will be forced out of business, or become a captive agent for only one lender or two utilizing their packages. The mortgage broker will therefore be left with the enhanced good faith estimate approach, which as stated herein, discriminates against the small business mortgage broker.

Further, it is questionable whether the packaging of settlement services and a mortgage loan will benefit consumers. While some argue that it will create ease in the shopping process, consumers will not be getting a clear picture to enable them to make a sufficient comparison in the packaging world. Under HUD's Proposed Rule, the services performed in the package are not required to be itemized until settlement. Thus, when a consumer receives their GMPA, it will not contain a list of all services performed as part of the package.¹⁹ A consumer may have two or three GMPAs for comparison purposes but those same three GMPAs may not contain the same services. The "black box" of settlement services created by packaging will not benefit consumers; rather it will only make it more confusing and difficult for consumers to shop.

HUD's Economic Analysis and NAMB's Economic Study

NAMB believes that the Economic Analysis and Initial Regulatory Flexibility Analysis (Economic Analysis) prepared by HUD does not provide a clear picture of the potential impact on a market that is functioning effectively and does not accurately reflect the

¹⁸ "Economic Analysis" at p. vii.

¹⁹ HUD's Proposed Rule does provide that certain services (pest inspection, lender's title insurance, credit report, and/or appraisal) must be shown as "anticipated" if they so are. Real Estate Settlement Procedures Act, 67 Fed. Reg. 49,134, 49,160 (July 29, 2002).

Proposed Rule's impact on small business. In fact, HUD's Economic Analysis is flawed, incomplete, and inaccurate.

Basing a proposed rule on flawed economic analysis will result in a flawed final rule that harms consumers and could have devastating repercussions on a housing market that has been one of the only sectors sustaining our economy. NAMB believes that further analysis by HUD is necessary to ensure that any proposed rule impacting the housing market is based on a foundation of market realities and not just good intentions.

HUD's failure to accurately analyze the economic impact on small business can be illustrated through their own reported inconsistencies. HUD's Paperwork Reduction Act Submissions to the Office of Management and Budget (OMB) states that annual responses for Good Faith Estimates (GFEs) is 11 million.²⁰ However, HUD's Economic Analysis states that if the rule applied in the year 2002, it would impact 19.7 million applications.²¹ This is significant because the submission to OMB underestimates the paperwork burden by at least 8.7 million GFEs and an additional \$57 million.

In addition, HUD's Economic Analysis states that "originators and closing agents will have to expend some minimal effort in explaining to consumers the cross walk between the enhanced GFE and the more detailed HUD-1."²² However, HUD did not perform their due diligence to ascertain these costs since the costs were not included in HUD's submission to OMB. The cost associated with explaining to consumers the new streamlined GFE and the more detailed HUD-1 is not "minimal." NAMB believes a detailed and accurate estimate should be provided.

HUD states that the program change being mandated by the Proposed Rule would increase the burden on the industry by 2,530,000 burden hours.²³ HUD has testified that this is a one-time transition burden.²⁴ NAMB believes that this one-time transition burden that is equal to 289 years will eradicate small businesses in the mortgage industry. The extreme burden HUD's Proposed Rule forces upon small business will not only dismantle small businesses, but it will also alienate consumers from the dream of homeownership.

NAMB's review of the Economic Analysis and its obvious flaws led to NAMB's commission of an economic study on the underlying assumptions of HUD's Economic Analysis, and, among other things, the effect the Proposed Rule would have, if implemented as written, on small businesses.²⁵ NAMB's study "anticipates that small originators/brokers and small third party service providers will lose more than 60% of their revenue."²⁶ This is a tremendous loss and will cause many small businesses to close, ultimately resulting in a loss to consumers in their choice and access to credit.

²⁰ See Attachment 3, "Supporting Statement for Paperwork Reduction Act Submissions," U.S. Department of Housing and Urban Development, August 2001, p. 5.

²¹ "Economic Analysis" at p. 9.

²² *Id.* at p. 25.

²³ "Supporting Statement," p. 7.

²⁴ Senate Banking Committee Hearing, "Hearing on Issues Relating to HUD's Proposed Rule on the Real Estate Settlement Procedures Act," March 20, 2003.

²⁵ See Attachment 4, Blalock, Joseph and Tyler Yang, "Analysis and Comments on HUD's RESPA Economic Analysis and Initial Regulatory Flexibility Analysis," IFE Group, February 24, 2003, p. 1.

²⁶ Blalock at p. 20 - 21.

The study also explains “this lost revenue will not go to consumers, however, but is likely to go to larger businesses.”²⁷ The study cites that “on balance, smaller businesses will be driven from the market or driven to join in business or even ownership with larger firms, but the overall benefit to consumers from this concentration and reduction in competition is questionable.”²⁸ Unfortunately, when dealing with a housing market that is a driving factor for our economy, such questions should not go unanswered.

The stark reality of business is that the more the mortgage marketplace condenses and consolidates as a result of the Proposed Rule’s anti-competitive effect, both in the world of the enhanced GFE and the GMPA, a consumer’s access to credit will contract. Consumers will lose the service small business is known for. The end result will be access to less credit for consumers – again, a perverse impact of a rule that is being implemented to help consumers.

Regulatory Flexibility Act of 1980²⁹

NAMB believes the Proposed Rule requires further analysis under the Regulatory Flexibility Act (RFA).³⁰ When promulgating proposed and final rules, the RFA requires federal agencies to review the rules for their impact on small businesses and consider less burdensome alternatives. Pursuant to the RFA, if a proposed rule is expected to have a significant economic impact on a substantial number of small entities, an Initial Regulatory Flexibility Analysis (IRFA) must be prepared.³¹

NAMB does not believe HUD sufficiently complied with the RFA when promulgating their Proposed Rule. HUD’s IRFA³² did not contain a sufficient comparative analysis of alternatives to the Proposed Rule that would minimize the impact on small entities nor did it accurately describe the projected reporting and record keeping requirements and other compliance requirements of the Proposed Rule, including an accurate estimate of the classes of small entities which will be subject to the requirements as required by RFA.

The Small Business Administration Office of Advocacy (SBA), the voice for small business, even expressed concern to HUD regarding their IRFA. Pursuant to SBA’s statutory duty to monitor, examine and report agency compliance with the RFA, as amended by the Small Business Enforcement Fairness Act of 1996 (SBREFA), the SBA submitted a comment letter encouraging HUD to issue a revised IRFA “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

²⁷ Blalock at p. 2.

²⁸ Blalock at p. 2.

²⁹ 5 U.S.C. § 601 *et seq.*

³⁰ 5 U.S.C. § 601 *et seq.*

³¹ If the proposed rule will not significantly impact a substantial number of small entities, the head of an agency must certify as such and provide factual determination. When an agency issues a final rule, it must prepare a Final Regulatory Flexibility Analysis (FRFA). 5 U.S.C. § 603.

³² The IRFA must describe the economic impact of the Proposed Rule on small entities including a description of the projected reporting, record keeping and other compliance requirements of the proposed rule. It must also contain a comparative analysis of alternatives to the proposed rule, which would minimize the impact on small entities and document their effectiveness in achieving the regulatory purpose.

business.”³³ The SBA recommended that HUD publish a supplemental IRFA to provide small businesses with “sufficient information to determine what impact, if any, the particular proposal will have on its operations” and “provide a meaningful discussion of alternatives that may minimize that impact.”³⁴ NAMB believes it is imperative that HUD issue such an analysis before they issue a final rule so that small businesses could get a better understanding of how the rule will impact their business and ultimately, their ability to serve consumers. Although HUD’s Economic Analysis states that \$3.5 billion of the \$6.3 billion (55%) in transfers to consumers will come from small businesses,³⁵ the SBA explained in their comment letter that HUD’s Economic Analysis would be improved by a revised IRFA, which clearly defines the impact on small entities, instead of citing the mere overall cost to small business.³⁶ Since HUD did not specifically compute the cost of compliance per small business, HUD could not and did not sufficiently analyze regulatory alternatives as required by RFA that would minimize the burden on small businesses. The National Federation of Independent Business (NFIB) has also stated that the specifics of the impact on small businesses “were missing from the initial regulatory flexibility analysis.”³⁷

NAMB finds this very troubling in the sense that small business – particularly in the housing industry today – is one of the few pillars in this economy that has not fallen. NAMB is concerned that arbitrarily reducing small business revenues while substantially increasing the regulatory burden on small business by 2.5 million burden hours will absolutely devastate small business. As a result, consumers will suffer an increase in the cost of credit and a reduction of choice and access to credit.

Conclusion

NAMB sincerely appreciates the opportunity to share its concerns with this Committee on the impact HUD’s Proposed Rule will have on small business and consumers. We commend you Chairman Shelby for convening this hearing on this very important issue. NAMB is very concerned that if HUD proceeds to finalize the Proposed Rule in its current form, small businesses will be driven out of business, especially mortgage brokers. As a result, consumers will experience a reduction in the availability and access to credit and homeownership will likely decline as a result. We ask this Committee for its support to request HUD to revise their Proposed Rule so that it accomplishes HUD’s stated goals and objectives to simplify the mortgage process and increase homeownership while not creating competitive disadvantages in the marketplace.

³³ See *Attachment 5*, Comment Letter, Small Business Administration Office of Advocacy, “RESPA: Department of Housing and Urban Development: Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs for Consumers; Proposed Rule; Docket Number: FR-4727-P-01,” p. 1, October 28, 2002.

³⁴ SBA Comment Letter at p. 4.

³⁵ “Economic Analysis” at p. 26.

³⁶ SBA Comment Letter at p. 3.

³⁷ Letter from the National Federation of Independent Business to the Honorable Mel Martinez, Department of Housing and Urban Development, March 7, 2003.