

Statement of
Representative Donald A. Manzullo
Chairman, House Committee on Small Business

Before the Senate Committee on Banking,
Housing, and Urban Affairs

“The Impact of the Proposed RESPA Rule on Small Business and Consumers”

April 8, 2003

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, thank you for inviting me to testify on the effects on the small business community of the Department of Housing and Urban Development’s (HUD) proposal to revise the regulations implementing the Real Estate Settlement Procedures Act (RESPA). I come before you today not just as the Chairman of the House Small Business Committee but also as a member of the House Financial Services Committee. In addition, prior to being elected to Congress, I was an attorney in private practice for 22 years and I have personally closed more than 1000 real estate transactions.

The question before us today could be, “Why is HUD taking a position that essentially legitimizes kickbacks to large lenders that enter into agreements with settlement service providers and allows those relationships to be hidden from consumers?” The

proposal should focus on better disclosure of the various settlement fees so that consumers are fully advised of all of fees going into a settlement transaction rather than permitting large mortgage lenders to hide their fees charged to consumers and the monies received from settlement providers.

I fully support simplifying and clarifying the settlement process so that more first-time homebuyers can enter the market, however, I believe that HUD's RESPA proposal will make fundamental, and most likely, irreversible changes to our residential real estate market. In the short-term, the proposal may jeopardize our robust real estate market. In the long-term, the proposed changes may undermine the goals of providing affordable housing and enhanced protections for consumers. In my opinion, the proposal is bad for small business and it is bad for consumers.

On March 11, I chaired a hearing of the House Small Business Committee to hear testimony from Secretary Martinez and the small business community on the impact of the proposal on small entities. The hearing was a bi-partisan effort with members of both sides of the aisle expressing strong concerns about the proposal, including Ranking Member Nydia Velazquez who also wrote a comment letter to HUD about her concerns. Several of the members, including Ms. Velazquez, are members of the House Financial Services Committee and several other members have had broad experience with real estate transactions prior to being elected to Congress.

In addition, there are bi-partisan members of the House Financial Services Committee who share our concerns. Congressman Mel Watt of North Carolina is a Democratic member of the Financial Services Committee. We have very similar backgrounds and were elected to Congress the same year. The Congressman and I have the same view of the RESPA proposal and believe that it would significantly harm our real estate market.

While the small business community has many concerns about HUD's RESPA proposal, the two primary concerns are that the proposal is tilted unfairly towards the mortgage lending community and against small business real estate professionals and that HUD did not fulfill its obligations pursuant to the Regulatory Flexibility Act to demonstrate the anticipated burdens to be faced by small businesses.

The overwhelming majority of the small business community that have contacted the Committee, including virtually all of the small settlement providers and a significant proportion of the community banks, believes that the proposal would unfairly give significant power to the mortgage lending community, especially large lenders, to put together Guaranteed Mortgage Packages. HUD's proposal would permit mortgage lenders to determine what real estate settlement professionals may participate as a part of a package, to negotiate "bulk pricing" with the settlement providers, and to minimize the disclosure requirements to consumers on the costs of the package contents.

In addition, packagers would be allowed a safe harbor from liability under Section 8 to permit payments between package participants without any disclosure to the consumer.

Small businesses, that are unable to participate in package arrangements, must attempt to compete using the detailed itemized listings under the proposed Good Faith Estimate reforms. Those small businesses also would be ineligible for safe harbor relief.

A significant fear is that large mortgage lenders may use the package of settlement services as a “loss leader” in order to obtain the more lucrative servicing and secondary market fees associated with the administration of a residential real estate loan. Once competition in the marketplace is reduced, the packagers may attempt to bulk price other products, services, and items for the purchase of a home.

For example, a lender may suggest that all homes built prior to 1990 must be installed with energy efficient windows. The lender may have entered into a bulk pricing agreement with the window manufacture for the windows and a contractor to install the windows. If faced with such a situation, a consumer may be unable to discern whether being able to obtain a settlement and loan package is predicated upon other packages being offered by the lender. If competition for lending is reduced, some consumers may find it unclear as to how many financing alternatives the consumers really has and what may be necessary to secure a loan.

In October of 2002, the Administration through the Office of Management and Budget undertook a government-wide initiative to end federal agencies from bundling federal contracts to large businesses. The Administration believes that contract bundling is not good for our economy as it reduces long-term competition in the marketplace.

HUD appears to be taking the opposite position with the Guaranteed Mortgage Package Agreements. According to the American Banker, the top 10 mortgage originators account for more than 53 percent of the industry. With Guaranteed Mortgage Package Agreements, it is anticipated that that figure will climb quickly. In my opinion, HUD needs to further explore the long-term economic ramifications of its proposal prior to adopting Guaranteed Mortgage Package Agreements with a safe harbor from Section 8 liability.

With regard to its economic analysis conducted pursuant to the Regulatory Flexibility Act and Executive Order 12866, HUD acknowledged that the proposal would place a \$9.4 billion burden on small businesses. Of this \$9.4 billion figure, \$3.5 billion comes from the revised Good Faith Estimate proposal and \$5.9 billion comes from the initiative to allow the packaging of settlement services. However, HUD does not break down the costs in its economic analysis for each segment of the industry.

HUD did not provide a detailed economic analysis for the community banks – small realtors – small title agencies – small appraisers – small pest management companies, just to name a few among the many other small businesses not specified in the analysis. It also should be noted that the economic analysis does not contain any analysis of the additional 2.5 million hour burden that HUD disclosed in its Paperwork Reduction Act filing with the Office of Management and Budget. The \$9.4 billion burden may, in fact, be significantly higher.

In addition, on pages 73 through 75 of the Regulatory Flexibility Analysis, HUD insists that small loan originators and small third party service providers can compete effectively against large lenders and service providers in packing settlement services. Unfortunately, HUD offers no economic analysis to support such claims. Without such analysis it was extremely difficult for small businesses to comment on that section of the proposal.

In fact, HUD was so deficient in its small business regulatory economic analysis that the federal government's small business watchdog, the Office of Advocacy of the Small Business Administration, requested that HUD issue a supplemental regulatory analysis in order "...to provide small businesses with sufficient information to determine what impact, if any, the particular proposal will have on [the small businesses'] operations."

HUD added even more confusion to the RESPA proposal by asking 30 specific questions that would have been more appropriate as part of an Advanced Notice of Proposed Rulemaking. The questions were designed to elicit detailed concerns on how the Good Faith Estimate and the Guaranteed Mortgage Package Agreements should be implemented. However, it was unclear as to whether the answers to the questions would be made part of any final RESPA rule.

For example, question 22 on the Guaranteed Mortgage Package Agreement proposal requests whether state laws that are inconsistent with the proposed package arrangements should be preempted. Without knowing whether HUD intends to include state law

preemption in the final rule, it is extremely difficult for small businesses to adequately comment on the regulatory burdens of the proposal.

Congress passed RESPA in 1974 with the intention of providing greater clarity to the home buying settlement process for consumers. Congress passed the Regulatory Flexibility Act in 1980 with the intention of providing greater clarity to federal regulatory process for small businesses. Ironically, the question before us is whether HUD, in its efforts to improve the clarity in the home buying process for consumers, has provided the adequate and necessary disclosures to small businesses for clarity in the federal regulatory process. I believe that HUD has not.

In the same way that HUD proposes to require the real estate industry to put forth a firm Good Faith Estimate to consumers on the costs of settlement, the Regulatory Flexibility Act requires federal agencies to put forth a "Good Faith Estimate" known as an Initial Regulatory Flexibility Analysis to let small businesses know the cost of regulations up front. In either case, there should be no surprise costs or added charges by the time a real estate settlement reaches the table or by the time an agency's final regulation reaches the table.

Originally, I had believed that HUD, at a minimum, should issue a supplemental Regulatory Flexibility Analysis to clarify the exact burdens to be faced by small business. However, after careful consideration, I do not believe that this would answer the many questions of the proposal being asked by small businesses. In addition, I do not believe that HUD can cure the deficiencies in the final rule as it would deprive small businesses the

ability to comment on any major revisions or changes in economic assumptions. I strongly believe that HUD should issue a revised proposed rulemaking incorporating the answers to the pertinent questions and seek public comment.

If HUD does finalize its rule proposal, HUD may find itself in an uphill battle in the court system. I believe that small businesses have a legitimate claim to set aside the rule until a sufficient small business economic analysis is conducted. I am not sure why HUD is risking the uncertainty that will be caused by the litigation or the thousands of hours and dollars to be spent defending such a legal challenge.

Before we tinker with the successful formula that has created our very strong residential real estate market, we should carefully and deliberately consider the reform proposals before us. Rushing to finalize the proposal may cause unintended, and perhaps, irreversible harm to competition in residential real estate market and prevent us from achieving meaningful consumer benefits.

Just as HUD does not want consumers to face surprises at the real estate settlement table, HUD should not provide surprises to the small business community and consumers in a final RESPA rule and its Final Regulatory Flexibility Analysis. I strongly believe that the proposal, as drafted, is bad for small businesses and it is bad for consumers.