AMERICAN
LAND TITLE
ASSOCIATION

TESTIMONY OF CHARLES J. KOVALESKI
PRESIDENT-ELECT
AMERICAN LAND TITLE ASSOCIATION,
ON

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

BEFORE THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
U.S. SENATE

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My name is Charles Kovaleski and I am the President of Attorneys' Title Insurance located in Orlando, Florida. I am appearing today as President-Elect of the American Land Title

Association[1], which represents both title insurance companies and over 1,750 title insurance agents, most of which are small businesses. With me today is Ann vom Eigen, ALTA's Legislative and Regulatory Counsel.

ALTA, and I personally, would like to thank the Chair for holding these hearings. The HUD proposals may not only have a very significant and adverse impact on our industry, on our customers, and our insureds. They could also have a very negative impact on what has been the one healthy area of the American economy in recent years – the residential real estate market.

RESPA is the guiding federal regulatory program for our industry. It affects the activities of our industry, our relationships with our customers, and our relationships with lenders, real estate brokers and other settlement service providers. Indeed, no other federal statute or regulatory program has such a pervasive impact on how we do business and how we compete for business. Accordingly, ALTA and its members have been deeply involved in RESPA issues since Congress debated its enactment in the early 1970's. Over the years, we have participated extensively in every legislative and HUD regulatory forum to ensure that the RESPA rules serve the interests of consumers while providing fair and reasonable rules from the standpoint of our members.

We understand the concerns that may have prompted the HUD proposed regulations that were published in July 2002, and believe that the Secretary and the Department deserve credit for the boldness of their initiative. However, our Association and its members are deeply

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[1] *The American Land Title Association membership is composed of 2,300 title insurance companies, their agents, independent abstracters and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders against losses from defects in titles. Many of these companies also provide additional real estate information services, such as tax search, flood certification, tax filing, and credit reporting services. These firms and individuals employ nearly 100,000 individuals and operate in every county in the country.

concerned about how these proposals, if promulgated in final form, will impact our customers, our industry, and the real estate and mortgage lending markets throughout the country. Accordingly, we filed detailed comments on the proposed rule with HUD in its rulemaking proceeding. We also participated in an SBA roundtable on the effect of the proposal on small businesses.

What I would like to do today is highlight why we believe the proposals do not serve the interests of the consumers of our products and services, and why they would adversely affect competition in our business, particularly hurting small businesses that are the cornerstone of our industry. Please note that the proposed rule is likely to have such a dramatic effect on our industry that the ALTA Board has authorized the Association to explore litigation should a final rule be substantially similar to the proposed rule. I will highlight an alternative we have recommended to HUD that would achieve many of the agency's objectives while minimizing consumer and industry problems. We urge the Committee to ask HUD to seriously consider these alternatives.

HUD SHOULD PROCEED SLOWLY

We, as well as other groups affected by the proposed regulations, are concerned that any reforms along the lines proposed by HUD – or even our own two-package alternative –, which would so radically affect the mortgage lending and settlement services markets throughout the United States, should not be undertaken without appropriate statutory authorization.

The revised GFE and packaging regimes constitute complex and far-ranging regulatory superstructures for which the only statutory foundation is a single sentence in § 5(c) of RESPA, enacted in the RESPA amendments adopted one year after the original statute was enacted, that requires a mortgage lender, within three business days of receiving a loan application, to provide to the applicant a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur." That slim statutory foundation will not support such weighty regulatory measures as HUD is proposing, no matter how well intentioned they may be. Moreover, the original RESPA statute contained provisions for the kind of firm estimates of closing costs that HUD has proposed, but these provisions were repealed in the 1975 amendments in which the "good faith estimate" language was adopted. We believe that, irrespective of whether one believes that the HUD proposals are good or bad, or workable or unworkable, this Committee and the Congress should be concerned about HUD's implementing such changes without clear legislative authority.

First, there is a significant question of public policy at issue here – whether modifications of such proportion that will so fundamentally affect a major segment of the American economy should be implemented without legislative direction and authorization.

Second, the HUD regulations could well be challenged in the courts and the legal uncertainty regarding whether they will be upheld or struck down will, by itself, cause significant disruption in the real estate and mortgage lending markets. I have enclosed, as appendices to our testimony, not only our comments to HUD on the proposed rule, but a legal memorandum describing the legal issues. The HUD proposals, if adopted, will require massive and costly efforts by all parties in the residential real estate and mortgage lending industries to restructure their business arrangements, modify their forms and software, retrain personnel, etc. Much of that effort and costs to accommodate to the new regulations would be rendered useless if, after the regulations are promulgated in final form, the courts find – as our lawyers tell us is likely – that the regulations are unauthorized and cannot be enforced. Many Federal agencies, faced with this type of situation issue reproposed rules. This process would allow the agency to address concerns expressed in comments on the original rule, modify their original proposal, and allow industries and affected parties to further analyze a revised proposal. This would provide substantial benefits.

In short, this is not an issue where we – or the Congress – can afford to say "let's see how the courts come out on this." Our members and the real estate and mortgage markets need greater certainty that any final regulations adopted by HUD will not be found to be unauthorized. We urge this Committee and the Congress not to allow such uncertainty to be created.

THE IMPACT ON CONSUMERS OF TITLE INSURANCE AND TITLE-RELATED SERVICES.

Under the current RESPA statute and regulations, lenders must provide consumers, within three business days of receiving an application, a "good faith estimate" of the closing costs the borrower "is likely to incur" in connection with the transaction. HUD is proposing to replace that regime with two alternative new regimes. The first, which is a revision of the current GFE regime, would require lenders to give less detailed estimates by category of costs, with limited or no tolerances for the accuracy of those estimates. The second regime would encourage mortgage lenders to offer what HUD refers to as a Guaranteed Mortgage Package – which would contain essentially all of the loan and other real estate-related settlement charges at a single guaranteed price, together with a loan at a guaranteed interest rate.

It appears to us that these proposals were developed with the refinance market in mind. However, it is clear that the two regimes would pose problems for consumers in purchase/sale transactions where the current homeowner is not merely refinancing an existing loan. The proposals are based on the faulty proposition that whatever services are needed by, and are good enough for the lender, will also meet the needs of the consumer. This may well be true in refinance transactions, where the settlement services obtained by the lender are intended solely to protect the lender's interest, and the borrower cares only about the total charges he or she may have to pay to obtain the loan. But it is not true in purchase/sale transactions, where the buyer and the seller have their own interests in the nature and quality of the title and closing services that are provided with regard to the conveyance of title from the seller to the buyer. HUD's proposals, particularly the GMP proposal, do not take those interests into account.

For example, the HUD proposals do not require the lender to specify what title-related services are included in the revised GFE estimate or in the GMP price, or how much of the GFE estimate or GMP price is attributable to those services. Accordingly, if the lender has decided to accept a reduced form of title protection because it believes the additional profit it will realize on the GMP as a result of the cost savings will offset the additional risk it is taking, the buyer/borrower may not appreciate that the protection the lender has decided to accept on the mortgage loan may not meet the buyer's needs with regard to the purchase transaction.

Second, because the consumer will not know what services at what costs are included in the GFE or in the GMP price, it may be impossible for the consumer to do an apples-to-apples comparison of offers from different lenders.

Third, the buyer and the seller may have agreed on the selection of the provider of certain title or closing services (such as the escrow company in states where escrow closings are customary, or a title company that will provide the title and closing services) in connection with the execution of the purchase contract and before the buyer has begun to shop for a mortgage loan. In these situations, the price of the GMP package will also include those services and the borrower could end up paying twice for the same service.

Finally, in most areas of the country the seller generally pays half of the costs for the handling of the closing and will pay for all or a significant portion of the title insurance charges for the owner's policy. In addition, it is customary in most areas for the seller to pay for the governmental charges relating to the recording of the deed (with the buyer paying the charges for the mortgage). The GMP proposal, which assumes that the buyer/borrower pays for all closing costs, completely fails to reflect these widespread seller-pay practices.

<u>THE IMPACT ON THE TITLE INDUSTRY AND SMALL BUSINESSES IN THE INDUSTRY</u>

The HUD proposals tilt heavily in favor of the packaging alternative, because packagers are provided an exemption from RESPA § 8 for any discounts or things of value they may receive in connection with the selection of service providers for their packages. Because a mortgage loan at a guaranteed interest rate must be part of any GMP, everyone recognizes that only lenders will effectively be able to offer packages under the HUD proposal. Accordingly, title companies and other providers of settlement services will be placed in a position where they will effectively be deprived of market access to consumers and will only be able to effectively compete by becoming part of a lender's package. This will have adverse consequences for all ALTA members, but particularly for our small business members.

Major lenders will, of course, be aware that inclusion in their GMPs may be the only effective means by which providers of title and closing services will be able to obtain any significant amount of business in residential mortgage loan transactions – or, indeed, to survive. Moreover, HUD has structured its GMP proposal in a way that mortgage lenders are in a position to realize greater profits on their GMP prices by negotiating lower prices from the providers of the services in the package. The combination of these two factors means that providers of title/closing services will face enormous economic pressure to offer cut-rate prices and/or cut-rate services in order to be selected for inclusion in lender-created GMPs.

The backbone of our industry – the smaller abstractors and title agencies – will not have the resources to be able to offer substantial discounts. Based on a survey conducted by ALTA in 2002, which was a boom year for the real estate industry, 51% of the title insurance agents and abstractors in the country had less than $500,000 in gross revenue in 2001, and 72% had less than $1 million. 68% had 10 or fewer employees, and 42% had less than 5. These individuals and companies have demonstrated that they can effectively compete with anyone for the consumer's business, but in a world in which major lenders are able to use the clout derived from the volume of transactions they handle to extract discounts from major providers, these small businesses will simply be unable to compete on that basis.

Equally important, we believe that the proposals, if implemented in their present form, would effectively close the door to future entry into this business by small businesses.

Second, while HUD maintains that "anyone can provide packages" under its proposed Guaranteed Mortgage Package regime, because the GMP Agreement offered to consumers must include a loan at a guaranteed interest rate it is highly unlikely that anyone other than lenders will be in a position to effectively offer GMPAs. The mortgage lending industry has become increasingly concentrated. In the last 5 years the top 10 mortgage originators have doubled their market share from 25% to 50%.[2] The HUD packaging proposal will also have the effect of increasing the concentration in the title and settlement services industry.

It is clear that HUD is aware of the potential negative consequences of their proposals, but believes that the adverse impact on small business is outweighed by (a) the likelihood that major lenders will be able to obtain deep discounts from major settlement service companies who will want to be part of their packages, and (b) the prospect that mortgage lenders will pass through to their borrowers the benefits of such discounts. HUD estimates that small businesses will lose somewhere between $3.5 billion and $5.9 billion in annual revenues if their proposals are implemented. Whether these estimates are accurate – or too low – is not the critical issue. The critical issues are:

- What assurances are there that lenders will pass any savings along to consumers?

- Why is HUD so willing to tilt the playing field in favor of large lenders and large providers?

- Why is HUD so cavalier about the adverse impact on small businesses, which have been a mainstay of this industry?

[2] "Consortium Approach Gains in Home Loans," American Banker, July 12, 2002, at 1, 10.

We have been unable to get answers on these questions from HUD, but we hope you will.

If the packaging regime becomes widespread, as is likely to happen because it has the backing of the major mortgage lenders in the country, providers of title and settlement services will only be able to market their services to and through lenders. Lawyers and title companies that today are able to obtain business by direct contacts with the consumer will be faced with the situation where the lender, and only the lender, decides which attorney or which title company will be part of its package, and the consumer will have to accept that selection if it wants a loan from that lender. These adverse effects will be particularly severe in rural areas of the country where local attorneys and title companies will inevitably find that they cannot gain entry to the packages of the major lenders operating in that area.

The competitive advantage of small businesses – service to the consumer – will be undermined because the only successful marketing approaches will be those that enhance the profitability of the packages sold by the lenders. Likewise, there will be fewer competitive opportunities for new small businesses to enter this market since the only way they will be able break into the market will be to offer even greater discounts to lenders than those lenders can obtain from the major settlement service companies. This is unlikely to happen.

A review of the economic analysis on which HUD has based its evaluation of the savings associated with the changes proposed in their rule raises many questions. HUD appears to have relied heavily, in their assumptions, on an extrapolation of data from FHA loans, which represent a small portion of the mortgage market. These are typically lower priced homes, not true examples of the residential housing market. Consequently, the sample on which the analysis is based is not typical.

In essence, the HUD packaging proposal is predicated on the expectation that there will be a substantial shift of revenue from settlement services providers to the major mortgage lenders, who will have the economic clout to obtain discounts as the price of entry into their packages, and that most or all of this revenue shift will be passed on to consumers. Apart from the fact that this is an artificial shift in revenues for which there is no significant justification, it is questionable how much of these discounts and rebates will trickle down to the consumer. The fact that so many major mortgage lenders are so strongly in favor of packaging suggests that they believe the profits from packaging are likely to be significant.

HUD's economic analyses concludes that lower prices for originators and third party settlement service providers will drive out the less efficient firms, with the more efficient firms surviving and doing the work. This fails to recognize the current reality of the local marketplace and its potential evolution. Many counties in this country currently have only one closing or title agent. Some of these firms may be inefficient. However, particularly in rural areas, implementation of packaging could eliminate some of those providers, and consumers may not have <u>any</u> access to those services.

HUD has even posed questions in its proposed rule on the validity of state law. Specifically, HUD has asked what state laws merit pre-emption. Many state laws relating to title insurance, such as rate regulation, are designed as consumer protection measures which ensure adequate access to these services at a reasonable price.

Mr. Chairman, if small businesses cannot compete effectively with their larger competitors for the consumer's business, then, in the long run, they are not going to survive. But HUD's proposals do not create a playing field in which the most efficient, or the best, competitors end up winning the race. Rather, HUD's proposals create a playing field in which those lenders with the most clout, or those service providers who are best able to offer significant inducements to lenders to get into their packages, will end up winning the race. Small lenders may be very efficient at making mortgage loans, but if they lack the clout to obtain the kind of discounts that their larger lender competitors can squeeze out of service providers, they will not be able to compete effectively. In other words, they will lose market share not because they are inefficient lenders, but because they cannot command the kind of discounts from third-party providers that their larger competitors can command.

Similarly, smaller title companies or smaller providers of settlement services have demonstrated that they can compete effectively with their larger competitors in providing title and settlement services. But in the competitive world that HUD wants to create, these companies could well lose market share to their larger competitors who are in a better position to offer discounts or other things of value to lender-packagers. This would enable those lenders to realize greater profits on their packages than by including smaller providers in their packages. Again, smaller title companies and other settlement service providers will lose market share not because they are inefficient providers of settlement services, but because they cannot provide the kind of discounts that their larger competitors can offer.

The bottom line is that consumers will effectively have fewer choices in their selection of providers of legal and title-related services for their real estate transactions. Under HUD's approach, the consumer selects the lender and must accept whatever service providers are in that lender's package. This is a problem with regard to services, such as those provided by lawyers and title companies and agencies that are provided for the benefit of the purchaser and seller of the real estate.

Consumers should have choice in the selection of their service providers, and this will not be possible under the Guaranteed Mortgage Package Agreement. In addition, HUD has estimated that some of the economic benefits of packaging will be time savings because consumers will not shop for settlement services, and lenders and settlement service providers will not have to answer questions. Achieving savings through reduced knowledge and understanding by consumers of their personal financial investments is not a good result.

HUD also estimates substantial savings to both consumers and service providers through reduced time spent in shopping for services and responding to consumer concerns. While we believe the source and estimate of these savings is very uncertain, we also question whether elimination of time spent with consumers is a worthwhile goal. Consumers deserve to make informed decisions about the financial products and the services they choose.

ALTA'S PROPOSAL FOR A TWO-PACKAGE APPROACH

ALTA's written comments to HUD did not merely criticize the HUD proposals. We offered a realistic alternative that we believe would achieve HUD's objectives while avoiding many of the consumer and competitive problems I have just discussed.

Our alternative is that there should be two packages:

- a "**Guaranteed Mortgage Package**" that would be offered by lenders along the lines of the current HUD proposal (or as it may be modified after the public comment period) and that would consist of: (i) a loan at a guaranteed interest rate in accordance with whatever requirements HUD ultimately determines is appropriate; and (ii) all lender-related services and charges (basically the 800 series charges on the HUD-1 form); and

- a **"Guaranteed Settlement Package"** that could be offered by any party – title insurers and title insurance agents, real estate brokers, lenders, escrow companies, or attorneys – and that would provide a guaranteed single price for all of the 1100 series services and charges (the title and related charges), the 1200 series charges (government recording and transfer charges), and those charges required for title assurance or closing purposes that may be listed in the 1300 series (miscellaneous settlement charges).

We believe this "two-package" approach would better achieve HUD's goals of (1) ensuring price certainty in the settlement process for consumers, and (2) injecting significant, "shoppable" price competition into both the lending and the settlement industries. It will help ameliorate the effects on small business because it will allow lenders and others to package on a local level. This packaging alternative will take into account the unique costs, needs, and allocation of responsibilities that exist in a local jurisdiction, and allow customization to meet consumer needs. It would also serve other important goals, such as allowing for the development of Settlement Packages in purchase/sale transactions that differ from those in refinance transactions, that would accommodate regional differences in practices, and, most importantly, would permit settlement service providers to market directly to consumers, thus preserving the competitive access of the diverse and vibrant small businesses that make up a significant part of the American settlement industry.

We also have expressed concern that the HUD proposal might freeze the way in which settlement services are delivered, and prevent the evolution of new forms of service delivery. We believe the HUD proposal would channel settlement services primarily through large lenders, thus inhibiting the development of technological and market improvements that could lead in different directions. We expressed these concerns in the Mortgage Reform Working Group in the late 1990s. Since that time, technological advances have led to dramatic improvements in consumers' access to loan and settlement services information. Many consumers now shop on line for both loan and settlement services, and some even close on line. We believe that consumers would like to continue to take advantage of these opportunities.

It is particularly ironic that, at the same time HUD is pursuing a "packaging" approach that so clearly favors large companies over smaller business entities, the Bush Administration has proposed a strategy to all federal agencies calling on them to reduce the adverse impact on small business resulting from the "bundling" of federal contracts. As discussed in the October 2002 OMB report entitled "Contract Bundling: A Strategy for Increasing Federal Contracting Opportunities for Small Business," bundling of federal contracts has been an increasing practice in recent years so that fewer, larger groupings of contracts are put out for bid. While such bundling has made things easier for federal contracting officers and their agencies, it has had the effect of eliminating competitive opportunities for small businesses which want to compete for government contracts. To counteract that trend, OMB has urged executive branch agencies to revise their regulations to eliminate unnecessary contract bundling and, in the words of the Administrator of OMB's Office of Federal Procurement Policy, to make "a significant step forward towards ensuring that small businesses and entrepreneurs have access to federal contracting opportunities." It seems to us that HUD's packaging proposal is completely out of step with the thrust of OMB's "unbundling" approach to government contracts.

The loss of these small businesses will eliminate the local companies that support the community, provide jobs, and pay taxes.

We thank you for holding this hearing to address this most important issue.