

Testimony
Before

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

Regarding

“The Impact of the Proposed RESPA rule on Small Businesses and Consumers”

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Mr. Chairman and Members of the Committee, the National Association of Consumer Advocates¹ thanks you for inviting us to testify today about HUD's recent proposed rulemaking regarding the Real Estate Settlement Procedures Act. We offer our testimony here today on behalf of our members and the tens of thousands of consumers they represent

Last July, the U.S. Department of Housing and Urban Development issued important proposed changes to RESPA regulations that attempt to dramatically alter the way the mortgage lending market operates. Initially, I'd like to commend HUD for taking bold action to reform the current RESPA regime that undeniably provides little benefit for consumers. HUD has recognized that changes must be made, and that it is the agency's responsibility to develop the necessary rules and regulations that will allow this important statute to achieve its purpose of protecting consumers in the mortgage settlement process.

The stated goals and orientation of HUD's Proposed Rule are exactly on target – to protect consumers. We believe that the proposal offers some very positive features that if properly implemented would improve the prime mortgage marketplace for consumers. These positive features include:

¹ The National Association of Consumer Advocates is a non-profit organization designed to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country. Our mission is to serve as a voice for consumers in the ongoing struggle to curb unfair and abusive business practices, especially in the areas of finance and credit.

1. ***Requiring an Interest Rate and Closing Cost Guarantee when a Guaranteed Mortgage Package Agreement is offered.***

Some parts of the mortgage industry are strongly pushing HUD to transform the GMPA into a package of closing costs instead of a package of all closing costs and points and interest rate. In its proposal, HUD has correctly refused to allow a section 8 exemption for a lender's offer of merely a closing cost package. After all, as HUD has recognized, a lender who offers a guarantee for the closing cost package, without also guaranteeing the points and the rate, has no impediment to simply increasing the points or the rate after the consumer is locked into using the lender because the closing cost package has been purchased.

2. ***HUD's attempt to recharacterize yield spread premiums as a payment from the lender to the borrower.***

During the last several years, no issue has been more contentious than the use of yield spread premiums in the home mortgage lending process. Time and again, consumers have unknowingly received a mortgage with a higher interest rate than they had otherwise qualified for because of inappropriate and illegal kickbacks paid by lenders to brokers in the form of yield spread premiums. HUD's proposal to change the way yield spreads are disclosed is an important first step (although much more is needed) in allowing consumers to have greater

control in choosing the type and structure of their loans and in the method to compensate *their* mortgage broker.

3. ***HUD's bright line rules attempt to make the Good Faith Estimate a meaningful binding document that provides real information to consumers.***

Far too often, the Good Faith Estimate offered to consumers barely resembles the loan the borrower ultimately receives. HUD's proposed rule attempts to severely limit the bait and switch gaming rampant in the home mortgage marketplace involving closing costs. The GFE should be a true reflection of actually anticipated costs, not an opportunity for lenders to mislead consumers – as it is currently. Lenders who make numerous loans absolutely have the capacity to determine their own charges and those of settlement service providers that they choose and require.

While we strongly appreciate HUD's positive efforts, we nonetheless have several overarching concerns about the proposed rule and believe a myriad of important details must be worked through to ensure that the Rule does in fact protect consumers, instead of simply providing a shield behind which mortgage originators can hide inappropriate, unfair, and illegal activities. We will use the remainder of our testimony to broadly describe these problems.

Problems with HUD's Proposed Rule

1. *These rules do not address predatory lending.*

As the Secretary has already noted in his testimony to the House Financial Services Committee on October 3, 2002, these rules do not provide the answer to predatory lending. It is imperative that HUD clarify that this Rule is not designed to address the problem of predatory lending and that other reforms are still needed. Indeed, HUD does not have the authority under RESPA to address predatory lending by itself in a global way. The rule is intended to facilitate shopping for mortgages and to promote competition. This laudable goal should be pursued. However, as victims of predatory mortgages are targeted by lenders who actively work to eliminate shopping opportunities, no amount of improvement to the RESPA rules will protect them.

2. *These rules must avoid facilitating predatory lending.*

The Guaranteed Mortgage Package Agreement is a creative and novel proposal

that, if implemented properly, will enable mortgage shoppers in certain markets to shop more effectively. However, we must keep in mind that shopping does not actually occur among all consumers – particularly those who are today the victims of predatory mortgages and those who will be targeted in the future. The predatory lending market thrives in an atmosphere in which lenders and brokers target homeowners and experience little pressure to provide the best products. Indeed, the incentives run in the other direction – borrowers are steered to the worst products. The GMPA must not provide a new means for lenders in the subprime market to avoid liability for non-compliance with consumer protection law in that segment of the marketplace that most needs more substantive consumer protection.

Because the GMPA proposal eliminates disclosures that otherwise make it possible for consumers and their advocates to evaluate compliance with both the Truth in Lending Act and the Home Ownership Protection Act, HUD must tread carefully in developing this RESPA rule and follow two essential principles:

- Limit the GMPA to the prime market - As the purpose of the GMPA is to encourage shopping in the open marketplace of competitive mortgage lending, the GMPA should only be provided to that section of the market that is most capable of using competitive pressures in the open marketplace to protect themselves – to the prime market.
- The GMPA rule should only be finalized after full coordination with the Federal Reserve Board – It is crucial that both regulators and consumers

be able to determine compliance with TILA and HOEPA simply by looking at the information provided on the documents required by federal law.

Under the current proposal, it is unclear that this will be the case and HUD must work with FRB to develop a transparent GMPA that allows for this determination to be made.

3. ***The substantive change proposed regarding yield spread premiums must be included in the regulations relating to RESPA's Section 8, not just as disclosures.***

For yield spread premiums to be what the mortgage industry claims them to be, merely one of several methods consumers can choose to compensate their mortgage brokers (and not an illegal kickback), enforceable regulations must be created that require the following:

- The consumer must be informed up-front just how much the mortgage broker will charge.
- The consumer must be provided the opportunity to choose how this payment will be paid from choices actually available to the consumer.

4. ***The Good Faith Estimate proposal rules, while good in concept, do not sufficiently protect consumers.***

This is particularly true of HUD's language describing the mortgage broker's relationship to the consumer. Section I of the proposed GFE allows brokers to describe themselves like this: "We do not offer loans from all funding sources and we cannot guarantee the lowest price or the best terms available in the market. You should compare the prices in the boxes below and shop for the loan originator, mortgage product, and settlement services that best meet your financing needs." Both of these statements must be deleted from the GFE.

In many states, a broker can establish an agency relationship with a borrower through the broker's conduct or by written and oral representations.² The broker may have fiduciary duties of an agent to the borrower, which may include the duty to advise the borrower of disadvantageous loan terms in an offered loan or the duty of loyalty to the borrower that would require the broker to seek out a loan with favorable terms for the borrower. HUD's statement in the GFE therefore conflicts with obligations that may be imposed on brokers under state law. Moreover, this misguided statement will undoubtedly be used, by unscrupulous brokers, to defeat borrower claims that a fiduciary relationship was established or that the broker made misrepresentations about the loan terms or the broker's role.

² In addition, some states have passed legislation specifically regulating mortgage brokers and these laws may impose additional disclosure or substantive requirements.

5. ***There must be effective enforcement mechanisms for an originator's failure to comply with all aspects of these new rules.***

Even perfect consumer protection rules will only work in the marketplace if they are enforced in a meaningful way. Lenders must have incentives to comply with the rules, because lack of compliance is too costly. The Proposed Rule does not currently include *any* mechanisms to punish transgressors. The proposal only provides that once the transgression is caught, the remedy is for the lender to provide what was promised all along. This rewards *lack of compliance* because the cost of being caught breaking the rules is the same as compliance. For the rules to be effective HUD must allow for civil enforcement of each element under the rule including the requirements for treatment and disclosure of the yield spread premium, the new rules for the Good Faith Estimate, as well as for a lender's failure to keep the promises in the GMPA. This can be accomplished by:

- Removing HUD's stated prohibition against enforcing violations of section 8 through class actions. The 2001 Statement of Policy explicitly requires a court's individual review of each transaction, eliminating the efficient enforcement mechanism of class actions. Once HUD's Proposed Rules provide the new rules of the road, there is no reason a court cannot evaluate and enforce the yield spread requirements in class reviews – as the only issue will be whether the mortgage broker actually gave the

consumer the full benefit of the payment from the lender.

- A Statement from HUD articulating its belief that the failure to comply with proposed GFE rules is unfair and deceptive. This should enable some private enforcement under state and federal prohibitions against unfair and deceptive acts and practices.
- Creating a presumption establishing a lender's failure to follow the rules when offering a GMPA, or its failure to close on a loan that conforms to the GMPA violates RESPA's Section 8.

In summary, while we applaud HUD's positive efforts to reform RESPA, important detailed changes to their rulemaking must be implemented before HUD's stated goal of simplifying the mortgage market for the benefit of consumers can be achieved.