Prepared Testimony of

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On

"RESPA and its Impact on Small Business"

Before the

Committee on Small Business

United States House of Representatives

Thursday, May 22, 2008

Good morning Chairwoman Velázquez, Ranking Member Chabot, and Members of the Committee, I am Marc Savitt, CRMS, President-Elect of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on the Real Estate Settlement Procedures Act ("RESPA") and its impact on small business. We appreciate the opportunity to discuss this issue of vital importance to the small business community and specifically, mortgage brokers.

NAMB is the only trade association exclusively devoted to representing the mortgage broker industry and speaks on behalf of more than 18,000 members in 50 states and the District of Columbia. Our members are independent, small business men and women that adhere to a strict code of ethics and best lending practices[1] when taking consumers through the loan process. We typically maintain business relationships with various lenders to provide consumers with numerous financing options. These partnerships allow our members to offer consumers the most competitive mortgage products available, often in areas where traditional mortgage lenders may not have offices.

We would like to thank Chairwoman Velázquez and the members of this Committee for your leadership and interest in the proposed Department of Housing and Urban Development ("HUD") RESPA rule[2] ("Proposed Rule") and your continued commitment to protect small businesses. NAMB commends this Committee for holding this important hearing to examine the Proposed Rule and the impact on small businesses in America. NAMB would also like to thank this Committee for its vigilance in holding hearings on this issue, the first of which was held March 11, 2003 on the effects of the RESPA rule on small business. We will not reiterate all of our concerns with HUD's proposal as we have detailed our concerns previously through several Congressional hearings and will submit full comments to HUD by June 12, 2008. Instead, we will focus today on the regulatory process HUD used in promulgating their Proposed Rule and the impact on small business mortgage brokers.

I. Mortgage Brokers & the Current Market

A. Licensing & Regulation of Mortgage Brokers

Today, all 50 states[3] and the District of Columbia license or otherwise regulate the occupation of finding, placing, negotiating, or soliciting residential first mortgage loans. The laws regulating mortgage brokers are designed to protect the public from the incompetence, fraud, misrepresentation, or dishonesty of those engaged in brokering loans. The majority of the states that regulate mortgage brokers have enacted specific licensing laws. In some states, however, mortgage brokers fall within an occupational category known as ''loan brokers,'' which refers to persons who find or arrange loans for others, whether or not the loan is secured by real property. At least one state, Maine, subjects mortgage brokers to the law applicable to credit services organizations. In California, one may broker mortgage loans if licensed as a real estate broker.

While each state's mortgage broker law defines the terms ''mortgage broker'' or ''loan originator'' in specific terms, generally speaking, mortgage brokers under state law are defined as persons or entities that (i) find or arrange real estate-secured loans for borrowers, or (ii) find potential borrowers for lenders, or negotiate loan terms with borrowers on behalf of lenders. A

[1] All mortgage originators who wish to be members of NAMB will be required to meet the Lending Integrity Seal of Approval® criteria as a requirement of membership by January 1, 2009. In order to use the Lending Integrity Seal, members must meet the following criteria: 1) must hold a valid state license/registration; 2) national criminal background check; 3) minimum of six (6) hours of professional education yearly; minimum of two (2) hours of ethics training every two (2) years; 4) three letters of reference or three professional references; 5) pledge to adhere to NAMB Code of Ethics and Professional Standards, *and* abide by NAMB's grievance review process and rulings.
[2] Real Estate Settlement Procedures Act (RESPA): Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs 73 Federal Register 14,030 (March 14, 2008) Docket No. FR-5180-P01.
[3] The Alaska mortgage broker licensing act has been enacted, but will not be effective until July 1, 2008. All other states have applicable laws currently in effect.

mortgage broker solicits prospective borrowers, through advertising or otherwise, and places loan applications with lenders, or offers to find lenders who will make mortgage loans. The receipt of compensation, or the expectation of compensation, is generally essential to the characterization of the foregoing activities as those of a mortgage broker.

Federal law governs how mortgage brokers relate to their customers and how brokers participate in real estate financing transactions. In general, federal law is focused on how real estate transactions are conducted, not on the licensing or other regulation of individual mortgage brokers. Three federal statutes are most directly applicable to mortgage brokers: 1) RESPA; 2) the Truth in Lending Act[4] ("TILA"); and 3) the Home Ownership and Equity Protection Act[5] ("HOEPA").

In addition, NAMB supports legislation, *e.g.,* H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007 passed by the U.S. House of Representatives, which creates minimum standards for education, criminal background checks and a national registry for *all* originators. NAMB supports these efforts, so long as, the proposals apply to all mortgage originators. All consumers deserve the same standard of professionalism, information and protection against fraud and abusive lending practices regardless of where they go to get their mortgage. A national registry that assigns a permanent, non-transferable identification number and requires a national criminal background check, such as the one in H.R. 3915, promotes accountability and tracking of all loan originators.

B. The Role of Small Business Mortgage Brokers

Mortgage markets have evolved rapidly in recent years, as have the roles of mortgage professionals and entities, who may work in multiple capacities. A real estate financing professional or entity acts in a mortgage broker capacity when the professional or entity works with both borrowers and lenders, though representing neither, to obtain a mortgage loan. A mortgage broker adds value through various means, by providing goods with quantifiable value, such as a customer base and goodwill, facilities, and services. A broker works with consumers throughout the complex mortgage origination process. Accordingly, a mortgage broker's role may include taking the application; performing a financial and credit evaluation; producing documents; working with realtors; ordering title searches, appraisals, and pay off letters; assisting in remedying faulty credit reports or title problems; and facilitating loan closings. The assistance a mortgage broker may or may not provide varies widely, depending on the nature of the transaction, the requirements of the lender or loan purchaser, and other factors.

A mortgage broker may have a working relationship with one or more banks and other lenders and may provide the consumer with access to a wide range of options for financing a home. This allows mortgage brokers to provide consumers a highly efficient and cost-effective means to obtain a mortgage that fits the consumer's financial goals and circumstances. Because brokers facilitate competition, a 2005 independent study conducted by economists at three major universities concluded that "broker-originated mortgages are less costly to the borrower than lender-originated mortgages after holding other loan terms and borrower characteristics

[4] 15 U.S.C. §§ 1601-1667f.
[5] 15 U.S.C. §§ 1602(aa), 1639.

constant." [6] Similarly, a study by Mr. Todd of the Federal Reserve Board of Minneapolis and Professor Kleiner stated, "Brokers have helped to shorten the loan process and made it cheaper."[7] That study also showed that when certain state regulatory burdens were imposed on brokers that impeded brokers' entry into mortgage markets, the number of brokers declined, and those states also experienced "higher foreclosure rates, and a greater percentage of high-interest-rate mortgages."[8]

It is in the brokers' own interests, as well as in the interests of the customers they serve, to ensure that mortgage markets work effectively. Lower prices to consumers, and the relative pricing advantage brokers often confer, result from the same dynamic that brings down price and improves quality for almost any other good or service: competition. For that reason, NAMB welcomes any initiatives by HUD that will increase access to mortgages and foster competition among mortgage originators.

Through enhanced competition, markets expand, costs decline, and service improves—developments which benefit the general public. NAMB strongly supports measures which empower consumers to select mortgages based upon their own assessment of the comparative price, most appropriate product, and highest quality service (regardless of whether such a mortgage is obtained with the assistance of a broker). NAMB is confident that if rules are established and enforced to ensure that consumers are given the tools to make informed decisions in their own best interests, then the members of NAMB will compete successfully.

C. Converging Roles of Mortgage Originators

The roles of mortgage originators have rapidly converged in recent years. As a result, as noted in the Broker Regulations Analysis by the Federal Reserve's Richard Todd and Professor Kleiner of the University of Minnesota, "[T]he actual roles of brokers, loan officers, lenders, and others are not rigidly bound and often blur."[9] Even the Mortgage Bankers Association has acknowledged this fact, recently stating that "Mortgage bankers sometimes function as mortgage brokers, offering the loan products of other, larger mortgage bankers."[10] However, the regulations promulgated under RESPA, which are largely unchanged since 1992, have failed to keep pace with fundamental changes in market realities.

Historically, mortgage brokers and mortgage lenders could be readily distinguished. Brokers did not lend money, and lenders did not serve as portals for competing providers of funds. However, in recent years, the lines between distribution channels have blurred, as the "originate to distribute" model of mortgage financing, in which lenders promptly repackage and

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[6] Amany El Anshasy (George Washington University), Gregory Ellihausen (Georgetown University) & Yoshiaki Shimazaki (Oklahoma State University), *The Pricing of Subprime Mortgages by Mortgage Brokers and Lenders*, July 2005 ("Mortgage Pricing Study"), at 12. That study was prepared without the knowledge or support of NAMB.
[7] Morris Kleiner & Richard Todd, *Mortgage Broker Regulations that Matter: Analyzing Earnings, Employment, and Outcomes for Consumers*, National Bureau of Economic Research Working Paper 13684 (December 2007) ("Broker Regulations Analysis")© Morris M. Kleiner and Richard M. Todd, at 7.
[8] Broker Regulations Analysis at 1.
[9] Id. at 5, n.4.
[10] *Mortgage Bankers and Mortgage Brokers: Distinct Businesses Warranting Distinct Regulation,* Mortgage Bankers Association (May 2008), fn 9, at 13.

sell loans they originated, is commonplace. Moreover, as the Mortgage Pricing Study observed, "Borrowers may canvass mortgage originators without taking into account or even knowing whether an originator is a broker or lender."[11] Nor, quite often, is it even possible to tell the difference: the on-site signage or internet logos are typically indistinguishable.

Increasingly, mortgage bankers or lenders functionally act as a brokers because they often (i) have entered into multiple contracts with various banks and lenders to offer an array of products, (ii) know at the time of closing they will quickly sell the loan, and (iii) generally know how much they will make off the loan when the sell it. Today, most lenders quickly sell their loans onto the secondary market. Mortgage bankers and lenders that operate as correspondent lenders are simply fronting the funds for another bank, lender or the secondary market, and then being compensated from the market, in addition to the consumer, for such temporary fronting of funds.

Conversely, some brokers may act as lenders. For example, a broker may fund a loan through accessing a warehouse line of credit, and promptly sell that loan to a purchaser who had committed to buy it before funding. Accordingly, some state laws now expressly acknowledge that a single entity may be acting in multiple capacities as both lender and broker.

Dramatic advances in technology also have served to accelerate the convergence of the roles of mortgage originators. The introduction of automated underwriting, web-enabled credit scoring, and the ubiquity of computers have helped blur the distinctions among historically different functions. In fact, originators tend to use the same software regardless of whether they are acting in a broker or loan funder capacity. The distinctions among originators have come to be determined largely through the click of a mouse.

It is now common for mortgage companies to act in multiple capacities. Indeed, even within a single transaction, the role in which a company may act may change during the application and processing functions from a lender to a broker, and back again, depending on circumstances. In addition, since HUD authorized affiliated business arrangements ("AfBAs"), many entities in the mortgage industry have established such relationships with developers, builders, real estate agents, and title companies, thus further confusing traditional roles and responsibilities.

To the consumer, none of this is readily apparent. Moreover, consumers are largely unaware of, and indifferent to, the specific attributes of the originators with whom they are dealing. Consumers also seek, and would benefit from, the same information about the mortgage transaction regardless of the type of originator involved. Yet, unlike brokers, lenders do not need to disclose what they are paid for originating loans that they do not retain for their own portfolios, but sell days after closing. As discussed below, regulations implementing RESPA and other provisions of applicable law drafted before the "originate to distribute" model became ubiquitous retain vestigial distinctions between brokers and lenders that are no longer meaningful, creating market dysfunction which the Proposed Rule should seek to remedy, not exacerbate.

[11] Mortgage Pricing Study at 8.

To serve consumers' interests effectively, any regulatory initiatives relating to mortgage originators must address the mortgage market as it is today, not as it existed a generation ago. That means acknowledging the convergence of the roles of brokers, banks, and lenders, and, as a consequence, applying rules equally to all originators.

In April 2007, the Joint Center for Housing Study at Harvard University released a 75 page report which detailed the similarities between different loan originators, including the way both brokers and loan officers are compensated, and the common consumer protection concerns each origination channel presents. In view of that convergence, the Harvard Mortgage Markets Study presented among its four key recommendations for reforming mortgage markets a call for federal regulators to "Establish Minimum Standards and Apply Rules Equally to the Marketplace", which it further stated would require regulators to "Create effective and adequately funded enforcement strategies to ensure that all mortgage brokers, loan officers, and mortgage originators play by the same rules."[12]

One of the Harvard Mortgage Markets Study's two authors, Ren Essene, made similar points at a June 14, 2007 hearing on the Home Equity Lending Market held by the Federal Reserve Board, stating:

> Fundamental fairness suggests that the nature and extent of federal oversight and consumer protection should not depend on the details of which particular mortgage broker or loan officer takes the mortgage application, which particular retailer or wholesaler originates the mortgage, and which secondary market channel is tapped to secure the investment dollars that ultimately funds the loan.[13]

Neither the Harvard Mortgage Markets Study nor Ren Essene's testimony is discussed, or cited, by the Proposed Rule.

II. HUD's Proposed RESPA Rule & the Current Market

The Proposed Rule, published on March 14, 2008, seeks to simplify and improve the disclosure requirements for mortgage settlement costs under the Real Estate Settlement Procedures Act of 1974 ("RESPA"), and, as a consequence, to protect consumers from unnecessarily high settlement costs. Accordingly, the Proposed Rule would, among other initiatives, revise and standardize the Good Faith Estimate form ("GFE"), modify the HUD-1 Uniform Settlement Statement ("HUD-1"), impose additional disclosure requirements, require recitation of a "closing script" to borrowers, and clarify instructions as to how applicable forms are to be completed.

NAMB applauds HUD's forceful response to problems in mortgage markets, and shares HUD's resolute commitment to protecting consumers from unnecessarily high settlement costs. NAMB believes that measures which target abusive practices and enhance transparency of the loan origination process benefit not only consumers, but also NAMB's members, who are already

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12 Harvard Mortgage Markets Study at vi.

13 Testimony of Ren Essene, Research Analyst, Joint Center for Housing Studies at Harvard University, Before the Board of Governors of the Federal Reserve System Hearing On the Home Equity Lending Market (June 14, 2007) http://www.federalreserve.gov/SECRS/2007/August/20070823/OP-1288/OP-1288_90_1.pdf, at 8.

required to adhere to a professional code of ethics and best lending practices. In fact, for that reason, NAMB strongly supports numerous consumer protection measures in addition to those presented by the Proposed Rule, including provisions which are beyond the jurisdiction of HUD and within the purview of other federal agencies or state regulators.

NAMB objects, however, to those components of the Proposed Rule that would not best serve the consumer, either because they would impede competition, treat direct competitors differently, fail to reflect the most authoritative research, or do not consider the most effective and least burdensome alternatives.

HUD proposes to make bold changes in the marketplace through implementation of the Proposed Rule. In light of the current market situation – rising home foreclosures, the credit crunch and recent changes proposed to the Federal Housing Administration ("FHA") Program,[14] among other factors – NAMB questions the appropriateness of the timing and implementation of the Proposed Rule. Today's, mortgage market is significantly strained and continues to experience turmoil and change. The market has lost over 250 lenders, underwriting standards have tightened, minimum credit scores have increased and new rules are being considered by the Federal Reserve Board (*e.g.,* the proposal to implement standards under TILA Section 32 and the Risk-Based Pricing Notice). In addition, Congress is considering sweeping changes to how loans are originated in the United States. Before implementing sweeping changes to the origination process, a thorough analysis should be undertaken to ensure the market can accommodate the changes in the Proposed Rule.

At this time, NAMB believes HUD's efforts, and the mortgage market in general, may be better served by focusing on the market today and providing support for consumers currently at risk of losing their home to foreclosure. NAMB believes HUD should continue to move forward with the RESPA reform process, but should consider delaying implementation of any new policies or procedures until all originators can digest the multitude of events already occurring in today's market. As Regulators, Congress and industry focus on the issues at-hand we must ensure the market is able to stabilize, accommodate changes and provide assistance to the high volume of borrowers currently in need of refinancing and/or foreclosure assistance through programs administered by HUD.

III. Compliance with Federal Law

A. Regulatory Flexibility Act Compliance

The Regulatory Flexibility Act was passed in 1980, in an effort to help reduce the burden placed on small businesses by federal regulatory action. The Regulatory Flexibility Act requires federal agencies to prepare an Initial Regulatory Flexibility Analysis ("IRFA") anytime a regulation is proposed. The IRFA must describe the impact of the proposed regulation on small businesses.[15]

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[14] In August 2007, HUD announced the creation of the FHA Secure program, which will enable homeowners to refinance various types of adjustable rate mortgages (ARMs) that have recently "reset" through the FHA. For more information see MORTGAGEE LETTER 2007-11.
[15] 5 U.S.C. § 603.

Among other things, the IRFA must: (1) describe the economic impact of the proposed rule on small entities; (2) include a description of the projected reporting, record keeping and other compliance requirements outlined in the proposed rule; (3) identify any existing rules that may conflict with or overlap the proposed rule; and explore and analyze alternatives to the proposed rule, which would accomplish stated objectives, but minimize the economic impact on small entities.[16]

NAMB believes that HUD has failed to adequately comply with the Regulatory Flexibility Act when promulgating its proposed rule for two primary reasons. First, HUD's IRFA relies upon outdated information when estimating the economic impact of the proposed rule on small entities, including mortgage brokers. Second, HUD's IRFA does not reflect sufficient comparative analysis of less burdensome alternatives to the proposed rule, which would minimize the adverse impact on small entities.

i. HUD's Economic Impact Analysis Fails to Consider Current Market Realities, Instead Relying on Data from Previous Years

HUD readily acknowledges in its IRFA that the mortgage industry is continuously evolving.[17] Today's mortgage market is vastly different from the market that existed five years ago. Moreover, today's market is vastly different than the market that existed just one year ago. As such, it is imperative that HUD's economic impact analysis under the Regulatory Flexibility Act reflect current market realities in order to accurately determine the true costs and burdens of the proposed rule on small businesses.

HUD's IRFA estimates significant compliance and implementation cost burdens for small business entities under the proposed rule. However, HUD's IRFA bases these estimates on data that may not accurately reflect the current state of the mortgage industry, thus potentially under- or over-estimating the burden on small businesses.

Since early 2007, we have witnessed unprecedented turmoil in the mortgage and housing markets. This turmoil, which has not yet subsided, has inflicted a credit crunch on American consumers and has driven both small and large entities out of the mortgage industry in record numbers. The result of this has been, and continues to be, an ongoing reorganization of the mortgage origination industry landscape.

To ensure compliance with the requirements of the Regulatory Flexibility Act and to adequately protect small business entities from unnecessary and costly regulatory burdens, NAMB believes it is HUD's responsibility to demonstrate that it's IRFA examined the most current and accurate data on today's mortgage industry and the impact of the proposed rule on small business.

ii. HUD's Comparative Analysis is Limited to its own Earlier Proposals, and Fails to Sufficiently Weigh other Alternatives that Would Reduce the Impact on Small Businesses

[16] *Id*.
[17] 73 Federal Register 14105.

While HUD's IRFA indicates that the impact of the proposed rule is likely to be significant, and will likely affect a substantial number of small entities, the agency has failed to sufficiently explore alternatives that would be less burdensome than the current proposal is to those entities.

HUD explains in Appendix VI of its IRFA that the agency considered many alternatives to the proposed rule and describes in detail steps taken to minimize the impact of the proposed rule on small business. However, it is clear from the IRFA that HUD focused its exploration of "alternatives" on its own prior proposals and the requirements set forth in the current rule.

HUD's IRFA must contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. HUD is not the only regulator responsible for addressing consumer costs disclosures in mortgage transactions. There are other federal agencies, as well as virtually every state, that have promulgated rules dealing with mortgages and specifically mortgage cost disclosure. However, the IRFA does not indicate whether HUD has seriously investigated how different states or other regulatory agencies have addressed the issue. NAMB believes it is important for HUD to analyze what these other regulators are doing.

B. Administrative Procedures Act Compliance

The rulemaking process by federal agencies, including HUD, is governed by the Administrative Procedures Act ("APA"), which sets forth clear standards that any proposed rulemaking must meet. In its current form, the Proposed Rule fails to comply with some of the most critical APA standards. Moreover, because of the materiality of those shortcomings, they may not be remedied in the final rule. At a minimum, the APA concerns relating to the Proposed Rule require the rule to be proposed again in a form which satisfactorily addresses those concerns, and which permits the public to comment upon changes and additions to the Proposed Rule's rationales and supporting materials.

The animating principles of the APA are relatively straight-forward: an agency may not abuse its authority by acting either arbitrarily or unilaterally. Although agencies develop regulations pursuant to statutory authority, they nonetheless may only act after articulating an adequate rationale for the proposed action, and identifying any data, studies, or analyses supporting the proposed policy course. Moreover, that rationale and supporting authorities must be presented to the public, which must be given an opportunity to comment on the proposed rule and its premises. In short, an agency may not simply assert that a regulation is in the public interest, it must demonstrate that the regulation is so, and it must afford the public it presumes to serve the right to examine and challenge the rule's premises.

Under the APA, if the final rule is not adequately justified by the rationale articulated by the issuing agency, if that rationale is not properly supported by the facts and data presented, or if the facts and data are not timely presented to the public to permit comment prior to adoption of a final rule, that rule is not valid.

i. The Proposed Rule fails to articulate an adequate rationale and supporting basis for key provisions

The APA requires agencies to "incorporate in the rules adopted a concise general statement of their basis and purpose."[18] The Proposed Rule exhibits several shortcomings. Most obvious, perhaps, is the Proposed Rule's failure to explain, let alone justify, its arbitrary distinctions among mortgage originators, and the harm to consumers which would result from that competitive imbalance. More generally, the Proposed Rule fails to cite any bases for some of its key provisions, and did not address relevant information that was readily available. Perhaps most egregiously, the Proposed Rule attributes unethical conduct to mortgage brokers without any basis for doing so, yet assumes that originators competing against brokers would not abuse the marketing advantages which the Proposed Rule would confer to drive consumers away from brokers.

Under the APA, issuing regulations and presenting policy proposals without first conducting the appropriate research is simply not enough. HUD's flawed research methodology and failure to address key issues presented by the Proposed Rule does not constitute "reasoned decisionmaking" under the APA. HUD proposed key policies without first conducting appropriate research, soliciting critical input from the public, or giving proper consideration to some of the most relevant and authoritative studies in the field. HUD must conduct further research into the operation of mortgage markets and the efficacy of proposed disclosures which utilizes all these sources of information. HUD should then disclose its findings anew to the public in a subsequent proposal to permit proper consideration of the Proposed Rule.

ii. The Proposed Rule failed to consider less restrictive, reasonable alternatives for its chosen policies and offer a reasoned explanation for rejecting them

The APA requires an agency engaged in a rulemaking proceeding to consider less restrictive, reasonable alternatives for its chosen policies and offer a reasoned explanation for rejecting them. The Proposed Rule fails to address alternatives to achieve its stated policy goals. For example, with respect to the proposed broker compensation disclosures, the Proposed Rule does not adequately assess the merits of several clear alternatives, including those already provided by current or proposed law and industry practice, and those presented by the Federal Reserve Board in its proposed amendments to Regulation Z, with which the Proposed Rule stated it would be coordinated.

The Proposed Rule's failure to consider such alternatives must be remedied if it is to withstand scrutiny under the APA. The Proposed Rule must consider a full range of alternative means to achieve the articulated policy goals and subject each of those possible alternatives to rigorous examination to determine, based on all available studies and the most thorough empirical research, which alternative best achieves the policy objectives. In particular, HUD must carefully consider data and quantifiable evidence produced by other government agencies with particular expertise in the subject area or independent academic researchers whose backgrounds permit them to make an informed and disinterested assessment of the relevant facts.

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[18] 5 U.S.C. § 553(c).

iii. The Proposed Rule's unsubstantiated allegations about the conduct of mortgage brokers suggests impermissible prejudgment by HUD

In the Proposed Rule, HUD makes harsh, unsubstantiated allegations about improper conduct among "many" brokers, and speculates, without basis, about what brokers "*may* even assert".[19] No other mortgage originator—indeed, no other participants in mortgage markets—are singled out for such impugning. HUD's comments are so remarkable that they suggest an impermissible prejudgment of how to proceed with respect to the Proposed Rule. The content of HUD's language suggests that mortgage brokers as a class should be a particular target of any RESPA regulations, and the tone of HUD's statement suggests that no public comments are likely to alter that view, notwithstanding, for example, overwhelming evidence of the convergence of the role of mortgage originators and the need to treat all originators similarly.

Under the APA, the proposition is well established that a rulemaking is not valid if the agency has "an unalterably closed mind on matters critical to the disposition of the proceeding." [20] As the District Court in the Eastern District of California recently noted in discussing "troubling" evidence of prejudgment in a HUD rulemaking, "Allowing the public to submit comments to an agency that has already made its decision is no different from prohibiting comments altogether."[21]

To remove that taint, HUD must not only show that "many" mortgage brokers engage in the conduct alleged through data that is more compelling than ""flimsy anecdotal evidence".[22] In addition, HUD also must show why other participants in mortgage markets do not share culpability with those brokers, if any, who act as HUD suggests.

iv. The Proposed Rule solicits significant new data or other information relevant to its provisions, impermissibly denying the public the opportunity to comment

On numerous points, the Proposed Rule solicits significant new data or other information relevant to its provisions. Although HUD should seek that information, that is only the first step in the rulemaking process. In addition, commenters on the Proposed Rule must also have the opportunity to review and comment on any studies or data upon which HUD relies in developing any proposed regulations. By soliciting information in the Proposed Rule, rather than gathering it earlier and presenting it in the Proposed Rule, HUD is impermissibly denying commenters essential input into the final rule. Unless the public is afforded that opportunity, the Proposed Rule cannot stand under the APA.

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[19] 73 Fed. Reg. at 14,042 (Emphasis added).

[20] *See Alaska Factory Trawler Ass'n v. Baldridge*, 831 F.2d 1456, 1467 (9th Cir. 1987) (citing Ass'n of Nat'l Advertisers, Inc. v. FTC, 627 F.2d 1151, 1170 (D.C. Cir. 1979)).

[21] *Nehemiah v. Jackson*, Civil Action No. S-07-2056 LKK/DAD (D.E.D. Ca. 2008) at 31, 33.

[22] *See AmeriDream v. Jackson*, Civil Action No. 07-1752 (PLF)(D.D.C. 2008) at 18 (holding that "flimsy anecdotal evidence 'is not sufficient to enable [the Court] to conclude that the [Final Rule] was the product of reasoned decisionmaking.'"; *citing Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. at 43.

v. **HUD must repropose its revisions to the regulations implementing RESPA to permit public comment on rationales and supporting data not presented not in the Proposed Rule**

Given the extent and materiality of the Proposed Rule's (i) failure to articulate an adequate rationale and supporting basis for key provisions; (ii) failure to consider less restrictive, reasonable alternatives for its chosen policies; and (iii) solicitation of significant new data or other information relevant to its provisions, those shortcoming can only be remedied by presenting another proposed regulation which includes all material information that HUD may regard as a basis for a final rule.

vi. **HUD must address key questions before moving forward in the rulemaking process**

In reproposing the Proposed Rule, HUD must not simply present its updated research or discuss alternatives, it must also address the policy concerns raised by the proposed Rule's provisions. Particular attention must be given to those legitimate objections that have been raised by commenters.

The Proposed Rule presents many important questions and prompts many legitimate objections. For example, how does HUD justify basing the Proposed Rule on vestigial distinctions between brokers and lenders that are no longer meaningful, creating market dysfunction which the Proposed Rule should seek to remedy, not exacerbate? Similarly, how does the Proposed Rule explain how consumer interests are protected, and comparative shopping encouraged, by creating a systemic preference for originators that are not required to disclose their compensation over those that are required to disclose?

Prior to finalizing any regulation, HUD must respond to those questions and many others raised in this comment letter. NAMB looks forward to that response, and is committed to continuing to work with HUD and this Committee to develop policies that best serve the public interest.

IV. Specific Proposals Negatively Impacting Small Business Mortgage Brokers

A. Yield Spread Premiums ("YSP")

The Proposed Rule reclassifies YSP as a credit to the borrower. The practical effect of this change is to put mortgage brokers at a competitive disadvantage by imposing asymmetrical disclosure obligations among originators receiving comparable compensation. Recharacterizing YSP as a credit to the borrower also may invite gamesmanship by competing originators that may create, rather than eliminate, confusion among consumers.

The Proposed Rule perpetuates the basic inequity between broker and lender transactions that exist in the marketplace as regulated under RESPA. Despite the fact that almost all originators act as brokers (even temporarily) in the "originate to distribute"[23] marketplace, the Proposed Rule will maintain, and accentuate, the difference between a broker transaction (disclosure of

[23] Broker Regulations Analysis at 5, n.4.

YSP) and a lender transaction (no disclosure of similar in-direct payments – *i.e.,* Service Release Premium ("SRP")). The era of clear differentiation between competitors in the mortgage market is gone. This arbitrary distinction represents a fatal flaw in the Proposed Rule.

NAMB urges HUD and this Committee to treat direct competitors the same and remove this artificial distinction between originator transactions, which overwhelmingly disadvantages small business mortgage brokers. In today's market originators across channels act in the same capacity, use the same computer software and perform the same functions. By accentuating the form of disclosure over the function of the marketplace, the Proposed Rule seeks to reinforce a difference without a distinction. The Proposed Rule disadvantages small businesses by maintaining and accentuating the distinction between broker and lender transactions.

In addition, exhaustive studies of mortgage disclosures by the Federal Trade Commission ("FTC"), the government's principal consumer protection agency, in 2004 and 2007[24] show that additional disclosures of mortgage broker compensation created confusion, caused consumers to choose more expensive loans, led to a bias against broker-assisted transactions, and impeded competition, thus hurting consumers. In order to promote comparison shopping, and meet the objectives for the Proposed Rule, there should be a corresponding requirement for lenders to disclose compensation paid to their own sales staff. Fees similar to the YSP are present in any mortgage origination distribution channel, regardless of whether a broker is involved.

Requiring brokers, but not other loan originators, to make compensation disclosures enable the brokers' competitors to steer consumers away from brokers, even if brokers offer more favorable loans. In addition, this policy will inhibit competition, limit consumer choice, increase prices, and hurt borrowers. For these reasons, NAMB believes the FTC should conduct a through analysis and field testing to ensure the market remains competitive and new disclosures do not lead to biases or fraudulent practices between distribution channels.

B. Volume Discounts

Volume Discounts disadvantage small business. Negotiating discounts based on how much volume an originator produces disadvantages small business originators. Naturally the larger entities in the marketplace will be able to obtain larger discounts due to the volume of loans they originate. Thus placing small business originators at a disadvantage because they cannot offer the same volume to service providers they cannot offer the same discounts to their consumers.

In the short run, this practice may reduce the competitiveness of small business. In the long run, if smaller players are not able to compete, larger players will raise prices. The policy may initially save consumers money however, overtime the policy will likely harm consumers because it will force small businesses out and limit the market to a few large entities leaving consumers with limited choice.

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[24] James M. Lacko & Janis K. Pappalardo, The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment (2004)("2004 FTC Study"); James M. Lacko & Janis K. Pappalardo, Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms (2007)("2007 FTC Study").

V. Conclusion

Again, thank you for the opportunity to appear before this Committee today to discuss this timely issue. I am happy to answer any questions that you may have.