WRITTEN STATEMENT OF IVY JACKSON

Director, Office of RESPA and Interstate Land Sales
U.S. Department of Housing and Urban Development

Hearing before the Committee on Small Business

United States House of Representatives

"Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs"

May 22, 2008

Chairwoman Velázquez, Ranking Member Chabot and distinguished Members of the Committee, I appreciate the opportunity to be here today to discuss important issues related to the Real Estate Settlement Procedures Act (RESPA), and highlight aspects of the proposed rule to revise the RESPA regulations entitled *Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs*, generally referred to as "RESPA Reform."

Consumers need to know – *deserve* to know – what they are buying when they buy a home. What type of loan are they entering into? How much will it cost per month? What is included in their monthly payment? Will the amount stay the same? Today consumers have no assurance the loan terms and closing costs they are offered will be what they will see at the settlement table. Today's mortgage foreclosure problems are often associated with difficult to understand loan terms such as "teaser rates." The RESPA Reform proposal, in combination with planned Truth In Lending Act disclosure improvements, can improve consumer understanding of these terms, significantly reducing the odds borrowers will take on financing too risky for their circumstances.

Revision of HUD's RESPA regulations and related legislative proposals are a high priority of the Administration, Deputy Secretary Roy Bernardi and Federal Housing Commissioner Brian Montgomery. HUD views RESPA as very important to its mission to increase homeownership and help provide affordable housing opportunities.

Through RESPA Reform and other initiatives, HUD is undertaking meaningful mortgage reform in America – reform that will help millions of consumers to shop for and better understand the fine print in their home loans.

The RESPA Reform process has been thorough and inclusive. HUD has sought input from consumers, industry, and Congress about how to update and improve the arcane settlement process all homeowners endure when they purchase their homes. We are in the midst of a housing downturn where hundreds of thousands of Americans are faced with the prospect of losing their homes through foreclosure. There is no doubt the process of buying a house itself has been part of the problem. Many homeowners go to the settlement table and sign a mountain of documents they don't fully understand and pay thousands of dollars for services most don't understand.

Most people have never heard of the Real Estate Settlement Procedures Act. RESPA was enacted more than 30 years ago to provide consumers with certain disclosures before they buy their home. But in reality, RESPA often is ineffective as a tool to help consumers shop for the best loan. The homebuying process governed by RESPA is too confusing, and because of that confusion, buying and refinancing a home is too expensive!

We don't think the average homebuyer should need a degree in finance to understand what it takes to buy a home. In far too many cases, consumers facing foreclosure today signed on the dotted line when they shouldn't have, in large part because they didn't understand the process. HUD believes this is wrong. This settlement process is little different from how Americans bought homes in the early 1970s, when RESPA was first enacted.

RESPA

RESPA was enacted in 1974 to protect consumers during the homebuying and mortgage process by: (1) requiring consumers receive certain information in the form of disclosures during the process; and (2) prohibiting certain practices that unnecessarily increase the costs of settlement.

Disclosures currently required by RESPA include the Good Faith Estimate (GFE) and the HUD-1 Settlement Statement. The Good Faith Estimate given by the lender or mortgage broker is, as the name implies, required to provide a "good faith estimate" of the charges the borrower will likely have to pay to close the transaction. The HUD-1 Settlement Statement itemizes the charges actually imposed upon both the buyer and seller in connection with the settlement. All charges by the lender and other settlement service providers must be reported on the standardized HUD-1 form.

RESPA covers millions of transactions every year involving virtually all loans secured by one-to-four family residential properties. RESPA extends to all providers of settlement services required to close the loan or for which the settlement service provider requires a borrower or seller to pay (24 C.F.R. § 3500.2). Such services include, but certainly are not limited to, appraisals, credit reporting, mortgage loan origination, and title and closing services.

Another key purpose of RESPA is to eliminate practices such as kickbacks, referral fees, and unearned fees in the settlement process "that tend to increase unnecessarily the costs of certain settlement services." Specifically, Section 8(a) of RESPA provides "no person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to, or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." Section 8(b) prohibits the giving or receipt of "any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service… other than for services actually performed."

HUD's RESPA Proposal

In July 2002, HUD published a proposed rule that sought to improve transparency in settlement procedures and help consumers compare the prices of mortgage loans and related settlement services. The proposed rule did not become final. In 2005, HUD held seven roundtable discussions with consumer and industry groups, as well as small and large businesses, in Chicago, Ft. Worth, Los Angeles, and Washington, D.C., to gather information from stakeholders concerning how to improve the homebuying and mortgage process. The roundtables held outside of Washington were conducted in conjunction with the Small Business Administration (SBA). HUD has thoroughly considered various options and opinions arising from these meetings in developing the current proposed rule.

HUD believes its current proposal will achieve RESPA's original goals and build upon the information it obtained during the roundtables and through its outreach. HUD's current proposal is narrower than the 2002 proposal and no longer contains packaging. The current proposal is designed to promote early comparative shopping by consumers for the best loan terms and lowest settlement costs by providing clearer and more extensive loan term and settlement cost disclosures, and by limiting settlement cost increases and fee proliferation at closing.

The proposed rule includes:

- A standardized GFE to improve disclosure of loan terms and settlement costs and to make it easier to shop among settlement providers, which will help lower costs to consumers;

- Limitations on how much final charges for certain types of settlement services can vary from the estimated charges, in order to provide greater cost certainty for consumers;

- Modification of the HUD-1 settlement statement to reference the GFE cost categories, making it easier for consumers to compare the estimated charges on the GFE to their final charges and limit fee proliferation;

- A "closing script" as an addendum to the HUD-1 will be reviewed with each borrower at the closing to compare the final HUD-1 charges with the GFE estimated charges, and describe the precise terms of the loan the consumer receives at closing; and

- Clarification that volume-based discounts must be passed on to consumers, and establishing guidance for average cost pricing.

Lastly, the proposal requires indirect fees paid to the mortgage broker by the lender and charged to the borrower through the interest rate are applied to reduce the consumer's closing costs at settlement.

Forms Design

(A) The GFE

The first page of the proposed GFE provides a consumer-friendly description of the important loan terms and details, as well as an aggregate estimate of the closing costs for obtaining the loan. The costs for settlement services are delineated in categories on page two. The categorizations are designed to eliminate fee proliferation of costs for settlement services at the GFE stage, as well as on the HUD-1 at closing. Pages three and four provide information and instructions useful for the consumer to understand the relationship between up-front charges and interest rates, how tolerances apply, and other information.

Although the complete GFE is four pages, the summary information clearly displayed on the first page is the single most important comparison shopping tool throughout the proposed mortgage shopping process. Comparison shopping leads to greater price competition in the marketplace and lowers charges to consumers. HUD's consumer testing indicated consumers liked and understood the form and said they would use it.

(B) The HUD-1

The proposed HUD-1 has been designed to allow consumers to easily compare page two of the HUD-1 with page two of the GFE, and relate the charges they will be paying at the closing for settlement services performed to the estimates of those charges as listed on the GFE. It also compresses certain origination and title fees into categories of charges to reduce or eliminate fee proliferation at closing. Finally, the "closing script" addendum to the HUD-1 apprises the borrower of the loan terms and details of the loan, and compares charges on the HUD-1 with the estimates of those charges on the GFE, to assure tolerances are not exceeded. The loan terms section of the "closing script" will provide similar information to that in the loan terms section on page one of the GFE, to assure the borrower is getting the loan which was negotiated.

The Proposed Rule and Small Business

A: Overall Consumer Savings

The new, standardized GFE format in the proposed rule will improve consumer shopping for mortgages, which will result in better mortgage products, lower interest rates, and lower origination and settlement costs for borrowers. There is substantial evidence some consumers are paying higher prices than others for origination and settlement services. The improved understanding of indirect charges based on the interest rate, discount points, and the trade-off between interest rates and upfront costs; improved consumer shopping among originators; more aggressive competition by originators for settlement services; and increased competition associated with discounting will benefit consumers by reducing both originator and third-party fees. Also critical to consumer savings is that clearer presentation of loan terms will improve borrower understanding of risky mortgage features such as "teaser rates," interest-only loans and balloon payments. Such features are at the root of many, if not the vast majority, of today's troubled and foreclosed mortgages. To avoid today's problems in the future, it is imperative disclosure eliminate any opaqueness about these terms.

Consumer savings achieved with the proposed GFE were estimated under a variety of scenarios about loan originator and settlement costs. In the base case of 12.5 million loans annually, the estimated savings to borrowers comes to $8.35 billion, or 12.5 percent of the $66.7 billion in total charges (i.e., origination fees, appraisal, credit report, tax service, flood certificate, title insurance, and settlement agent charges). This represents savings of $668 per loan.

B: Overall Efficiency Gains and Costs

The $8.35 billion in consumer savings results in transfers to borrowers from high-priced producers, with $5.88 billion coming from loan originators and $2.47 billion from other settlement service providers.

Additionally, there are efficiencies and costs associated with the rule. Mortgage applicants and borrowers realize $1.07 billion of savings in time spent shopping for loans and third-party services. It is anticipated loan originators will save $1.40 billion in time spent with shoppers because they: (1) are expected to spend less time answering follow-up questions; and (2) achieve a reduction of compliance costs from average cost pricing. Third-party settlement service providers save $113 million in time spent with consumers. Some or all of the $1.40 billion and $113 million in efficiency gains have the potential to be passed through to borrowers through competition.

C: Compliance Costs

The total one-time compliance costs to the lending and settlement industry of the proposed GFE and HUD-1 are estimated to be $570 million, $390 million of which would be borne by small business. Total recurring costs are estimated to be $1.23 billion annually or $98.48 per loan. The share of the recurring costs on small business is $548 million.

Recurring costs of the proposed GFE would be additional time spent by loan originators processing the new forms and making third-party arrangements to meet the tolerances. The one-time adjustment costs of the proposed GFE would be the cost of the training, software upgrades, and legal advice necessitated by switching to the new form. Recurring costs of the new HUD-1 arise from the addition of the closing script. Settlement agents would be obliged to prepare the script, read it to the borrower, and answer questions generated by the script. Requiring the script would impose a cost on the settlement industry only when it increases the average time spent to complete a settlement. It is conceivable the burden imposed on the average conscientious agent is very modest. In a worst case scenario of the added time required of a non-conscientious agent dealing with a very complicated loan product, HUD assumes the script would lead to an additional thirty minutes preparing the script, and an additional fifteen minutes to the actual closing procedure consisting of five minutes reading the script, and ten minutes answering questions. There will be one-time adjustment costs of the new HUD-1 form and its addendum, the closing script. These costs consist of software upgrades, training, and legal advice.

D: Small Business Impacts

(1) Transfers from Small Businesses. There is no evidence small businesses have been disproportionately charging high prices; for this reason, there is no expectation of any disproportionate impact on small businesses from the proposed rule. It is estimated $4.13 billion, or 49.5 percent, of the $8.35 billion in consumer savings comes from small businesses, with small originators contributing $3.01 billion and small third-party firms contributing $1.13 billion. Within the small originator group, most of the consumer savings come from small brokers ($2.47 billion, or 82 percent, of the $3.01 billion). This is because small firms account for most broker revenues but a small percentage of lender revenues. Within the small third-party group, most of the transfers come from the title and closing industry ($680 million, or 60 percent of the $1.13 billion), mainly because this industry accounts for most third-party fees. In the title analytical approach, small title and settlement closing companies account for $950 million of the $2.5 billion in savings.

(2) Compliance Costs Incurred by Small Business. Small business would bear $390 million of the estimated $570 million in one-time compliance costs: $280 million from the proposed GFE and $110 million from the HUD-1. The proposed rule would result in $548 million in annual recurring compliance costs on small business (out of a total $1.23 billion).

(3) Small Mortgage Brokers. The main issue raised by mortgage brokers concerned the treatment in the 2002 proposed rule of yield spread premiums on the proposed GFE. This was also the main small business issue with the 2002 proposed GFE because almost all mortgage brokers qualify as small businesses. The current proposed rule addresses the concern expressed by mortgage brokers the reporting of yield spread premiums in the 2002 proposed rule would disadvantage them relative to lenders. However, this assertion ignored the fact mortgage brokers have been required to disclose indirect compensation (the yield spread premium) by regulation, since 1992. HUD has redesigned the proposed GFE form to focus borrowers on the right numbers so competition is maintained between mortgage brokers and lenders. The forms adopted in the proposed rule were tested on hundreds of subjects. The testing indicated borrowers who comparison shop have little difficulty identifying the cheapest loan offered in the market – whether from a mortgage broker or a lender – and, most important, there is no bias in the form against mortgage brokers.

The consumer outreach function brokers perform for wholesale lenders will not change with RESPA reform. Wholesale lending, which has fueled the rise in mortgage originations over the past ten years, will continue to depend on mortgage brokers reaching out to consumers and supplying them with loans. Mortgage brokers play the key role in the upfront part of the mortgage process and this will continue with the proposed GFE.

RESPA reform will also not change the basic cost and efficiency of brokers. Mortgage brokers have grown in market share and numbers because they can originate mortgages at lower costs than others. There is no indication their cost competitiveness will change in the near future. Mortgage brokers, as a group, will remain highly competitive actors in the mortgage market, as they have been in the past. The main impact of the proposed rule on brokers (both small and large) will be on those brokers (as well as other originators) who have charged above competitive market prices through the combination of high origination fees and yield spread premiums.

(4) Small Lenders. Lenders include mortgage banks, commercial banks, credit unions, and thrift institutions. More than 10,000 lenders would be affected by the RESPA rule, as well as almost 4,000 credit unions that originate mortgages. While two-thirds of the lenders qualify as a small business (as do four-fifths of the credit unions), these small originators account for 23 percent of industry revenues. Thus, small lenders (including credit unions) account for $540 million of the projected $2.35 billion in transfers from lenders.

In general, there was less concern expressed by lenders (as compared with mortgage brokers) about potential anti-competitive impacts of the GFE on small businesses. Small lenders – relative to both brokers and large lenders – will remain highly competitive actors in the mortgage market, as they are today. Small mortgage banks, community banks and local savings institutions benefit from their knowledge of local settlement service providers and of the local mortgage market. Nothing in the proposed rule changes that.

There will be an impact on those lenders (both large and small) who are charging above competitive market prices. Improved consumer shopping with the proposed GFE would reduce the revenues of those lenders. Thus, as with brokers, the main negative impact on lenders (both small and large) of the proposed GFE will be on those lenders who have been charging above competitive market rates.

(5) Title and Settlement. The title and settlement industry – which consists of large title insurers, title agents, escrow firms, lawyers, and others involved in the settlement process –is expected to account for $1.79 billion of the $2.47 billion in third-party transfers under the proposed GFE. Within the title and settlement group, small firms are expected to account for 38.1 percent ($680 million) of the transfers. Evidence suggests there are more opportunities for price reductions in the title industry, as compared with other third-party industries.

One of the primary concerns of small title firms is the potential adverse effect of volume discounting. First, it should be emphasized the rule merely clarifies volume discounting is currently legal under RESPA as long as the savings are passed along to the consumer. Firms that are currently profitable should not be negatively impacted because the change is only superficial for those that understand the law. However, there is a great deal of confusion in the industry concerning the legality of volume discounts because courts have made different interpretations of the law. Nonetheless, HUD does not expect small title firms to be adversely affected for reasons explained below.

An important issue when considering the impacts of the proposed RESPA reform on the title industry concerns the local nature of the industry. The title industry has a high degree of geographic specialization. Until there is widespread use of standardized electronic land record keeping accessible by the Internet, the information-gathering service the industry provides will require proximity to land title records (or the establishment of "title plants," i.e., duplicates of local records, the maintenance of which requires proximity to local government records). Even if a provider is efficient and charges low prices, it will not be able to compete against title and closing firms located closer to the site in question. Thus, title and closing services are, by economic necessity, provided by local firms. Reinforcing this local orientation is the value of local expertise and the importance of personal networks in receiving referrals.

The local orientation of the title industry could change over time. However, it is unlikely the RESPA rule would be the catalyst. The advances in technology that could change business practices are independent of actions HUD takes in reforming RESPA. The only change the proposed rule will introduce is title and closing services may occur at lower prices negotiated between providers and lender originators. There will be no significant change in the local provision of title and closing work. Nor will there be a reduction of the number of services purchased because this rule will not result in a drop in the number of mortgages that require these services. Large lenders will have to deal with multiple settlement services providers to ensure complete geographic coverage, and large multi-jurisdictional title firms have no apparent cost advantages over smaller title firms. In fact, large multi-jurisdictional title firms may have location-related cost disadvantages. There is no reason to believe small title firms charging competitive prices will be adversely impacted by the proposed changes in this rule. The demand for the services of these local firms will continue.

Proposed Legislation

The success of HUD's regulatory effort to make RESPA a more efficient tool for both industry and consumers depends greatly on realistic and effective guidance and enforcement. To further bolster consumer protection and to ensure uniform and consistent enforcement of RESPA, HUD intends to seek legislative changes to the Act that will complement the regulatory improvements made by the proposed RESPA Reform rule.

Currently, RESPA does not provide HUD with enforcement mechanisms for some of the most important consumer disclosures and protections. This lack of enforcement authority and clear remedies for violations of critical sections of RESPA negatively impact consumers and diminish the effectiveness of the statute. For example, currently RESPA does not include authority for regulators to enforce important sections of the statute; there are no remedies for violations of the requirements relating to the Good Faith Estimate, settlement costs booklet, or HUD-1 settlement statement. The effectiveness of RESPA would be enhanced by providing the Secretary and State regulators with the necessary tools to enforce the statute.

HUD, therefore, would like to work with Congress to enact legislative changes to RESPA that include:

- Requiring delivery of the HUD–1 to the borrower 3 days prior to closing.

- Authority for the Secretary to impose civil money penalties for violations of specific RESPA sections, including sections 4 (provision of uniform settlement statement), 5 (GFE and special information (settlement costs) booklet), 6 (servicing), 8 (prohibition against kickbacks, referral fees, and unearned fees), 9 (title insurance), and portions of 10 (escrow accounts); as well as authority for the Secretary and State regulators to seek injunctive and equitable relief for violations of RESPA.

CONCLUSION

In closing, the proposed RESPA Reform rule is designed to take much of the guesswork out of shopping for the largest and most important purchase most Americans will ever make.

HUD's proposal would revise the RESPA regulations to improve disclosure of the terms of a mortgage and control closing costs consumers will pay when they buy or refinance their home. For the first time, consumers would receive a standardized Good Faith Estimate that would disclose the key elements of the loan and control closing costs to allow consumers to shop more effectively for the lowest cost loan.

Even if industry passes along all of the recurring costs of the rule to consumers, consumers will still enjoy substantial benefits. Consumer's savings are expected to be between $500 and $700 per loan. Efficiency gains are expected to be $86 per loan for borrowers and applicants and $112 per loan for loan originators. The recurring compliance costs are estimated at $98 per loan and the one-time adjustment cost at $570 million. If industry imposes all of the adjustment costs on borrowers in the first year and does not pass on any efficiency gains, then the net consumer savings for the average consumer would be $524 per loan in the first year and $570 per loan every year afterwards. Accounting for the benefits of the time saved by consumers and assuming loan originators pass on their own efficiency gains increases the estimated benefit to consumers of this rule. There would be a positive net benefit of $722 per loan for consumers in the first year and $768 per loan every year afterwards.

In addition, other economic effects, which are important but difficult to quantify, should also be considered. For example, as a result of the proposed reform, consumers are less likely to engage in risky and uninformed borrowing, which would have positive impacts on the housing market, financial system, and the national economy. RESPA Reform and Truth In Lending Act improvements are both important and necessary efforts for improving consumer understanding and making it significantly less likely borrowers will assume too much risk. The results of overly risky borrowing are all too clearly exhibited in today's mortgage problems.

It is clear a lot of the mortgage problems we see today are directly related to the fact many people did not understand the mortgage process. Buying a home can be very intimidating. Frequently, consumers have had no assurance the loan terms and closing costs they are offered reflect what they will see at settlement, and has been one of the factors driving the current housing downturn. Our new rule fixes this. We owe it to American homebuyers to give them the information they need to make smart choices.

The time for reform is now. It is no longer acceptable to stand in the way of millions of Americans who are crying out for clarity when it comes to the biggest purchase of their lives. We need to assure homebuyers get fair value for their investments. RESPA Reform is HUD’s effort to improve consumer protection for homebuyers and homeowners, while expanding a fair and competitive marketplace.

The housing market is a vital part of the economy. We all need to work together to help stabilize it and strengthen our communities. When President Bush announced the administration’s comprehensive plan to address rising foreclosures last August, he pledged to offer new mortgage rules that would help families avoid getting into trouble in the first place. The proposed RESPA Reform rule makes good on that pledge. The current proposal will give consumers the tools they need to understand what they’re getting into before they sign on the dotted line.