<u>Testimony of Julia Gordon</u>
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Before the U.S. House of Representatives
Committee on Small Business

"RESPA and its Impact on Small Business"

May 22, 2008

Chairwoman Velázquez, Ranking Member Chabot, and members of the subcommittee, thank you for holding this hearing on RESPA.

I am Policy Counsel at the Center For Responsible Lending (CRL), (www.responsiblelending.org), a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help (www.self-help.org), which consists of a credit union and a non-profit loan fund.

For the past 28 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get home loans. In other words, we work to provide fair and sensible loans to the people most frequently targeted for predatory and abusive subprime mortgages. Self-Help has provided over $5 billion of financing to 60,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Although Self-Help is technically a subprime lender, its responsible lending practices keep its annual loan loss rate under one percent – far less than the typical subprime loss rate.

In addition to making direct loans, Self-Help encourages sustainable loans to applicants with blemished credit through a secondary market operation. Self-Help buys high-risk loans from banks, holds on to the credit risk, and resells them to Fannie Mae. Self-Help has used the secondary market to provide $4.5 billion of financing to 50,000 families across the country, loans that have performed well and increased these families' wealth.

Today, as the U.S. economy faces significant challenges, there has never been a stronger need to ensure a transparent accounting of costs in real estate transactions. Right now, it is estimated that 20,000 foreclosures on subprime mortgages take place every single week.[1] The negative spillover effects from these foreclosures are substantial: property values are dropping by billions of dollars, crime is up in high-foreclosure communities, cities are losing their tax bases, and millions of Americans who depend on a robust housing market are losing jobs and income. As foreclosures accelerate during the next two years, these economic effects will be felt even more strongly.

As an affiliate of Self-Help, we appreciate the impact the requirements of the Real Estate Settlement Procedures Act (RESPA) may have on relatively small lenders. At the same time, we understand that confusing, misleading, and inaccurate information has played a contributory role in this crisis, and we believe that reforms to the current disclosure requirements are long overdue.

We must acknowledge, however, based on overwhelming evidence, that poor disclosure has not been the sole, or even the most destructive, culprit in the slew of forces that has brought us all to where we are now. Inadequate disclosure has been only part of a broader system of skewed incentives that have encouraged brokers and lenders to steer consumers into the riskiest, highest cost loans available – because investors paid the most for these loans. Brokers could wash their hands clean of them as soon as they collected their origination fees and lenders could do the same as soon as they sold them off into the secondary market.

In these comments, I will offer the following recommendations:

- **Coordinate with the Federal Reserve Board (FRB).** It is crucial to coordinate the information disclosure requirements of RESPA and the Truth-in-Lending Act (TILA). HUD and the FRB must consider how best to harmonize these disclosures to avoid yet more confusion for consumers.

- **Eliminate yield-spread premiums that do not offer benefits to consumers and significantly improving disclosure.** CRL believes that, at least in the subprime market, lender-paid origination fees to brokers, known as yield-spread premiums, constitute impermissible kickbacks under RESPA. Although we do not believe better disclosure will necessarily avert the harm caused by the yield-spread fee incentive system, we offer a few recommendations to strengthen the proposed disclosure. Our recommendations concerning yield-spread premiums are confined to subprime mortgages, and would have no effect on mortgages made in the prime market.

- **Add key information to the Good Faith Estimate (GFE)**: Because consumers shop primarily on total monthly payment, the GFE needs to include that number and ensure that it accurately states the true, grand total monthly housing payment. We also are concerned that the proposed GFE focuses so much on settlement costs that it does not give proper weight to the cost of credit over time. The total cost of the loan is a function of both origination cost and interest rate. We therefore recommend to HUD that the annual percentage rate (APR), which factors in both some settlement costs and the note interest rate, be included on the GFE.

- **Strengthen protections related to the closing script**. While we support efforts to ensure that the consumer understands the mortgage, we cannot rely on this script to do so. Therefore, we offer several protections that will ensure the script does not cause more problems than it solves.

- **Pass along discounts**. We support volume-based discounts as long as those discounts are passed along to the consumer.

- **Charge consumers an average price only when the originator pays an average price.** *Average cost pricing*, i.e., passing along a price paid to a third party as an average, is fine, but *average pricing,* i.e., paying a specific price to a third party but charging the consumer an average, is not.

- **Ensure adequate enforcement to ensure that RESPA does what it's meant to do**. Not only should Congress add or enhance civil penalties and equitable relief under several sections of RESPA, but it should add a private cause of action for all elements of the RESPA requirements.

I. The misaligned incentives and predatory lending of recent years have caused not only a foreclosure crisis in the housing market, but a national and international economic crisis.

It seems like a distant memory, but less than one year ago, some in the mortgage industry were still insisting that the number of coming foreclosures would be too small to have a significant impact on the economy overall.[2] No one makes that claim today. As foreclosures reach an all-time high and are projected to grow higher,[3] the "worst case is not a recession but a housing depression."[4] At least two million American families are expected to lose their homes to foreclosures initiated over the next two years.[5] Industry projections forecast that by 2012, 1 in 8 mortgages – that's all mortgages, not just subprime mortgages – will fail.[6]

Recent data shows that 30% of families holding recent subprime mortgages now owe more on their mortgage than their home is worth.[7] These families are at an increased risk of foreclosure because "negative equity" precludes the homeowner from selling, refinancing or getting a home equity loan or other mechanism for weathering short-term financial difficulty.[8]

As we show in our recent report on the "spillover" effect of subprime foreclosures, the negative effects of foreclosures are not confined to the families who lose their homes. Forty million of their neighbors will see their property values decline as a result by over $200 billion.[9] Federal Reserve Chairman Ben Bernanke recently noted

> At the level of the individual community, increases in foreclosed-upon and vacant properties tend to reduce house prices in the local area, affecting other homeowners and municipal tax bases. At the national level, the rise in expected foreclosures could add significantly to the inventory of vacant unsold homes—already at more than 2 million units at the end of 2007—putting further pressure on house prices and housing construction.[10]

Robert Schiller recently noted that the meltdown and resulting crisis has erased most of the gains in the homeownership rate since 2001**,** which stands to fall further yet.[11] Even more ominous, according to the IMF, direct economic losses stemming from this crisis will likely top $500 billion and consequential costs will total close to a trillion dollars.[12]

Sadly, many of the families losing their homes to foreclosure today might not have found themselves in this position if they had been given the type of loan that they actually qualified for. Last year, the Wall Street Journal found that of the subprime loans originated in 2006 that were packaged into securities and sold to investors, 61% "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[13] Even those applicants who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate loans for -- at most -- 50 to 80 basis points above the "teaser rate" on the unsustainable exploding ARM loans they were given.[14] Indeed, many consumers were charged 100 basis points more for "no-doc" loans when they had already handed over their W-2 statements or readily would have done so, but for the broker's desire to originate these riskier loans. That made the typical risky adjustable rate subprime loan more expensive than far safer thirty-year fixed-rate loans *even at the initial payment.*

Wall Street's appetite for risky loans incentivized mortgage brokers and lenders to aggressively market these highly risky ARM loans instead of more sustainable loans. As Alan Greenspan told Newsweek:

> The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime loan market would have been very significantly less than it is in size.[15]

Market participants readily admit that they were motivated by the increased profits offered by Wall Street in return for risky, higher-yielding loans. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the New York Times, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?"[16] Even the chief economist of the Mortgage Bankers Association, when asked why lenders made so many loans that they knew were unsustainable, replied, "Because investors continued to buy the loans."[17]

In short, this crisis was caused by loan originators selling unnecessarily risky loans to homebuyers and homeowners who did not understand what they were getting into, either because they were affirmatively misled or because the information they were given was simply too complex and voluminous. We believe that a primary role of RESPA reform should be to make such steering less likely by providing potential homebuyers with the clear and concise information that will help them fully understand their mortgage options. We note that even improved disclosure, however, will not provide sufficient protection to consumers dealing with complex mortgage transactions, particularly when they are subjected to inherently abusive practices and provisions. Only substantive protections, in addition to improved disclosures, can adequately protect consumers, curb abusive lending practices, and restore health to the market.

II. HUD needs to coordinate disclosure requirements with the Federal Reserve Board's HOEPA rules.

Nearly ten years ago, HUD and the FRB recognized the importance of coordinating the information disclosure requirements of RESPA and the Truth-in-Lending Act (TILA). [18] One set of disclosures focuses on the overall cost of the loan, while the other focuses solely on closing costs (an important part of any loan, but not the biggest cost item of a mortgage), but the consumer must digest and make sense of them both.

For close to a year now, the FRB has been working toward issuing rules for mortgage origination under the authority delegated to it by HOEPA. There have been several rounds of public comment and discussion, culminating with the promulgation of rules that are expected to be issued in final form this July.[19] One of these rules establishes a required disclosure of anticipated broker origination fees prior to a consumer paying any fees to a broker.[20]

Especially since the proposed RESPA changes also relate to disclosure of origination fees, we strongly suggest that HUD await the issuance of the final FRB rules and attempt to coordinate the RESPA disclosures in such a way that works with any new FRB disclosures.[21] Given the enormous confusion already faced by consumers in relation to yield-spread premiums, it is crucial that HUD and the FRB harmonize these disclosures to avoid yet more unnecessary and costly confusion for consumers.

III. It is crucial that the GFE disclosures facilitate understanding of the riskiest features of the loan.

A. The GFE should include total monthly payment information in a clear and conspicuous location.

The vast majority of consumers shop for a mortgage focusing not on rates or settlement costs or other loan features, but on the one key number that signals to them whether they can afford the loan: the grand total that they will have to pay each month for their home. Most people know how much income they take home each month, and they try to figure out whether out of that monthly amount, the monthly mortgage payment will fit into their budget.

Unscrupulous lenders fully understand the desire to shop on monthly payment amounts, and one of the ways to sell abusive loans is by failing to include certain costs in the "total" for the monthly payments. For example, many subprime lenders do not require escrow for property taxes and insurance, which makes the monthly total appear very low in comparison to totals that included the full PITI. This deception has been particularly useful for lenders seeking to refinance people out of an existing loan into a loan that looks cheaper, but is in reality much more expensive.

The new RESPA rules propose that the GFE disclose the monthly total of principal, interest, and mortgage insurance. We recommend that the GFE also disclose the estimated monthly payment for property taxes and insurance as well as a grand total of principal, interest, taxes, and all insurance. For any adjustable rate mortgages, the GFE should present a grand total both for the initial monthly payment and for the maximum monthly payment that could be reached under the loan terms.

B. The GFE must include the Annual Percentage Rate (APR) and reduce its disproportionate focus on settlement costs.

While consumers look first to the total monthly payment in assessing loan affordability, to the extent that they shop in any more detail at all, they are accustomed to looking at the APR. The APR is used in disclosures of other, more routine, consumer transactions, such as credit cards and auto loans, and consumers are familiar with it.

While looking at the note rate might be helpful to some extent, we believe that the APR is far more representative of the total cost of the loan than the note rate, as it puts the closing costs in context. Further, it enables an apples-to-apples comparison of loans in a single price tag, rather than by comparing the components of the price tag one by one, as is the case when the stand-alone note rate and settlement costs are the sole focus of the disclosures. The GFE should therefore disclose the APR instead of the note rate to give consumers some ability to shop based on the total cost of the loan.

Further, HUD should un-bold and un-shade the “Total Estimated Settlement Charges” figure at the bottom of page one. Such emphasis on this figure will give consumers the impression that settlement charges are the most important cost to consider when selecting their loan, when in reality the APR is the far better measurement of the entire cost of the loan. While we understand how important settlement costs are, they are not the major price component of a mortgage loan, and the “cheapest” settlement costs may, or may not be the cheapest loan. (As we discuss below, this is particularly the case when settlement costs include charges that ostensibly buy up, or buy down, a rate.)

C. The GFE must disclose the first possible date on which the interest rate can rise on page one.

In most adjustable rate loans, an increase in the monthly payment will follow an increase in the interest rate. Where it does not, as in payment option ARMs, it is still important that the consumer understand that the typically very low initial interest rate will likely last a very short time, usually just a few days or weeks. Therefore, the GFE should disclosure the first possible date on which the interest rate could rise, both to warn borrowers when they should be prepared to meet a higher monthly payment obligation and to alert them to the fact that some “teaser” rates are extremely ephemeral.

D. In disclosure of prepayment penalties, the GFE also needs to explain what they are and how they are triggered.

In its new rules, HUD recommends that the GFE include disclosure of whether or not there is a prepayment penalty and, if so, the maximum amount of the penalty, on the first page. We commend HUD for adding this disclosure, because prepayment penalties have played the nefarious role of locking millions of customers into overly risky loans. In our comment to HUD, we will recommend some improvements to help explain the fee.

E. In crafting RESPA rules, HUD should take into account that yield-spread premiums have been a primary driver of the subprime fiasco.

Although we are glad to see the effort to improve the disclosure of the service charge brokers earn from lenders in the first chart, "Your Loan Details," on the top of page two of the proposed GFE, we believe that the proposed disclosure of the service charge and the "credit or charge for the specific interest rate chosen" is misleading and confusing and must be simplified.

In the Proposed Rule, HUD explains its desire to avoid disadvantaging mortgage brokers in the marketplace through its treatment of the service charge disclosure: "Many mortgage brokers offer products that are competitive with and frequently lower priced than the products of retail lenders, as evidenced by brokers' large and growing share of the loan origination market, and HUD wishes to preserve continued competition and lower cost choices for consumers."[22]

While this claim may be true in the prime market, empirical evidence demonstrates that in the subprime market, nothing could be further from the truth. In April, CRL released a study that found subprime borrowers pay *significantly* more for loans when using an independent broker than a retail lender.[23] In summary, subprime borrowers steered into higher rate loans pay additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[24] And it doesn't take long for the disparity to become significant: at the four-year mark, a time period chosen to reflect average loan life, the difference in costs is stark: $5,000.[25]

What was the primary driver of this inequity? We believe it is the yield-spread premium. Simply put, Wall Street investors were willing to pay more for ARMs with prepayment penalties that locked borrowers into riskier, higher-rate loans. To satisfy this demand, lenders used yield-spread premiums to reward brokers for steering consumers into higher-rate loans than those for which they qualified, and then rewarded them even more for locking in those higher rates with a prepayment penalty. The high penetration of potentially dangerous loan products in the subprime and nontraditional markets is inextricably linked to the distortions produced by these perverse incentives.

Our data did not permit us to examine the relationship between yield-spread premiums and direct broker fees, but prior studies indicate that yield-spread premiums on subprime loans do not serve to reduce fees significantly. One study has shown that borrowers only receive 25 cents in reduced fees for every one dollar paid in yield-spread premiums to brokers and that upfront fees are actually lower for retail loans than for brokered loans.[26]

Most subprime loans carry significant direct upfront broker fees *along with* the yield-spread premium. They compensate the broker at both the front and back end, essentially buying the rate down, then buying it right back up.

This understanding of the way yield-spread premiums have operated in the market informs both our recommendations for HUD as to RESPA revisions, and our recommendations to the Federal Reserve Board as to the proposed HOEPA UDAP rules. In both cases, we hope the agencies will address the fundamental problem, not merely try to improve the gloss.

1. Yield-spread premiums, when paid in exchange for nothing but a higher interest rate or inclusion of a prepayment penalty, constitute illegal kickbacks under Section 8 of RESPA.

It is our long-held position that yield-spread premiums, when paid in conjunction with direct broker compensation or other closing costs or made contingent upon inclusion of a prepayment penalty, essentially overcompensate brokers in a way that is not transparent to consumers. In RESPA terms, it does not constitute a fee in exchange for any goods, services, or facilities as required by Section 8. The premium is either duplicative, or, in fact, may be paid for the "service" of steering consumers into higher-cost or riskier loans than those for which they qualify. Again, to put that in RESPA terms, we believe that such yield-spread premiums violate RESPA's prohibition on kickbacks.

HUD in the past has said that yield-spread premiums are not compensation for services if they simply pay for "delivering a loan with a higher interest rate."[27] Rather than *assuming* that a yield-spread premium is a price trade-off, we believe that it is incumbent upon HUD to *require* that it be so, by clearly identifying the circumstances in which it is a "kickback" instead of compensation for services. Just as we hope the FRB will ensure that the purported trade-offs are real, we urge HUD to do the same.[28] Our research suggests that such a requirement would help curb the abuses in the subprime market without interfering with the legitimate practice as it may prevail in the prime market.

2. The indirect compensation to a broker should be explicitly disclosed and should not suggest a price trade-off benefit of lower origination costs unless such trade-off actually exists.

The proposed disclosure of origination fees is structured as if there is definitely a price trade-off between back-end fees paid to the originator by the lender and upfront closing costs. As discussed above, while this purported price trade-off may occur in the prime market, it virtually never occurs in the subprime market.[29] The proposed disclosure even refers to the yield-spread premium as a "credit," which we believe is misleading since the premium in fact results in an increase in costs. Indeed, even when there is a real price trade-off, a yield-spread premium is not a "credit," but an alternative method of payment,[30] one which, in the long run, could result in higher overall loan costs.

We hope that HUD will assure that real benefits accrue through clarifying when a yield-spread premium is a "kickback". Improvements to disclosures must follow reform of practices. Only then do we believe that the disclosure of indirect broker compensation can assume a price trade-off.

F. The GFE should educate consumers about their right to negotiate with mortgage originators

While we hope that an improved GFE and other RESPA rules can facilitate mortgage shopping, the fact is, most consumers, especially those working with a mortgage broker, do not shop extensively for loans, and many of them do not understand that mortgage costs and rates are negotiable. The formal format of the proposed GFE may play a role in suggesting that the costs disclosed are fixed and are standard terms offered to every customer, much like the price of a gallon of milk. Because loan applicants need to understand that their mortgage terms are negotiable, we will recommend that the GFE provide consumers with that valuable information.[31]

IV. Prescribed tolerances will help prevent unwelcome surprises at the settlement table.

As HUD recognizes with these rules, a significant problem for consumers is what is often a complete disconnect between the costs disclosed in the GFE and the costs appearing later on the HUD-1. Establishing realistic tolerances for the maximum percentage that originator-controlled costs can change from the GFE to the HUD-1 is an excellent way to prevent this most unwelcome surprise.

We would like to propose that the tolerance be calculated on each item rather than in the aggregate. Calculating the tolerance in the aggregate could still permit very significant changes in one or two cost categories. We believe a 10% tolerance on each item will make manipulation by originators less likely and thus do more to protect consumers.

It is true that for many reasons, consumers find it easier to look at total amounts rather than many different line items, and calculating the tolerance on each item may cause some confusion. Therefore, we propose that consumers also be presented with a total percentage change highlighted in a conspicuous manner at the top of any itemization of tolerances.

V. Volume-based discounts may offer value to the consumer, but safeguards are essential.

CRL believes that volume-based discounts may offer value to homebuyers, but this value is only realized if the cost savings are passed on to the consumer rather than retained by the lender. We commend HUD for requiring that all savings be passed through to the consumer and for further requiring that, if a violation is alleged, the burden is on the settlement provider to demonstrate compliance.

However, we remain concerned that discounts may lead originators to steer consumers to certain settlement service providers, limiting their choices. We would therefore support additional safeguards to ensure that volume-based discounts in fact benefit the borrower.

VI. Average cost pricing is fine, but *average pricing* is not, and the actual cost charged to the consumer must be the cost disclosed on the HUD-1.

We agree with HUD that average cost pricing may benefit consumers. However, in the Proposed Rules, HUD appears to use the terms *average cost pricing* and *average pricing* interchangeably, and we do not support average pricing. In the industry, average cost pricing generally describes an arrangement between an originator and the third-party settlement service provider whereby the service provider charges the originator an average price each time the service provider performs the service for the originator. Therefore, the originator pays the same amount for each consumer, and that amount is the cost disclosed on the HUD-1. We do not object to this method.

In its proposal, however, HUD appears to attempt to allow *average pricing*, whereby the originator charges the consumer an average cost while paying the third party settlement provider a different amount for each loan applicant. We believe there is no reason that the originator should not charge the actual cost of the third party service and reflect such cost on the HUD-1, as the vast majority of all settlement costs are known at the time the HUD-1 is completed. We further believe that RESPA requires such treatment. Therefore, we recommend that HUD clarify its proposal and ensure that *average pricing* is not allowed.

We also believe that even average cost pricing is inappropriate for certain costs that are partially dependent upon loan amount, such as title insurance premiums, recording costs, and transfer taxes, since average cost pricing would disadvantage those people purchasing or refinancing less expensing homes.

VII. Without additional protections, the risks entailed by this closing script may outweigh the benefit of providing an oral explanation to the consumer at settlement.

Given the extensive damage wrought to the international economy by the failure of lenders to explain highly complex loans to consumers, a clear, oral explanation of the loan seems both obvious and crucial. We commend HUD's efforts, and we agree that the opportunity for consumers to hear an oral explanation and ask questions is more effective than being handed a stack of forms with no discussion. However, in practice, it is difficult to figure out how to require such an explanation.

First, there is the possibility that closing agents or settlement attorneys might fail to read through the closing script in a meaningful way that adds to the consumer's understanding. Second, the agent or attorney might fail to read it at all, yet the consumer might still unwittingly sign it as part of the barrage of other signatures required at closing or might be persuaded to sign it as just another "meaningless government form."[32] Third, the agent or attorney themselves might not fully read through the loan documents and therefore provide the consumer with incorrect information received from the lender. Fourth, the existence of the signature might be used in court as evidence that the consumer understood the loan, even if that is simply not the case.

If this script is to be required, we strongly recommend that it does not have a consumer signature requirement. Alternatively, the rules should clarify that the borrower's signature is not conclusive evidence that the disclosures were made.

In addition, HUD should clarify that the lender is ultimately liable for any inaccuracies in the closing script. While we believe closing agents and settlement attorneys do have a duty to understand the loan that they are closing, reality suggests that sometimes, that understanding might be less than complete. If closing agents and settlement attorneys are the sole actors liable for inaccuracies in the closing script, the lender has no incentive to ensure that the agents or attorneys fully understand the loan. Additionally, most closing agents and settlement attorneys will be thinly capitalized, and if liability rests solely with them, it is unlikely that consumers will be able to be compensated for violations of the law. Thus, we recommend the new rules establish that the lender is jointly liable along with the closing agent or settlement attorney for the proper exercise of the closing script.

Finally, if a closing script is used, it must disclose and explain the APR. It must also prominently disclose the borrower's right to rescind through language similar to that contained in the Right to Cancel Notice required by the Truth in Lending Act.

VIII. Civil penalties, injunctive relief, equitable relief, *and* a private cause of action – particularly with respect to the GFE and HUD-1 – are vital to the effectiveness of RESPA.

RESPA violations are notoriously underenforced at this time. Consequently, we are glad to see that HUD is planning to ask Congress to provide for civil penalties, injunctive relief, and equitable relief for several sections of RESPA. However, unless a private right of action is also included for all sections of RESPA, enforcement will continue to be minimal and RESPA violations will continue to be rampant throughout the industry. Given the volume of mortgage lending in this country – and the credit crunch will heal some day – there will never be enough public resources to rely solely on public enforcement.

Therefore, we recommend that Congress add a private cause of action to RESPA, especially with respect to the HUD-1 and GFE, by codifying that the violation of those provisions constitutes an unfair trade practice, as some states have done. Absent the availability of a private cause of action, relief to borrowers taken advantage of by abusive lending practices is often completely out of reach.

CONCLUSION

In conclusion, we commend HUD for addressing the challenge of reforming RESPA. We believe the proposed GFE provides several important improvements over existing requirements. At the same time, we are hopeful that HUD will take our recommendations to heart. While we remain convinced that disclosure alone cannot solve the perverse incentives pervasive in today's mortgage market, we hope that HUD will shape its disclosure requirements with the aim of alerting those whom RESPA is designed to protect to the most hazardous loan terms that have been most detrimental to homeowners, the housing market, and the overall economy.

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[1] *See* Written Testimony of Mark Zandi, Moody's Economy.com before House Subcommittee on Commercial and Administrative Law (January 28, 2008), available at: http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; *See also* Center for Responsible Lending , Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[2] *See, e.g.*, Statement of John M. Robbins, CMB, Chairman, Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, DC (May 22, 2007) (Speaking of predicted foreclosures, Mr. Robbins stated: "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy."); Julia A. Seymour, "Subprime Reporting , Networks blame lenders, not borrowers for foreclosure 'epidemic,'" Business & Media Institute (Mar. 28, 2007) ("[T]here are experts who say the subprime 'meltdown' is not the catastrophe reporters and legislators are making it out to be. 'We don't believe it will spill over into the prime market or the U.S. economy,' said [Laura] Armstrong [Vice President, Public Affairs] of the Mortgage Bankers Association.").

[3] Renae Merle, Home Foreclosures Hit Record High, Washington Post, March 6, 2008.

[4] David M. Herszenhorn and Vikas Bajaj, "Tricky Task of Offering Aid to Homeowners," The New York Times (Apr. 6, 2008) (quoting Susan M. Wachter, a real estate finance professor at the Wharton School of the University of Pennsylvania. According to Professor Wachter, "In the market that we have in front of us, prices decline and supply increases, driving prices down further.").

[5] *See* Written Testimony of Mark Zandi, Moody's Economy.com before House Subcommittee on Commercial and Administrative Law (January 28, 2008), available at: http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; *See also* Center for Responsible Lending , Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[6] Rod Dubiksky, Larry Yang, Wen Zhang and Thomas Suehr, *Foreclosure trends – a sobering reality*, Credit Suisse, Fixed Income Research (April 23, 2008).

[7] Edmund Andrews, Relief for Homeowners is Given to a Relative Few, New York Times (March 4, 2008) (loans originated in 2005 and 2006).

[8] A recent Los Angeles Times article has called into question the widespread industry claim that people are simply walking away from underwater mortgages. However, when homeowners who cannot afford their abusive loans also have no options to refinance or modify, they are ultimately pushed into defaulting. Michael Hiltzik, Walk Away Homeowners May be Urban Myth, Los Angeles Times (March 10, 2008).

[9] *See* Center for Responsible Lending, Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[10] Statement of Federal Reserve Chairman Ben Bernanke on March 4, 2008, reprinted by Bloomberg.com and available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=apeU.0IaETdM ("Bernanke statement")

[11] Robert J. Shiller, *The Scars of Losing a Home*, New York Times (May 18, 2008), noting that the homeownership rate has fallen from 69.1% in 2005 down to 67.8% in the first quarter of 2008, nearly the 67.5% rate at the beginning of 2001.

[12] Christopher Swann, *IMF Says Financial Losses May Swell to $945 Billion,* April 8, 2008, *available at* http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=aK1zAj5FZ9Io.

[13] Rick Brooks and Ruth Simon, Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market, The Wall Street Journal at A1 (Dec. 3, 2007).

[14] January 25, 2007 letter from CFAL to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3.

[15] "The Oracle Reveals All," *Newsweek* (Sept. 24, 2007) pp. 32, 33.

[16] Vikas Bajaj and Christine Haughney, Tremors At the Door -- More People with Weak Credit Are Defaulting on Mortgages," The New York Times (Fri. Jan. 26, 2007) C1, C4.

[17] "Subprime Loans Defaulting Even Before Resets," CNNMoney.com, February 20, 2008. *See also* Atif Mian and Amir Sufi, *The Consequences of Mortgage Credit Expansion: Evidence from the 2007 Mortgage Default Crisis,* NBER Working Paper 13936, http://www.nber.org/papers/w13936; and Benjamin Keys, Tanmoy Mukherjee, Amit Seru and Vidrant Vig, "Securitization and Screening: Evidence From Subprime Mortgage Backed Securities, working paper (January, 2008)

[18] Joint Report to Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act, Board of Governors of the Federal Reserve System and the Department of Housing and Urban Development (July 1998).

[19] The proposed rules were published at 73 Fed. Reg. 1672 (January 9, 2008), and the public comment period closed April 8, 2008.

[20] *Id.,* Proposed Rule 226.36(a).

[21] Many advocacy groups, CRL included, have continued to advocate for a ban on subprime yield-spread premiums, at least in situations where the yield-spread premium is not a true trade-off for closing costs. While it may be unlikely, it is theoretically possible the FRB would take such an action, which is something that would require HUD to revise the RESPA rules accordingly.

[22] Real Estate Settlement Procedures Act (RESPA): Proposed Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs, 73 Fed. Reg. 14030-124 (March 14, 2008), hereafter "Proposed Rule,"at 14043.

[23] Keith Ernst, Debbie Bocian, and Wei Li, *Steered Wrong: Brokers, Borrowers & Subprime Loans* (Center for Responsible Lending, April 2008), hereafter *"Steered Wrong."*

[24] *Id.* at 16.

[25] *Id.* at 3-4.

[26] Howell E. Jackson and Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield-spread premiums*, 12 Stan. J.L. Bus. & Fin. 289, 332 (2007); *see also* Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 Harvard J. on Legis. 123, 139 n.94 (2007) and sources cited therein.

[27] 1999 Statement of Policy, affirmed in Statement of Policy 2001-1, 66 Fed. Reg. 53052, 53055 (Oct. 18, 2001).

[28] The language we suggested in our FRB comment for ensuring a trade-off was:

> "It is an unfair and deceptive practice to make or approve a mortgage loan that includes a yield-spread premium, or to collect a yield-spread premium imposed in violation of this paragraph, unless –
>
> > (A) the mortgage broker receives no other compensation, however denominated, directly or indirectly, from the consumer, creditor, or other mortgage originator;
> > (B) the loan does not include discount points, origination points, or rate reduction points, however denominated, or any payment reduction fee, however denominated;
> > (C) the loan does not include a prepayment penalty; and
> > (D) there are no other closing costs associated with the loan, except for fees to government officials or amounts to fund escrow accounts for taxes and insurance."

[29] CRL surveyed a listserv of hundreds of foreclosure attorneys, and of the thousands of subprime loans these attorneys had reviewed, there were literally not more than two or three loans where the higher rate and/or prepayment penalty actually reduced closing costs. Rather, the consumers paid numerous upfront fees and charges – more than typical in the prime market – ALONG with having a higher rate than that for which they qualified and a prepayment penalty.

[30] In fact, one of the sales tricks reported by an Ameriquest customer to a former assistant attorney general who is now one of my colleagues was to "upsell" the loan principal by $16,000 by pointing to two charges and saying that the extra $16,000 was "crediting" back those charges. In this, it is not dissimilar to the potentially confusing disclosure of "discount points," which nearly a third of survey respondents thought meant a discount to the settlement costs, not a fee *paid* that is supposed to [though sometimes does not] purchase a rate-buydown. James M. Lacko and Janis K. Pappalardo, *Improving Consumer Mortgage Disclosures*, at 34 (Federal Trade Commission, June 2007).

[31]Negotiations cannot work to a consumers' advantage when they do not know they are in a negotiable situation: it's hard to win a game if you don't know that it is a game. After all, we rarely haggle over prices at the grocery store or Wal-Mart. In Ian Ayres classic 1991 study on negotiations in car sales, he cited a study from the Consumer Federation of America that found that 37% of Americans did not know that the sticker price of a car was negotiable, and that African- Americans were almost twice as likely to be unaware of that fact than whites (61% of blacks did not know that, as opposed to 31% of whites.) Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 Harv. L. Rev. 817, 856 (1991).

[32] Predatory loan recipients often report that upon asking questions about a document that they didn't understand, they were told that it was just "red tape that the government requires" and that they shouldn't "worry' about it.