Testimony of Rebecca Borné
Center for Responsible Lending

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"HUD's Proposed RESPA Rule"

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Chairman Watt, Ranking Member Miller, and members of the Subcommittee, thank you for holding this hearing on HUD's Proposed RESPA Rule and for inviting us to testify.[1] HUD should be commended for its proposal to reform RESPA, which represents a significant step forward. However, before finalization, HUD should address several important deficiencies in its proposal, both disclosure-related and substantive. Most critically, HUD should use its authority under RESPA to eliminate a key driver of the foreclosure crisis: abusive yield-spread premiums.

I am Policy Counsel at the Center for Responsible Lending (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. Self-Help is a relatively small lender that must comply with RESPA. While HUD's Proposed Rule should do more to protect consumers, we believe its provisions, and any recommended changes we have made to them, are administratively feasible for both larger and smaller lenders.

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 purchase homes. 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 in financing to more than 60,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the United States. Although Self-Help is technically a subprime lender, its responsible lending practices have kept 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, which we have used to provide financing to thousands of families across the country—loans that have performed well and increased these families' wealth.

Today, as the U.S. economy faces significant challenges, the need to ensure a transparent accounting of costs in real estate transactions has become clearer than ever. Right now, it is estimated that at least 20,000 foreclosures on subprime mortgages are taking place every single week.[2] The negative spillover effects from these foreclosures are substantial: a single foreclosure causes neighborhood property values to drop, collectively adding up to billions of dollars of losses. Empty homes lead to higher crime rates. Lost property tax revenue hurts cities and counties that are already strapped. Millions of Americans who depend on a robust hosing market are losing jobs and income. As foreclosures accelerate during the next two years, these economic effects will be felt even more strongly.

Confusing, misleading, and inaccurate information has played a contributory role in the current mortgage crisis, and reforms to the current disclosure requirements are long overdue. We commend the staff of HUD for its diligent work in crafting this proposal. We recognize that the home mortgage process is unique and complex and that developing a fair and reasonable method of ensuring early and accurate price disclosure is challenging. HUD has done a tremendous amount of work to develop a proposal that represents some important improvements over existing requirements—it offers a standardized shopping tool with better linkages to the HUD-1, requires that some terms be binding, and requires improved disclosures aimed at alerting borrowers to the risky features of their loans. HUD should be congratulated for this effort.

We cannot overemphasize, however, that poor disclosure has not been the driver of the foreclosure crisis. It has been only part of a broader system of skewed incentives that have encouraged mortgage originators to steer consumers into the riskiest, highest-cost loans available. Brokers could wash their hands clean of these loans 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.

Lender-paid fees to brokers, or yield-spread premiums, played an integral role in this system of skewed incentives—a role that RESPA, by its statutory language alone, should not have allowed them to play. HUD has the authority and the responsibility, as the enforcing agency of RESPA, to recognize that under certain circumstances, yield-spread premiums violate the illegal kickback provisions of §8 of RESPA. Such recognition would be consistent with the purpose of the statute: *to ensure that consumers are protected from unnecessarily high settlement charges caused by abusive practices.*[3] And such recognition would be the single most helpful change HUD could make through RESPA because it would get to the real heart of the problem: a broken market, with broken incentives, that no disclosure—no matter how clear—will repair.

We further emphasize that even within the realm of disclosure, RESPA does not represent nearly the complete picture. RESPA governs disclosure of settlement costs, while the Truth in Lending Act (TILA) governs cost of credit disclosures that provide the bottom-line price tag for the loan. Settlement costs and finance costs are interdependent, and manipulation of the relationship between the two is a common way consumers have been tricked into abusive loans. Therefore, HUD should coordinate with the Federal Reserve Board to develop a comprehensive disclosure system that allows consumers to shop based on the entire cost of the loan. Short of coordination with the Federal Reserve, HUD should nonetheless design a Good Faith Estimate (GFE) that tries to alert consumers to the risky features of their loan. HUD's proposed GFE does this more effectively than what is currently required, but as we discuss later in this testimony, it should go further.

It's also critical to understand that RESPA disclosures do little for those consumers who are not in fact shopping independently. Most victims of predatory lending did not go out shopping for loans; rather, loans were push-marketed to them by people marketing their expertise, but who were in fact promoting not a loan with the interest rate and terms the consumer qualified for, but the *most expensive* loan. The most expensive loan earned the broker the most in kickbacks from the lender—kickbacks that are allowed only because HUD has not used its authority under RESPA to ban them.

In short, RESPA disclosures are no solution to predatory lending. Whatever decisions are made with respect to the disclosures in this Proposed Rule will not prevent future predatory loans from being made. They will not fix the misaligned market incentives that created this mess.

We understand that many in industry have called for the Proposed Rule to be withdrawn. We have not joined that petition in recognition that the Rule does represent important strides forward, and, with recommended improvements, could achieve real progress with respect to disclosure. HUD should not be asked to start from square one and completely overhaul its Proposed Rule. However, we also recognize that once final rules are issued, we may not see further RESPA reform for a very long time, and, if not done correctly, this iteration may stand as a lost opportunity. To ensure that this reform is worthwhile, HUD's proposed improvements should be enhanced by addressing several critical deficiencies in the Proposed Rule:

1. Eliminate yield-spread premiums that do not offer benefits to consumers;

2. Coordinate with the Federal Reserve Board to develop a single form that complies with RESPA and TILA;

3. Request Congressional action to provide adequate enforcement mechanisms, including a private cause of action, to ensure that RESPA does what it's meant to do;

4. Require an interest rate lock to allow consumers to meaningfully compare loan costs;

5. Avoid authorizing fees for the GFE because fees will create barriers to shopping for consumers;

6. Ensure that the GFE facilitates consumers' ability to understand the riskiest features of their loans, particularly by (i) increasing emphasis on the monthly payment; (ii) requiring disclosure of the APR; (iii) requiring disclosure of the first date the interest rate can rise; (iv) and disclosing broker compensation in a simple, straightforward manner;

7. Add protections to the closing script requirements; and

8. Update RESPA's servicing rules to better protect homeowners.

I. Laying the Framework: Misaligned Incentives and Predatory Lending Have Caused This Foreclosure Crisis, Spurring a National and International Crisis As Well.

Just over a year ago, some in the mortgage industry were still insisting that the number of foreclosures would be too small to have a significant impact on the economy overall.[4] No one makes that claim today. As foreclosures reach an all-time high and are projected to grow higher,[5] the "worst case is not a recession but a housing depression."[6] At least two million American families are expected to lose their homes to foreclosures initiated over the next two years.[7] Industry projections forecast that by 2012, 1 in 8 mortgages—that's all mortgages, not just subprime mortgages—will fail.[8]

As we show in our recent report on the spillover effect of subprime foreclosures, the consequences of foreclosures are not confined to the families who lose their homes. Forty million of their neighbors will see their property values decline by over $350 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 any gains in the homeownership rate made since 2001, and the rate 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]

It's not very hard to imagine how costs could get that high. Major banks and investment firms have already collapsed, and others appear not far behind. In March, Bear Stearns, after receiving an unprecedented emergency loan from the Federal Reserve, was purchased by JP Morgan for $10 a share, its stock-market value having plummeted to $3.5 billion from over $20 billion just over a year earlier.[13] In July, IndyMac was placed into conservatorship by the FDIC, representing one of the largest bank failures in U.S. history. On September 7, Fannie Mae and Freddie Mac were placed under conservatorship by the U.S. Treasury. And as this testimony was being written, the Treasury Department and the Federal Reserve were reportedly planning to assist in a sale of the badly struggling Lehman Brothers.[14]

This pervasive crisis may not have occurred if borrowers had simply been given the type of loan that they 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."[15] 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.[16] 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.[17] 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 the sustainable loans for which consumers qualified. 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.[18]

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?"[19] Even the chief economist of the Mortgage Bankers Association, when asked why lenders made so many unsustainable loans, replied, "Because investors continued to buy the loans."[20]

In short, this crisis was primarily caused by loan originators selling unnecessarily risky loans to 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. A primary role of RESPA reform should be to make such steering less likely by providing consumers with clear and concise information that will help them better understand their mortgage options.

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 encouraged by a broken incentive structure. HUD's effective blessing of incentives that encourage steering consumers to unaffordable loans only makes the situation worse. *Only substantive reform, in addition to improved disclosures, can adequately protect consumers, curb abusive lending practices, and restore health to the market.*

II. SPECIFIC RECOMMENDATIONS

1. Eliminate yield-spread premiums that do not offer benefits to consumers.

One of the primary concerns we have with the proposed GFE is its misleading disclosure of yield-spread premiums. We discuss these concerns in section 6, below. However, the most important point we hope to convey through our testimony is this: *Yield-spread premiums are more effectively and appropriately addressed substantively under RESPA's §8 than through disclosure.*

HUD holds to the position that the option to pay some closing costs through the rate should be available, but it also states that it "should be at the consumer's choice, based upon a complete understanding of the trade-off between up-front settlement costs and the interest rate."[21] As we explain in section 6, the proposed GFE falls short of providing the information necessary for an informed choice, and it simply cannot ensure that such a trade-off exists.

HUD's policy position on YSPs rests on two key points: (1) they can be a useful option to help pay some or all closing costs through the higher rate rather than financing them in the loan or paying cash upfront;[22] however, (2) payment solely for delivering a higher-cost loan to a lender is not a compensable service.[23] Unfortunately, empirical evidence now confirms that in the subprime, Alt-A, and FHA sectors, YSPs are often in exchange for exactly that—a higher cost loan, made so by a higher interest rate, no documentation, or a prepayment penalty.[24]

The irony with respect to prepayment penalties, of course, is that the public justification for them was that they were a price-trade-off that would result in a *lower* interest rate. Few consumers would knowingly choose to simultaneously pay a "rate-increasing" YSP and a "rate-reducing" prepayment penalty. Yet the subprime market was filled with loans with prepayment penalties and YSPs.[25]

Dr. Susan Woodward's recent study of FHA loans found that, except in the instance of true "no-cost" loans, YSPs are associated with higher, not lower costs. The net loss to those who pay YSPs ranges from $93 per $100 of YSP paid for brokered loans to $71 per $100 of YSP paid for mortgage bank loans.[26] Another study, released in 2007, showed that consumers only receive 25 cents in reduced fees for every one dollar paid in YSPs to brokers and that upfront fees are actually lower for retail loans than for brokered loans.[27] CRL released a study earlier this year that dramatically demonstrated the dichotomy between the prime and subprime markets.[28] The evidence from that study (which could not isolate settlement costs) indicates that brokers in the prime market may help consumers find the cheapest deal, but that this is not the case in the subprime market. Brokered loans, when compared to direct lender loans, cost subprime borrowers additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan. Even over a fairly typical four-year loan term, the subprime consumer pays over $5,000 more for brokered loans.[29]

Among the most important—although unsurprising—findings of both the Federal Trade Commission study of homeowners' understanding of mortgage terms and Dr. Woodward's study was that consumers have more trouble understanding complex loan terms.[30] It appears as though, in working with the focus groups on the proposed GFE, HUD resolved this quandary by designing a disclosure that assumes that "all else would be equal" in weighing the trade-offs. While that certainly makes for more streamlined disclosures, it does not change the fundamental problem. It only simplifies the disclosure—not the product, not the choices, and not the economic consequences of those choices. Assuming away complexity will not result in the "complete understanding" of the trade-offs that is HUD's stated goal in its disclosure proposal regarding YSPs. In reality, it is virtually impossible to disclose a way through the minefield of multiple terms layering impacts on the rate.

Fortunately, RESPA is not solely a disclosure law. Indeed, a cornerstone of the law is the prohibition against fees for referrals or otherwise unearned fees under §8.[31] In enacting RESPA, Congress recognized that anti-competitive behavior, and unearned compensation, made the already expensive mortgage even more expensive. It adopted a combination approach—disclosure plus substantive regulations taking square aim at anti-competitive, market-distorting conduct. By simply providing strict conditions to ensure that YSPs are in fact an "alternative" way to pay costs, rather than simply a reward to brokers for delivering loans with higher costs or riskier terms, HUD would give flesh to §8's intent to prohibit anti-competitive and costly market perversions.

In other contexts, we have recommended to regulators and legislators that YSPs be categorically prohibited in the subprime and non-traditional segments of the market, since experience and evidence demonstrate that YSPs do not result in a price trade-off in those segments. To the extent RESPA encompasses authority to make such a distinction, we would similarly urge a specific rule stating that §8 bans YSPs in those segments.[32] But where allowed at all—whether just in the prime market, or in all markets if HUD does not ban YSPs in the subprime and non-traditional markets—it is necessary that HUD use the power RESPA already provides it to fix this broken system. Under existing RESPA §8 provisions, prescribing a set of specific conditions as to when YSPs are permitted is well within HUD's authority, carries out the letter and spirit of the law, will curb the abuses where they exist, will not adversely affect the portions of the market where they do not, and, finally, will assure that the promised price trade-offs actually occur. We therefore recommend that the relevant portion of 24 CFR §3500.14 be amended to read:

> A yield-spread premium, or similar charge however denominated, may be permitted as *bona fide compensation* for services actually performed only where:
>
> (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.

We note that one state, Massachusetts, recently enacted regulations which effectively prevented originators from using YSPs as a mechanism for self-rewards, although it was accomplished in a different way.[33] The reform does not appear to be restricting access to responsible credit in the state.[34] HUD should step to the forefront nationally and enact similar regulations.

We also note that the Federal Reserve Board, in its most recent amendments to Regulation Z, attempted to address YSPs through disclosure alone. It ended up withdrawing that part of its proposal after consumer testing demonstrated that consumers did not understand YSPs at all and that the proposed disclosure did not necessarily lead consumers to choose the cheapest loan. It has committed, as it continues its comprehensive review of Regulation Z, to "consider whether disclosures *or other approaches* could effectively remedy this potential unfairness [caused by YSPs]" (emphasis added).[35]

2. **Coordinate with the Federal Reserve Board to develop a single form that complies with RESPA and TILA.**

Coordination between HUD and the Federal Reserve Board to develop a single disclosure form is long overdue. While HUD disclosures relate to settlement costs and the Federal Reserve Board disclosures relate to the cost of credit, the two types of costs are inextricably intertwined. Consumers should be able to evaluate all cost factors together in order to see the whole picture and make the most informed choice possible.

The proposed GFE includes several disclosures that overlap with related, but not identical, TILA disclosures, which may be very confusing to consumers. For example, the proposed GFE includes only principal, interest, and mortgage insurance in the monthly payment disclosure, while TILA also allows creditors to include taxes and homeowners' insurance in the monthly payment disclosure. The proposed GFE includes the "initial loan balance," while the "amount financed" included in TILA disclosures will be different if, as is common, the prepaid finance charges are financed as part of the loan. The proposed GFE requires the initial note rate while TILA requires the APR. HUD plans to use its Special Information Booklet to explain differences between the GFE and TILA,[36] but consumers are unlikely to read and process all four pages of the proposed GFE, much less an accompanying booklet. The two agencies should coordinate to develop one integrated form.

3. **Request Congressional action to provide adequate enforcement mechanisms, including a private cause of action, to ensure that RESPA does what it's meant to do.**

RESPA violations are notoriously underenforced at this time. Consequently, we were glad to see that HUD plans 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 and the possibility of actual damages also exist 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, there will never be sufficient public resources to rely solely on public enforcement.

Therefore, we urge 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 consumers taken advantage of by abusive lending practices is rarely obtained.

4. **Require a longer binding period and an interest rate lock to allow consumers to meaningfully compare loan costs.**

The 10-day period HUD has proposed for which the GFE must remain binding is remarkably short. A 30-day binding period would be far more reasonable. Many consumers will not have the flexibility within a 10-day period to gather a sufficient number of loan quotes. As a result, they will find themselves paying for multiple GFEs from the same originator because their 10-day guarantee period has run out. In addition, originators should easily be able to project settlement costs at least 30 days in advance.

The most striking problem with the 10-day period is that, despite being so short, it does not apply to the interest rate, which can come with no guarantee at all. HUD absolutely must require an interest rate lock in order for the GFE to be effective. Without a rate lock, consumers must shop on settlements costs alone, which are a relatively small component of total lost. It is also easy for originators to bait and switch consumers by presenting deceivingly low settlement costs, only to recoup those costs by increasing the rate when the consumer comes back a few days later. The large majority of prime rate lenders offer a *30-day* interest rate lock, which indicates that (1) the implementation cost of a required rate lock would be minimal; and (2) a 10-day rate lock is more than feasible.

5. **Do not explicitly authorize fees for the GFE because fees will create barriers to shopping for consumers.**

An essential element of effective shopping is the ability to obtain multiple loan quotes. The cost of obtaining multiple GFEs will add up to a significant total for many consumers and will discourage consumers living on the margin from obtaining more than one quote. In addition, we are concerned that the costs of completing the HUD-1 and TILA disclosures, which are prohibited from being passed along to consumers, will be slipped through to consumers instead as a "GFE fee." Some states have recognized the negative impact nonrefundable application fees have on consumers and prohibit them by law. In the interest of consumers and their access to shopping, HUD should at least remain silent on whether GFE fees may be charged, and it should by no means endorse it.

6. **Ensure that the GFE facilitates consumers' ability to understand the riskiest features of their loans, particularly by (i) increasing emphasis on the monthly payment; (ii) requiring disclosure of the APR; (iii) requiring disclosure of the first date on which the interest rate can rise; and (iv) disclosing broker compensation in a straightforward manner.**

We commend HUD for the extensive consumer testing it performed on numerous variations of the GFE. We understand that HUD may be hesitant to make changes to its proposed GFE given that extensive testing. However, we strongly encourage HUD to consider our recommendations in light of three limitations of its testing—the first a universal limitation, the second unique to the current mortgage market, and the third specific to HUD's approach. First, individuals respond differently when they know they are being tested than when they are not being tested. For example, a test subject may read long forms while being watched, while in a real-life transaction, these forms may be rarely read. Second, many originators, especially those who do not hold on to the credit risk of their loans, have a financial incentive to encourage consumers to ignore most of the GFE. Third, HUD's testing did not consider one crucial, slippery feature of loan pricing: the relationship between settlement costs and interest rate.

(i) *The GFE should include all components of the monthly payment on page one.*

The vast majority of consumers shop for a mortgage focusing not on rates, settlement costs, or other loan features, but on the one key number that signals to them whether or not they can afford the loan: the grand total that they will have to pay each month for their home.

Unscrupulous lenders fully understand the desire to shop based on monthly payment, which explains why a primary way they sell abusive loans is to artificially deflate the monthly payment through teaser rates, discount points that don't provide a fair rate trade-off, and prepayment penalties. In addition, many lenders do not require borrowers to escrow for property taxes and insurance, which makes the monthly total appear very low in comparison to totals that include 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 because the homeowner is currently escrowing, but in reality is much more expensive.

We applaud HUD's inclusion of the initial monthly payment and the maximum monthly payment of principal, interest, and mortgage insurance on page one of the GFE. We further commend HUD for including Total Other Annual Charges (property taxes, homeowners insurance, flood insurance, homeowner association/condominium fees) in the proposed GFE. We are concerned, however, that consumers will not consider them when weighing whether or not they can afford the loan because they are buried on page four. While we understand that these costs are not relevant to comparison shopping because they are not determined by the originator, they are nonetheless vital to determining affordability. Therefore, we suggest that the additional charges total be displayed on page one, as well as the sum of additional charges and the maximum monthly payment.

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

Ideally, of course, HUD and the Federal Reserve Board should coordinate and develop a single disclosure form. Short of that, however, the APR is still the better rate to disclose on any shopping document. We understand that with its proposed GFE, HUD is attempting to allow shopping for settlement costs while holding the note rate constant, rendering the APR irrelevant. The APR is far from perfect. However, it is the one single price that captures all finance charges, whether upfront or charged over time. It also potentially reduces the deception caused by teaser rate loans because it is a composite rate, reflecting both the initial low rate and the future increased rate. As a result, it could help consumers comparison shop between a fixed rate mortgage from one lender and an adjustable rate mortgage from another.

In addition, HUD's attempt to allow shopping based on settlement costs alone while holding the note rate constant is unlikely to play out in real life. Consumers may end up with three GFEs containing three different note rates, three different monthly payments, three different amortization schedules, and three different settlement cost amounts. In this case, the only apples-to-apples comparison is the APR.

(iii) *The GFE must disclose the first possible date on which the interest rate can rise.*

In most types of 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 must disclose the first possible date on which the interest rate could rise, both to warn consumers 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.

(iv) *Broker compensation should be disclosed in a simple and straightforward manner.*

In Section 1 above, we discuss the broader skewed incentives created by YSPs and explain why we believe they are illegal kickbacks in certain contexts. Apart from the need for substantive reform, the disclosure is misleading and must be replaced with a simpler disclosure even if substantive reforms are not made.

We appreciate HUD's effort to try to make the disclosure of broker fees more transparent. YSPs, and rate/point trade-offs in general, are so complex that disclosing them clearly is very difficult. We understand that one aim of HUD's disclosure was to avoid disadvantaging brokers relative to lenders. However, incentives driving the way brokers price loans are not equal to those driving lenders, so HUD's desire to treat the origination fees paid to each the same is not justified.[37] Moreover, as noted earlier, empirical evidence suggested brokered loans in the subprime market cost consumers significantly more than direct lender loans.[38]

There are several problems with the proposed disclosure. First and foremost, it *presumes* a trade-off for the consumer through a reduction in upfront costs, although the evidence is that such a presumption is not warranted. We understand that HUD believes that the "Looking at trade-offs" table on page three provides protections for consumers. However, it only ensures a fair trade-off in an environment of fixed and transparent pricing, which is not the reality of the subprime market. Consumers don't see originators' rate sheets. Originators could easily inflate the base rate and fill out the entire table, making it appear that the consumer is getting a fair-trade off—when in fact the same incentives are driving the same abusive practices and the consumer is still paying a higher interest rate than he or she qualifies for.[39]

Second, the disclosure's characterization of the YSP as a "credit" suggests that this arrangement is somehow saving the customer money, when it is in fact doing just the opposite. This nomenclature could even end up advantaging brokers over lenders, while seriously misleading prospective homebuyers.

Third, the disclosure in no way makes clear that this is a fee paid to a broker. It never uses the word "broker" and tells the consumer nothing about the dynamic at play among the broker, the lender, and the consumer's loan costs. There would be some value derived from the sheer "sticker shock" that occurs when a consumer realizes how much the total broker fee is in an abusive loan.

We recommended that the following more simple, straightforward, and honest disclosure replace number 2 on the top of page two. This disclosure breaks out the portion of the broker fee paid directly by the consumer and the portion paid by the lender and recouped from the consumer through a higher interest rate:

MORTGAGE BROKER COMPENSATION	
Mortgage Broker Fees paid by you directly (included in settlement charges):	$
+ additional fee received by broker from lender and paid by you through increased loan interest rate:	$
Total Broker Fees:	**$**

7. Add protections to the closing script.

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

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."[40] (In fact, this almost assuredly will happen frequently, as hurried closings are often part of a strategy for pushing unsuitable loans.[41]) 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 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 consumer's signature is not conclusive evidence that the disclosures were made. In addition, the script must disclose and explain the APR as the price which includes both interest and fees. It must also prominently disclose the consumer's three-day right to rescind for non-purchase money mortgage transactions.

Finally, HUD should clarify that the consumer has the right to rely on the accuracy of the closing script and that the lender is jointly liable for any inaccuracies in it.

8. Update RESPA's servicing rules.

The current foreclosure crisis has made clear the critical role servicers play once loans become delinquent. Often it has been the servicer that ultimately determines whether or not a consumer ends up with an affordable loan modification. RESPA's servicing rules should be updated (i) to require that servicers engage in reasonable loss mitigation prior to foreclosure; (ii) to prohibit broad release language in modifications or forbearance agreements that cuts off borrower's past and future claims against the servicer or holder; and (iii) to shorten the period of time a servicer has to respond to a borrower's Qualified Written Request from 60 days to 14 calendar days. For further discussion of these requirements, see the National Consumer Law Center's Comments on the Proposed Rule.[42]

We note that improved servicing protections are incorporated in H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, introduced by Chairwoman Waters, which we have endorsed.

CONCLUSION

In conclusion, we applaud HUD for addressing the challenge of reforming RESPA. We believe HUD's proposed GFE provides important improvements over existing requirements, but we do not think it should be finalized without incorporating our suggested changes aimed at alerting consumers to the riskiest features of their loan, particularly with respect to the broker compensation disclosure.

In addition, we remain convinced that there are some financial incentives so strong and so skewed that they create problems disclosures cannot fix. In fact, these incentives undermine most of what HUD hopes to accomplish through this Proposed Rule. We know that HUD shares our commitment to protect consumers, as recently conveyed by RESPA Director Ivy Jackson: "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."[43] As noted earlier, lack of clarity is not due to poor disclosure as much as it is due to complex loan terms driven by warped incentives that encourage minimal transparency in the mortgage market. This minimal transparency cannot be overcome even by the clearest of disclosures. We hope that HUD will make the substantive reform needed to correct this broken market and give consumers the clarity they deserve.

We look forward to continuing to work with HUD in its efforts. We appreciate the Subcommittee's interest in RESPA reform, and we are happy to answer any questions.

[1] 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").

[2] *See* Written Testimony of Mark Zandi, Moody's Economy.com, before House Subcommittee on Commercial and Administrative Law (Jan. 29, 2008), *available at* http://judiciary.house.gov/hearings/pdf/Zandi080129.pdf (hereafter "Zandi Testimony"); *see also* Center for Responsible Lending, *Subprime Spillover* (Rev. Jan. 18, 2008), *available at* http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html (hereafter "*Subprime Spillover*").

[3] 12 C.F.R. §2601 (emphasis added).

[4] *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").

[5] Renae Merle, *Home Foreclosures Hit Record High*, Washington Post (Mar. 6, 2008).

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

[7] *See* Zandi Testimony, *supra* note 2; *Subprime Spillover*, *supra* note 2.

[8] Rod Dubitsky, Larry Yang, Wen Zhang and Thomas Suehr, *Foreclosure Trends – A Sobering Reality*, Credit Suisse, Fixed Income Research (Apr. 28, 2008).

[9] See Center for Responsible Lending, The Impact of Court-Supervised Modifications on Subprime Foreclosures, (Feb. 25, 2008), *available at* http://www.responsiblelending.org/pdfs/us-info-with-fc-starts.pdf; for CRL's methodology for computing spillover, *see Subprime Spillover*, *supra* note 2.

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

[11] Robert J. Schiller, *The Scars of Losing a Home*, N.Y. Times (May 18, 2008) (noting that the homeownership rate has fallen from 69.1% in 2005 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,* Bloomberg.com (Apr. 8, 2008), *available at* http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=aK1zAj5FZ9Io.

[13] Robin Sidel, Dennis K. Berman, and Kate Kelly, *J.P. Morgan Buys Bear in Fire Sale*, Wall Street Journal (Mar. 17, 2008).

[14] David Cho and Heather Landy, U.S. Government Assisting in Sale of Lehman Brothers, Washington Post online (Sept. 11, 2008) *available at* http://www.washingtonpost.com/wp-dyn/content/article/2008/09/11/AR2008091102580.html?referrer=email.

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

[16] Letter from Coalition for Fair & Affordable Lending to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (Jan. 25, 2007) at 3.

[17] *See*, *e.g.*, Glenn R. Simpson and James R. Hagerty, *Countrywide Loss Focuses Attention on Underwriting*, Wall Street Journal (Apr. 30, 2008).

[18] John Meacham and Daniel Gross, *The Oracle Reveals All*, Newsweek 32, 33 (Sept. 24, 2007).

[19] Vikas Bajaj and Christine Haughney, *Tremors at the Door – More People with Weak Credit Are Defaulting on Mortgages*, N.Y. Times at C1, C4 (Jan. 26, 2007).

[20] *Subprime Loans Defaulting Even Before Resets*, CNNMoney.com (Feb. 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; Benjamin Keys, Tanmoy Mukherjee, Amit Seru and Vidrant Vig, *Securitization and Screening: Evidence From Subprime Mortgage Backed Securities*, working paper (Jan. 2008).

[21] 73 Fed. Reg. at 14041.

[22] *Id.*

[23] Statement of Policy 2001-1, 66 Fed. Reg. 53052, 53055 (Oct. 18, 2001) (Department affirms the 1999 Statement of Policy that "simply delivering a loan with a higher interest rate is not a compensable service.").

[24] The link is explained in greater detail in our comments to the Federal Reserve Board's recent proposed Regulation Z rules under HOEPA. Comments of the Center for Responsible Lending on Proposed Rules Regarding Unfair, Deceptive, Abusive Lending and Servicing Practices pursuant to the Home Ownership and Equity Protection Act (Docket No. R-1305) (April 8, 2008) (hereafter "CRL HOEPA Comment").

[25] Fully two-thirds (66.6%) of the subprime MBS market share for 2007 included prepayment penalties, down only slightly from 69.1% in 2006. Inside B&C Lending, p. 3 (Feb. 15, 2008). Even as overall subprime originations plummeted since August 2007, 47% of asset-backed securities issuances of 4Q07 included payment penalties. Inside B&C Lending, p. 3 (Feb. 15, 2008); Inside B&C Lending, p. 2 (Jan. 18, 2008).

[26] A Study of Closing Costs for FHA Mortgages, Prepared for U.S. Department of Housing and Urban Development, Office of Policy Development and Research, Prepared by Susan E. Woodward, Urban Institute at x (May 2008). In her report, Dr. Woodward cites one study which concludes that brokered loans were not more costly than retail loans. *Id.* at 15. However, the study does so based on a database of subprime loans made from 1995 to 2002, contributed by ten subprime lenders, *see* Amany El Anshasy, Gregory Elliehausen, and Yoshiaki Shimazaki, *Mortgage Brokers and the Subprime Mortgage Market,* at 7 (May 2004). The contributors are not identified, other than by membership in a particular trade association, and we are concerned that the data from a self-selected and limited group of originators may create some selection bias, making it an unsuitable database, or at least one which must be treated with great caution. We note that three major originators with dominant market shares over that six-year period (and who were members of that trade association during some or all of that period) were the subject of law enforcement actions, Household, Associates and Ameriquest. *These actions resulted collectively in over $1 billion in penalties and restitution.* Additionally, at least two other major lenders during the early years of that period utilized a similar business model to two of the law enforcement targets but collapsed in bankruptcy. If this study is to be considered in any regulatory decision, we urge that, at a minimum, HUD consult with regulators familiar with the business models and practices in which these lenders engaged during the period, to determine whether the illegal practices might have affected outcomes reflected in loans in that database, making the data unreliable for some purposes.

[27] 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.

[28] *Steered Wrong, supra* note 2.

[29] *Id.* That extra money, of course, is paid by the consumers in those subprime loans who could have—*should* have—been in the lower cost prime loans, and, but for the perverse incentives making those loans better for the middlemen, might have been.

[30] James K. Lacko & Janis K. Pappalardo, *Improving Consumer Mortgage Disclosures* at 74-76(Federal Trade Commission, Bureau of Economics Staff Report, June 2007). *See also* Ren S. Essene and William Apgar, "Understanding Mortgage Market Behavior: Creating Good Mortgage Options for All Americans," Joint Center for Housing Studies. Harvard University (2007).

[31] 12 U.S.C. 2607(a), (c)(2).

[32] Our comments to the FRB on its proposed HOEPA UDAP rules had offered specific definitions of subprime or higher-cost loans and "non-traditional loans" which HUD might adopt, or it might adopt the definition of "higher-cost loan" from the recently promulgated Fed HOEPA UDAP rules. *See* Comments of the Center for Responsible Lending on Proposed Rules Regarding Unfair, Deceptive, Abusive Lending and Servicing Practices pursuant to the Home Ownership and Equity Protection Act (Docket No. R-1305) (April 8, 2008); Federal Reserve System, 12 CFR Part 226, Truth in Lending; Final Rule (July 30, 2008), 73 Fed. Reg. 44522, 44533.

[33] Commonwealth of Massachusetts Attorney General's Regulations, 940 MA ADC 8.06(17), Mortgage Brokers and Mortgage Lenders – Prohibited Practices.

[34] This regulation precludes brokers from accepting compensation where there is a conflict of interest—functionally a ban on YSPs as the regulations define that conflict. Shortly after implementation, Wells Fargo changed its broker compensation system from "a sliding fee based on loan's profitability to a flat 1.5% of the loan amount." Binyamin Appelbaum, *Most Lenders Accept Tough New Mortgage Rules in Mass*, Boston Globe, (Jan. 10, 2008). The Massachusetts rule appears to be working to eliminate the perverse market incentives that have grown up around this practice.

[35] 73 Fed. Reg. 44565.

[36] 73 Fed. 14037.

[37] 73 Fed. Reg. at 14043.

[38] *See*, *generally*, *Steered Wrong*, *supra* note 2.

[39] Indeed, that practice is sadly common in the auto sales world, where a buyer loses the value of a down payment or a trade-in "credit" by the seller's simple act of raising the price of the car and add-ons to "swallow the down" or "swallow the trade." As with mortgage transactions, the more pieces at play in the pricing game, the harder it is for the consumer to keep track of them all.

[40] 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."

[41] Some predatory lenders—retail as well as brokers—made a practice of strategically scheduling closings shortly before closing time, or at times or places otherwise designed to discourage questions or a careful review of documents.

[42] National Consumer Law Center, Comments on RESPA, Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers, Department of Housing and Urban Development, 24 CFR Parts 203 and 3500, Docket Number FR-5180-P-01 (June 2008) at 42-43.

[43] 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, May 22, 2008.