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on behalf of

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before the

Committee on Small Business

U.S. House of Representatives

Hearing on

"Real Estate Settlement Procedures Act Regulations: Working Behind Closed Doors to Hurt Small Businesses and Consumers"

January 6, 2004

Good morning Mr. Chairman and members of the Committee. My name is Regina Lowrie, and I am President and CEO of Gateway Funding Diversified Mortgage Services, in Fort Washington, Pennsylvania. Today, I appear before you as Vice-chairwoman of the Mortgage Bankers Association (MBA).[1] MBA's membership consists of approximately 2,700 companies, and includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field.

I commend the Chairman's leadership in calling for hearings on the very crucial matter of the pending HUD regulations aimed at simplifying Regulation X, the rules which implement the Real Estate Settlement Procedures Act (RESPA). I also commend the Chairman for focusing on the concerns of small business entities. MBA shares those concerns. A major portion of our membership is composed of small business entities—both brokers and lenders—and we care deeply about the effects of this rulemaking on their operations and activities, as well as on consumers.

I'll start by summarizing MBA's views on this subject. MBA supports reforming the laws that govern mortgage lending in order to give consumers and our members a simpler and more straight-forward process. We urge, however, that reforms be done correctly, through improvements that are both workable and efficient in their application. In the undertaking to simplify the law, it is critical that we not lose sight of the consumer and that we ensure that any new regulatory system retain strong protections for mortgage shoppers and stimulate consumer choice and market competition. We can achieve all these objectives simultaneously, but only through a very careful balancing of interests. As proposed, the rule did not achieve this balance. Nor do we believe that HUD has

[1] MBA is the premier trade association representing the real estate finance industry. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership prospects through increased affordability, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate professionals through a wide range of educational programs and technical publications.

come up with the solutions necessary to address the panoply of implications that emerged from the far-reaching proposed rules.

For this reason, MBA reiterates its request to HUD to re-propose this rule. MBA believes that re-proposing the rule is the only step that will allow policy-makers carefully to balance all interests and enhance the quality of the final regulations. Further consideration of the rule's contents will also allow us to ensure that these amendments are not needlessly challenged by endless litigation.

MBA's Commitment

Mr. Chairman, I'll begin by reminding the Committee that the United States has the world's most efficient and inexpensive system for delivering mortgage capital to consumers. MBA has always believed, however, that we can improve on this system, and that we can create a disclosure process with better and more reliable consumer information that enables borrowers to truly shop for the best mortgage. For several years, our Association has been the most ardent and consistent proponent of reforming the mortgage process and simplifying consumer disclosures. Our efforts extend all the way back to 1997, when we led the industry in assembling groups of experts from all segments of the industry through the "Mortgage Reform Working Group," and engaged in crafting simplification plans acceptable to all interested parties. Even when the Mortgage Reform Working Group failed to reach consensus on certain difficult points, MBA persisted in its efforts to construct an improved disclosure system, and continued to advocate for realistic legislative reforms through meetings and negotiations with federal government representatives and consumer groups interested in mortgage simplification.

Our tireless efforts in this arena demonstrate our sincere commitment to the goal of "simplification." Our current appeal to HUD to re-propose rule is based on this commitment and on our deep understanding of the complexities and pitfalls of this endeavor. MBA's unwavering dedication to achieving meaningful mortgage reform has

strengthened our resolve to ensure that the final outcome is a clear step forward in a process that affects the opportunity for all Americans to become homeowners.

HUD's Reform Regulation

Consistent with our track record as advocates for reform, MBA voiced support for HUD Secretary Martinez's initiative to reform RESPA in July 2002. MBA welcomed the proposal as the initiation of a process that would re-engage all interested industry and consumer groups to discuss, in earnest, the modernization of the outdated RESPA rules. In preparing for those comments, MBA took unprecedented steps in getting the message of the proposed rule out to its members, and expended countless hours in collecting member views and researching, analyzing and developing the critiques and recommendations contained in the comments.

In the end, MBA submitted 60 pages of recommendations and edits on HUD's proposal. It is important to realize that mortgage lenders are the entities that are most directly affected by the disclosure requirements and penalty provisions of the RESPA statute, and, therefore, bear the most direct impact in this rulemaking. The comments submitted by MBA are based entirely on the operational experiences of mortgage lenders and they convey very fundamental market realities that are based on everyday business operations.

Comments to HUD's Reform Proposal

We believe that there is a special urgency to ensuring that the MBA comments are effectively incorporated into any final rule. Put simply, our members *are* the mortgage lending process. If they say something won't work, then it won't work. Making the changes and rectifications recommended by MBA will ensure the very viability of the new regulatory system. Some of the more important concerns relating to the proposed rule, and expressed in MBA's October 2002 comments, are as follows—

Interest Rate Guarantee: HUD is proposing radically to alter how consumers shop for credit by pressing mortgage creditors to offer firm interest rate disclosures when consumers apply for a "packaged" loan. In our comments, we warn HUD that it is tremendously risky to offer consumers solid interest rate guarantees only three days after they apply for a loan, or to offer solid commitments on interest rate "indices" based on the unclear provisions set forth in the proposed rule. The unpredictable nature of interest rate fluctuations will impose significant market risks on lenders. This increased market risk will, in turn, increase costs in any guarantee offered by lenders—costs that will be passed on to consumers through considerable premiums on the interest quote offered. Alternatively, lenders may decide to quote consumers a higher interest rate to ensure that they can "cover" any unexpected market shifts. Under either scenario, the result is increased costs for consumers. This is utterly contrary to the very purpose of the provision.

In its comments, MBA also highlighted that creating legally-binding 30-day offers, *en masse*, to the general public leads to such massive risks for lenders and the mortgage industry that public policy would dictate against engaging in such activities. Simply stated, without more clarity and specification, it is entirely unrealistic to expect lenders to bear the uncontrollable risks of interest rate fluctuations in the market.[2]

Changes to the Good Faith Estimate: HUD's sweeping changes to the current good faith estimate (GFE) system will bring about significant operational risks and will greatly increase legal uncertainties for lenders. Specifically, the proposed imposition of strict "tolerance levels" on lenders for settlement fees is risky and fundamentally unfair, as lenders neither set nor control the fees charged by third-party settlement servicers. Moreover, many fees are subject to variances based on consumer needs and preferences; such needs and preferences are not known or understood three days after application.

[2] In January 2003, MBA crafted a report containing recommendations to HUD on how to construct a system of consumer protections against improper manipulation of interest rate quotes by lenders. This report—entitled "RESPA Interest Rate Working Group Report"—contains very specific elements that MBA believes *must* be part of any interest rate provision in a final rule.

We note that by amending the upfront GFE disclosures, HUD is imposing changes to every other major disclosure required by RESPA. The regulations mandate that the GFE form list items in a way that corresponds to the listings of the HUD-1 Settlement Statement. Since the proposed rule completely reconfigures the GFE form, this means that the HUD-1 form may require alterations and edits. And, since HUD is proposing to alter the order and the rules that attach to the GFE disclosures, then HUD will also have to re-write RESPA's "Special Information Booklet" to ensure that consumers remain well informed of the new rules and disclosures that apply to mortgage transactions.

There is no doubt that the proposed RESPA reform regulations will force every single lender and broker in America, in one single swoop, to completely revamp their entire upfront disclosure systems—lock, stock, and barrel.

Changes to Definition of "Application": HUD proposes to replace the definition of the term "Application" under existing regulations with an ambiguous new standard. This definitional change is extremely significant because the full panoply of statutory requirements imposed under RESPA's strictures (and indeed the requirements of other statutes, such as the Truth in Lending Act and Home Mortgage Disclosure Act) are triggered by the technical details of whether a consumer's inquiry rises to the level of an "application," as defined by the RESPA regulations. Replacing the time-tested definition of "application" with an unclear standard will considerably disrupt mortgage lending operations nationwide.

Conflicts With State Laws: The implementation of the revised GFE form and the Guaranteed Mortgage Package (GMP), as proposed, will result in violations of—or at least conflicts with—the laws that currently exist in a *majority* of states. In many cases, there could be multiple conflicts within one single state. Without some relief from state restrictions, it will be impossible to achieve a uniform implementation of the GMP provisions of the proposed rule. We note that the patchwork of state provisions works

against the general thrust of capital market efficiency, which results in lower costs in the mortgage market.

Conflicts With Federal Laws: There are various elements in the proposed rule that intersect with elements covered by other federal laws, particularly the Truth in Lending Act (TILA). In some instances, HUD explicitly imports provisions of TILA into the new requirements advanced by the proposed rule. This overlapping of requirements is extremely confusing, and sometimes poses irreconcilable differences with HUD's proposed regulations. The confusion created by the overlay of the new rules on the veritable maze of existing rules and requirements that apply to mortgage lending operations will prevent scores of lenders from fully engaging in "packaging" activities. Moreover, the repercussions that flow from running afoul of any of these regulations, and indeed, the risks to reputation that loom in instances of even minor violations, will act to severely restrict the number of entities willing to participate in "packaging," and will therefore diminish the vigorous competitive effects of this regulatory experiment.

Concerns Stemming From Elements Outside the Proposed Rule

MBA members have even more profound concerns with a crucial issue that arises outside of the proposed rule's written provisions. In the Economic Analysis to the proposed rule, HUD states that "lenders, real estate brokers, appraisers, settlement agents, or literally anyone else may form the package and may be eligible for the safe harbor for which it qualifies." The Economic Analysis goes on to state that "[o]riginators could develop their own packages or specialized firms could develop packages or components of packages, which they would then sell to the originator." Then, in a statement that has no explicit support from the language of the proposed rule itself, the Economic Analysis further explains that "sub-packages may be formed and sold to full-fledged packagers" and that "[t]his is permissible since the sub-packager is within the package."

The broad language of the Economic Analysis creates alarming "loop-holes" that allow unscrupulous players to use the protections of the GMP to collect improper "kick-backs" and referral fees. There are three possibilities for abuse. First, if entities are allowed to "sub-package," consumers could be "pre-sold" on a package that contains either inferior services or above-market profit margins. In this scenario, the lender receiving the referral would be obligated to accept the services of the "sub-package" and refrain from making any competitive counter-offers for fear of losing future business referrals. Second, the "sub-packager," having already captured a customer, could improperly steer that customer to the lender that promises to pay the highest referral fee. If the lender uses the services, the "steering" sub-packager would fall within the exemption of the full "package," and the otherwise illegal referral fee would be legal. Third, a dishonest party that refers business to a lender or other service provider could blatantly demand referral payments from the lender and then "cleanse" that payment by performing sham services (or no services at all), allegedly within the rubric of the "package." Under this scenario, the referral payment would be legalized, as fees paid within the package are exempt, and the dishonest player could penetrate the "package" without culpability because there is no requirement regarding minimal levels of services that must be performed to be part of that "package."

We note here that MBA does not disagree with the "safe harbor" approach taken by HUD in its proposal. We are concerned, however, that HUD must delineate that "safe harbor" more carefully, or risk a return to pre-1974 conditions where rampant "kick-backs" and referral fees served unnaturally, and needlessly, to inflate settlement costs. Unless carefully crafted, the "sub packaging" provisions described by HUD could lead to the disguising of referral fee payments, "sham" arrangements, and a host of other market distortions. To this end, HUD must address the "sub-packaging" descriptions and other ambiguous language contained in the Economic Analysis, as this language raises the specter of legalizing naked referral fee payments without any countervailing benefits for consumers.

<u>Concerns Regarding Judicial Challenges</u>

This rulemaking has a number of statutory problems that are not easily resolved, as they stem from fundamental questions about HUD's basic authority to administer the RESPA statute.

First, there is substantial agreement within the legal community that HUD lacks the requisite authority to enact a system of tolerances under RESPA's GFE provisions. Legislative history clarifies that the GFE disclosure is meant to provide consumers with an early set of cost disclosures that the consumer can use as a general guide to engage in further shopping and comparisons of individual settlement service providers. Congress never intended that the GFE form be regarded as a solid pledge or assurance from the lender to the consumer regarding third party settlement fees. Nor did Congress intend that RESPA's GFE provisions be used as a legal tool to *rescind* the mortgage transaction in instances where the estimated fees turn out to be inaccurate. To the contrary, by explicit Congressional design, nothing in RESPA's GFE provisions mandates precise accuracy in the initial three-day disclosures, particularly for those fees under the control of third parties. We believe, therefore, that by proposing strict cost tolerances and by proposing rescission-type remedies for consumers when such tolerances are unmet, HUD is inventing and implanting consumer protection provisions that Congress specifically intended to exclude. In short, HUD is clearly overstepping its regulatory authority.

HUD further overextends its authority by proposing to prohibit lenders from compensating mortgage brokers for services that they legitimately perform in the transaction. In the proposed rule, HUD proposes the elimination of so-called "yield spread premium" payments, replacing it with a requirement that any payment due from lenders to mortgage brokers (for services performed in the transaction) must be characterized as fees credited from the lender to the consumer and tendered to the broker. This proposed amendment is not only incredibly troublesome for purposes of brokered transactions, but it is also directly contrary to the plain statutory language

contained in Section 8(c) of RESPA that specifically allows for the payment of services actually performed and goods or facilities actually rendered.

Finally, MBA believes that serious statutory questions would surface should HUD decide to finalize a rule containing "dual packaging" options. The statutory doubts arise under two independent bases. First, as compared with the "single package" system proposed by HUD, the "dual packaging" system gives rise to unique competitive dynamics and completely different economic burdens on affected members. In addition, "dual packaging" is a system that would require a distinct set of regulatory requirements as it imposes new disclosure duties on entities that have no burdens under the existing regulatory regime. The novelty of this proposal, and the fact that HUD's thinking has evolved beyond the original proposed rule, mandates that HUD re-issue another proposed rule, and that it prepare another economic analysis, that fully explain how it seeks to structure this new option. Second, and perhaps more fundamentally, since the RESPA statute assigns the pertinent disclosure responsibilities to "lenders," it is uncertain that HUD even possesses the necessary authority to shift and re-define the statute's disclosure rules on entities other than lenders.

This brief and summarized explication should suffice to give the Department additional grounds for pause. There are serious legal problems and foundational doubts inherent in the reform proposals as proposed. We fear that, without deeper analysis and wider consultation regarding the new provisions, HUD's reform rules will be encumbered by multiple legal proceedings.

Conclusions

Mortgage reform promises to bring significant benefits to consumers and the real estate finance industry alike. However, if not done correctly, it should not be done at all, as it will "deform" rather than "reform" the mortgage process. The nature and extent of the changes proposed by HUD require that all segments of the industry and consumers be

granted a full opportunity to review HUD's latest reform plans through the issuance of another proposed rule.

No one will benefit by having a final rule that is unworkable and counter to efficient lending operations. No one benefits by the enactment of a law that hampers robust competition in the marketplace. No one will win by finalizing a rule containing overly broad exemptions that inadvertently strip consumer protections and allow for the masking of blatant referral fee payments. No one will gain from the enactment of legally ambiguous provisions that can be easily challenged and litigated into uncertain interpretive results. In the end, we will all lose by prematurely finalizing a rule that will alter, in entirely uncertain ways, the operations of an industry that has been, and continues to be, the strongest pillar sustaining our nation's economic health.

Mr. Chairman, the stakes are simply too high. We urge that this Committee join our call to convince HUD to re-propose the RESPA reform rules so that we can ensure a robust discussion and meaningful dialogue that allow for the maximum input from consumers and industry. We ask that you help us in convincing HUD that this rulemaking must be done right if it is to be done at all.