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Referendum on RESPA REFORM

AFTER YEARS OF INDUSTRY DEBATE, REGULATORY STUDIES AND, MOST significantly, changes in leadership at the Department of Housing and Urban Development (HUD), the push for mortgage reform crossed a colossal hurdle in July 2002. That's when HUD Secretary Mel Martinez published the much-anticipated and long-awaited proposed amendments affecting the Real Estate Settlement Procedures Act of 1974 (RESPA).

HUD's proposed rule on the Real Estate Settlement Procedures Act (RESPA) sparked 40,000 comment letters. Here's a look at what some said.

Industry and consumer groups alike have worked for years on RESPA reform, arguing variously that the current regulatory structure is overly complex and confusing, hinders competition or is itself an obstacle to effective consumer shopping. In years past, dozens of industry trade associations and consumer advocates even formed working groups (e.g., the Mortgage Reform Working Group) in an attempt to hash out compromise provisions on RESPA reform—all to no avail.

By Joseph M. Kolar and Nikita M. Pastor

Martinez, like a master chef, has whipped up a new casserole with this proposal, one whose breadth surpassed the predictions of virtually every observer. Now that the recipe for RESPA reform has been released, everyone is seeking to add or subtract ingredients to the dish to make it more palatable (or to avoid too much heartburn) at the table.

The newly proposed RESPA rule is a substantial and complex 93-page document whose goal is to lower costs and improve the mortgage shopping process for consumers by fostering competition through three key features. First, the proposed rule provides a crucial safe haven from Section 8's antikickback and unearned-fee provisions, for those who offer consumers guaranteed mortgage packages (GMP). Second, the proposed rule attempts to inject teeth into the good-faith estimate (GFE) by imposing tolerance levels on categories of costs. Third, outside the GMP context, the rule recharacterizes lender-paid mortgage broker compensation, including yield-spread premiums (YSPs), as a credit to the borrower who uses it to pay all broker charges directly.

Comments on the proposed rule were due by Oct. 28, 2002, and approximately 40,000 comments were submitted, with virtually all the industry trade associations and consumer groups submitting their recommendations. What follows is a brief discussion of some of the principal reactions of some of the major industry and consumer groups to HUD's proposed rule. Emphasis here is on *some*. A comprehensive survey is beyond the scope of this article.

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Of particular interest, however, are different versions or alternatives (replacement menus) proffered by certain trade groups in response to the proposed rule. A glimpse into the future follows at the end. Will this casserole really be served this year? And how long will we have to digest it?

The GMP: Most lenders support, with caveats

The GMP, with its attendant safe harbor exemption, is at the core of HUD's proposed RESPA reform rule. Many lending industry trade groups, including the Mortgage Bankers Association of America (MBA), the Consumer Mortgage Coalition (CMC), the American Financial Services Association (AFSA), the National Home Equity Mortgage Association (NHEMA) and most of the bank trade associations such as the American Bankers Association (ABA), the Consumer Bankers Association (CBA) and America's Community Bankers (ACB), expressed support or qualified support for the GMP concept.

The ABA, however, strongly urged HUD, after reviewing all the comments, to repropose the rule for additional consideration with the goal of achieving a more broad-based consensus that will make the reform effort more likely to succeed.

MBA commented that it has openly supported the packaging concept for several years. "Packaging simplifies the process for both the applicant and the lender. It also encourages market competition that benefits consumers," the MBA stated.

The Federal Trade Commission (FTC), in a significant comment, noted that mortgage packages can simplify the shopping process and reduce borrowers' search costs, and should lead to greater efficiency in the production of settlement services. The FTC also stated that "the safe harbor exemption is important," and that "packaging, rather than a ban on referral fees, is a better solution to the potential problem of loan originators accepting kickbacks from overpriced settlement service providers."

There were strong caveats to the lender associations' general support, however, and many significant structural changes were recommended as necessary. For example, many were opposed to the inclusion of an interest rate guarantee in the GMP, and articulated serious concern over HUD's move to incorporate Truth in Lending Act (TILA) disclosures into the GMP agreement (GMPA).

Interest rate guarantee component

Many GMP supporters say the final rule should not include an interest rate guarantee component, for two principal reasons. First, to characterize the interest rate offer as a guarantee is misleading to consumers because, under the proposal, the interest rate remains subject to final underwriting and is only a conditional rate. Second, an interest rate guarantee would be unworkable because offering multiple guaranteed interest rates to thousands of consumers simultaneously would significantly raise costs. Cost increases would make the GMP product much less cost-effective and less likely to be offered at all.

The inclusion of an interest rate guarantee for all GMP applicants, if pushed too far, will have a "resounding negative effect on mortgage delivery mechanisms, with the result that the GMP [will] become a regulatory experiment that is dead on arrival," CMC commented. The group suggested HUD should keep the proposed rule focused on those costs that are least understood and most subject to problems—the settlement costs of the loan. Still, if HUD insists on retaining the interest rate feature of the GMP, CMC and CBA, among others, suggested that HUD at least properly depict the interest rate as a "conditional interest rate" that remains subject to final underwriting, or, in the alternative (as stated by MBA), not implement the feature right away, leaving it to further study and analysis.

Many of the lender associations also expressed concern over the viability of tying floating interest rates to an observable and verifiable index. The Independent Community Bankers of America (ICBA), which opposed the GMP concept generally, objected particularly to HUD's indexing proposal and stated

that even the alternative of posting rates continuously on a Web site would be cost-prohibitive for community banks.

MBA is currently studying whether there is a feasible approach to the interest rate disclosure portion of HUD's proposal. To this end, MBA has gathered a team of capital market experts charged with finding workable solutions to the challenge of providing consumers with the interest rate protections suggested by HUD. MBA has pledged to work with HUD on this issue, and will make its findings available as they advance on this process.

TILA disclosures

In addition to simplifying the GMP to a guarantee of settlement costs, many of the lender commenters noted that, until TILA and RESPA are fully harmonized, HUD should refrain from importing TILA disclosures into the GMPA. The principal concern expressed was that incorporation of TILA loan terms into RESPA disclosures would be inconsistent and redundant, as well as confusing for consumers.

Certain of these groups (CMC, AFSA and NHEMA) suggested that the GMPA should include only those terms that identify the basic features of the loan (i.e., the loan does or does not contain a prepayment penalty, constitute an adjustable-rate mortgage [ARM] or contain a scheduled balloon payment). MBA and the ABA questioned HUD's authority to incorporate any TILA loan terms within its disclosures; the ABA stated that disclosure of loan terms is not within the purview of RESPA, which is meant to cover settlement costs.

The Federal Reserve Board, which took no position on the packaging concept, suggested that "creditors should be encouraged to combine their RESPA and TILA disclosures on a single form" so as to avoid duplication and redundancy. Still, the Board firmly stated that HUD should give deference to the Board's interpretation of TILA's disclosure requirements. The Board also urged HUD to consider the impact of federal anti-tying rules on the ability of banks to offer GMPs.

Scope of safe harbor and cure provision

Many who favor the GMP want the safe harbor exemption to provide for a cure provision to avoid needless and costly litigation. These groups felt that technical violations of the GMP requirements occurring during the regular course of business should not cause automatic loss of the safe harbor exemption. For example, one proposal, set forth by CMC, would provide for a 90-day cure provision that would avoid unnecessary loss of the Section 8 exemption due to nonwillful mistakes. MBA also urged that lenders and packagers be afforded an opportunity to cure, similar to the one found in TILA.

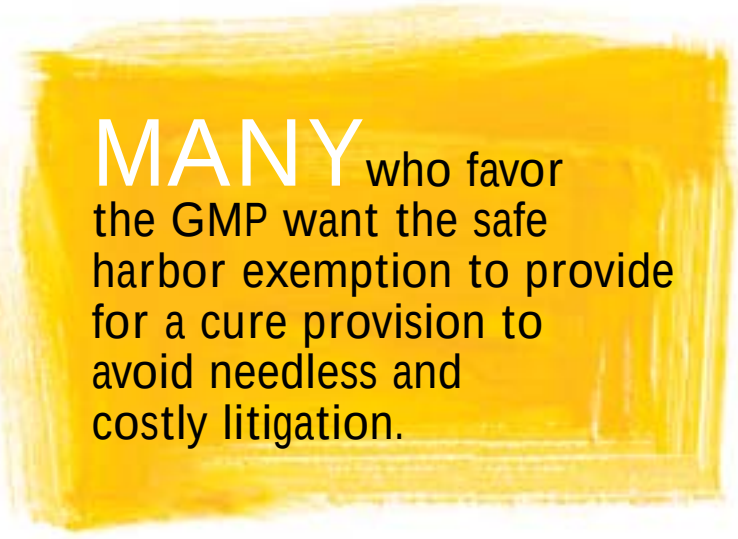
In addition to providing a cure provision, many favoring the GMP expressed the belief that the safe harbor should extend to loans whose interest rate and/or fees are high enough to be subject to the federal Home Ownership and Equity Protection Act (HOEPA). HOEPA borrowers, they argued, are those most in need of a GMP offer that reduces costs and enhances comparison shopping.

The FTC, for example, stated that, based on its work in the subprime market, there is no reason to believe that GMP loans are more likely to be abusive than non-GMP loans, and that providing clear disclosures backed by enforcement is an effective means of consumer protection.

The National Consumer Law Center (NCLC) and AARP took a different view. These consumer groups indicated that the subprime market is not ready for the GMP, and argued for the exclusion of HOEPA loans as well as all loans with five or more points or that have a prepayment penalty—features that these groups generally believe are associated with subprime loans.

Other recommended changes

Outside of the interest rate guarantee, TILA disclosures and safe harbor exemption, the GMP-supporter comments surveyed focused on the following points: (1) packagers should be able to charge an upfront fee sufficient to cover the costs of the GMP offer, (2) the GMP offer should remain valid for 10 or fewer days rather than the proposed 30 days, (3) the revised Special Information Booklet should contain the lion's share of explanatory information that the proposed rule currently includes in the model GMPA form and (4) certain costs should be excluded from the GMPA.



For example, with respect to excluded costs, several lender groups, including MBA, argued that the GMP cost amount should not include discount points, lock-in fees, mortgage insurance and flood insurance. Others sought to exclude charges payable in a comparable cash transaction and costs to satisfy underwriting conditions that are not for settlement services as well. In addition, commenters cautioned that HUD's GMP structure and the proposal's expanded definition of "application" could result in vast increases in reporting under the Home Mortgage Disclosure Act (HMDA) and notices under the Equal Credit Opportunity Act that are inappropriate.

Many of the lending trade associations, including MBA, CMC, AFSA, ACB, CBA and NHEMA, argued strongly for federal pre-emption of state laws, asking HUD to make a finding that the proposed rule is more protective of consumers than any other state law. On the other hand, the American Land Title Association (ALTA) asserted that HUD has no authority to pre-empt any state laws that govern the title insurance industry, and advised HUD that pre-emption of any state law

should be addressed solely through congressional action.

Are two better than one?

While the principal ingredient in the casserole, the GMP, may be at least partially pleasing to many industry groups, others clearly don't like the smell of it—at least in its present form.

In particular, ALTA, ICBA, the National Association of Mortgage Brokers (NAMB), the National Association of Realtors (NAR) and the Real Estate Services Providers Council Inc. (RESPRO) objected to the GMP, as proposed. ICBA and NAMB, among others, argued the proposed GMP would create an unlevel playing field and undermine the role of small businesses in the mortgage and settlement services industry, because smaller players will be unable to negotiate large discounts and compete with large lenders.

RESPRO also argued that the proposed GMP generally constrains competition in the market by nonlenders, such as real estate brokers, because the package must include an interest rate and other loan origination services that require lender participation.

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ALTA has both policy and legal concerns regarding HUD's proposal. "It fails to reflect the needs of consumers in buy/sell transactions, and would very severely affect our many members that are small businesses," says Jim Maher, ALTA's executive vice president. "In any event, we do not believe that the existing language of RESPA provides HUD the authority it needs to move forward with either the revised GFE regime or its packaging regime."

ALTA and RESPRO each proffered alternative "two-package" approaches that, they argued, would enhance competition and enable both lenders and nonlenders to offer packages, as compared with the HUD-proposed GMP. This alternative concept would follow a two-tier approach to packaging: Lenders would be able to offer GMPs for loan and loan-related services at a guaranteed price; and any other entity, including title companies, real estate companies and lenders, would be able to offer a separate package, the "Guaranteed Settlement Package" (ALTA version) or "Ancillary Services Package" (RESPRO version) for nonlender-related settlement services at a guaranteed price.

These two-package proposals would limit the GMP's safe harbor exemption. Under ALTA's version, payments made within, or the prices of, the Guaranteed Settlement Package (GSP) would continue to be subject to Section 8, with the following clarifications and/or exemptions: Discounted prices could not be "marked up" in calculating the GSP price to ensure that consumers received the benefit of the discount, the use of "average-cost pricing" would not violate Section 8, and GSP packagers would be able to use affiliated providers.

Under RESPRO's version, an exemption would apply within each package, but not between the packages. That is, lenders would not be able to provide discounts or engage in other activities to tie the loan's price to the lender's Ancillary Services Package.

RESPRO would also allow for a third package, a "plus" package that would cover additional settlement services of interest to the consumer that would not be included in either the lender-offered GMP or the GSP, such as owner's title insurance or radon, mold or roof inspections.

NAR initially opposed HUD's GMP rule, noting that the two-package approach endorsed by ALTA suggests that HUD should consider alternative reforms. In light of HUD's repeated claims that it will move forward with the GMP, NAR is assessing alternatives, such as the two-package approach, that offer additional opportunities for all industry players to market packages.

MBA is currently examining this proposal very closely. Upon initial review, MBA staff communicated that it believes the dual package proposals rest on a very weak legal premise. In addition, MBA believes the disclosure mechanics set forth by this alternative system—with two separate disclosures provided to consumers at differing times and by differing settlement servicers—do not achieve the basic goals of simplification and, more importantly, are potentially confusing to consumers.

The revised GFE

Regardless of their support or opposition to the GMP piece of the proposed rule, most of the industry commenters surveyed either opposed the revised GFE outright or believed the proposed structural changes to the GFE should be delayed to allow sufficient time for the GMP to be implemented and tested appropriately in the marketplace.

ALTA, ICBA and NAMB, among others, argued that the revised GFE should not be implemented at all. Others, such as CMC and AFSA, cited a litany of compliance and operational difficulties that are raised by revising the GFE and argue, as did MBA, that implementation of the proposed GFE should be delayed.

Most of those surveyed expressed the opinion that delay of the revised GFE will enable HUD to gain additional perspective on how readily the market will embrace the GMP and more aptly gauge the changes necessary for the GFE.

NAMB suggested an alternative to the proposed revised GFE—the "Uniform Costs Disclosure." This proposed disclosure would create two categories of mortgage loan costs: origination costs, which would be guaranteed for seven working days and thereafter if the consumer signs the disclosure, unless certain events occur (e.g., the consumer is ineligible for the loan or chooses a different loan program); and settlement costs,

which are estimated within three business days of application and can be redisclosed to the consumer no fewer than 15 days prior to closing if such costs change.

Any redisclosure of settlement costs would be subject to a 10 percent tolerance and would also remain available for seven working days. A consumer would also receive a redisclosure if he or she decides to lock in a rate, but such a redisclosure would not be subject to a 10 percent tolerance. After a consumer accepted the disclosure, additional costs would be allowed to be charged if permissible under state law.

The proposed Uniform Costs Disclosure would categorize costs and include a subitemization of fees; the interest rate (which would be subject to change unless locked); other loan terms, except for the APR; and the maximum amount of any YSP, which would be characterized as compensation for goods, facilities and services paid to a mortgage broker, if any.

AARP and NCLC applauded HUD's strengthening of the GFE. AARP included in its comment letter revised GFE forms that it believes are more consumer-friendly than those in the proposal.

Mortgage broker compensation disclosure

MBA, CMC, AFSA, ACB, CBA and NHEMA generally support clear disclosure to consumers of YSPs, as well as any other mortgage broker compensation. As an alternative to HUD's proposal to recharacterize lender payments to mortgage brokers as credits to borrowers, which may be confusing to borrowers and create additional compliance issues, these groups suggested the use of a "mortgage broker fee agreement" that the mortgage broker would provide to the borrower with the GFE. This agreement would disclose the broker's maximum compensation and role in the transaction. Some of these groups argued that such a disclosure should result in a Section 8 exemption, provided that the mortgage broker received no more compensation than it disclosed.

Few of the industry associations surveyed, however, support HUD's new treatment of mortgage broker compensation. ALTA, ICBA, NAMB and RESPRO staunchly opposed HUD's proposed new treatment of mortgage broker compensation. In particular, NAMB argued that the proposed recharacterization of YSPs on the revised GFE as a "lender payment to the borrower" (i.e., a lender credit) should not be implemented, because it limits consumer choice and prevents brokers from being able to compete with lenders, as well as generating significant risks of increased class-action lawsuits on the matter.

Effect on predatory lending—different views

While much ado is made about what this proposed rule should be able to accomplish, NCLC and AARP asserted in their comments what the proposed rule does not provide—an antidote to predatory lending. NCLC expressed the view that "As the GMPA streamlines disclosure of specific charges and services, it will allow mortgage originators to hide illegal fees and insulate lenders from legal challenges under both RESPA and [TILA]."

On the other hand, CMC and MBA regard the proposed rule as an important component in the effort against predatory lending, because consumers will understand the costs associated with their mortgage upfront and, therefore, will be better informed to comparison-shop.

Predicting the future

The reactions to HUD's proposed casserole are in. What occurs next remains to be seen. All reports from HUD indicate the rule will be finalized this year. Whatever happens, a pivotal issue is how long the industry will have to digest and implement the final rule.

The ABA asked for at least two years to implement the rule, given the enormous systems changes, necessary training of staff, management of quality control and development of new forms, policies and procedures for all channels of distribution. Other groups made similar requests.

But questions remain. Will the dish be served up only slightly modified (seasoned), or sent back for radical alterations (a new recipe)? Will the GMP and the GFE be served side-by-side, or will one component—the GFE—be sectioned off (frozen for leftovers)?

Will the GMP (the main ingredient) be pulled apart to accommodate a two-package approach? Anne Canfield, CMC's executive director, urges HUD not to try to achieve too much. "HUD will accomplish more if it does less," she says. "A simpler, less complex and workable rule will result in a more streamlined, less-costly system for both consumers and the industry."

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Rod Alba, an MBA director, government affairs, summed it up: "Let's not put too much on the plate. By delaying the GFE and focusing solely on a manageable GMP that is easy to offer and understand, HUD can create a self-enforcing disclosure regime that saves government resources, promotes competition and facilitates market innovation."

In other words, portion control. MB

Joseph M. Kolar is a partner and Nikita M. Pastor is an associate with Goodwin Procter LLP, Washington, D.C. They regularly represent financial institutions and other mortgage industry participants in all aspects of federal and state consumer credit law. Kolar also represents individual clients and mortgage industry trade associations before government agencies and Congress. The authors can be reached at jkolar@goodwinprocter.com and npastor@goodwinprocter.com.