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*President*

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Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 Seventh Street, SW, Room 10276
Washington, DC 20410-0001

Re: Docket No. FR-5180-P-01, Real Estate Settlement Procedures Act (RESPA): Proposed Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs

Dear Sir or Madam:

On behalf of the 1.26 million members of the National Association of REALTORS® (NAR), I am pleased to provide comments on the proposed rule[1] of the Department of Housing and Urban Development (HUD) to amend the Real Estate Settlement Procedures Act (RESPA) to simplify and improve the disclosure requirements for mortgage settlement costs and to protect consumers from unnecessarily high settlement costs.

The National Association of REALTORS® (NAR) is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations or boards, and 54 state and territory associations of REALTORS®.

## INTRODUCTION

## REALTORS® AND RESPA

REALTORS® have an important stake in RESPA reform. Real estate brokers and agents operate their businesses locally and achieve success through client satisfaction. Future business is obtained by earning a reputation for providing consumers with a successful home buying experience that results in securing an appropriate mortgage and high-quality settlement services at competitive prices. Therefore, RESPA reform is important to REALTORS® because:

1 73 Fed. Reg. 14030 (March 14, 2008).

- Real estate agents are typically the first contact in the home buying process, develop close working relationships with clients, and stay with the consumer through settlement. As a result, consumers look to real estate professionals to help them understand the home buying process from beginning to end.

- Abusive lending practices are most likely to occur when consumers are overwhelmed by a transaction involving unfamiliar financial terms and confusing compensation models and unfamiliar settlement services.

- Early disclosures, clearly presented, will help consumers identify the mortgage product that provides the optimal combination of cost and value for their particular circumstances.

NAR supports the need for greater transparency in the settlement process. However, we are very concerned that the changes proposed will only marginally improve a consumer's understanding of the costs of settlement while imposing additional costs on the borrower, home sellers, and settlement service providers. We also question the wisdom of undertaking what HUD acknowledges is a major overhaul of the rules that will require significant time and expense to implement at a time when housing and mortgage markets are in disarray.

Given the importance of RESPA to NAR members, we support RESPA reform to the extent it is focused narrowly on simplification, including clear disclosures provided early in the transaction that provide a functional understanding of the key components of the home buying process. NAR generally does not support HUD's other proposed reform provisions and will address our concerns in this letter as follows:

I. The Proposed Rule Fails to Strike the Right Balance Between Simplification and Understanding.

II. Provisions in the Proposed Rule on Cost Reduction Are Anti-Competitive and Will Reduce the Quality of Settlement Services.

III. Required Use and Average Cost Pricing Provisions Have Negative Unintended Consequences.

IV. The Rule Should Not be Finalized Until TILA and RESPA Disclosures are Harmonized.

V. The Proposed Rule Underestimates the Cost of Implementation and Overestimates the Benefits.

The proposed rule is poorly timed, too complex, and its costs are underestimated. The simplicity that the Department is attempting to achieve would be better served by a simpler approach.

## I. THE PROPOSED RULE FAILS TO STRIKE THE RIGHT BALANCE BETWEEN SIMPLIFICATION AND UNDERSTANDING

The proposed Good Faith Estimate (GFE) format and disclosure provisions do not strike the right balance between simplifying the process for consumers and providing sufficient information to allow consumers to make informed decisions. NAR believes that some explanations in the GFE and HUD-1 don't go far enough to achieve understanding, e.g. YSP, and in other situations the explanations come too late in the process, e.g. closing script.

### A. The Good Faith Estimate

The primary feature of HUD's RESPA reform is the proposed mandatory Good Faith Estimate which serves as the vehicle for new consumer disclosures and which incorporates a variety of price-related mechanisms designed to lower settlement costs. This section will focus on the format and disclosures put forward in the proposed GFE.

#### 1. Format

NAR supports some of the innovations HUD has developed for the proposed GFE, including an improved look and the attempt to put complex financial information into language consumers will understand. Nevertheless, despite the suggestion of its own design consultants and a broad consensus of industry and consumer groups, HUD did not reformat the GFE and HUD-1 to match each form's look and organization – an obvious design change that NAR believes should have been given the highest priority.[2] Marrying the two forms to mirror one another is a common sense solution that would provide consumers with greater transparency at closing when information is transferred from the GFE to the HUD-1. NAR believes this change would greatly assist consumers in understanding whether or not the terms and expenses that were disclosed to them at loan application are those that are the governing terms and costs at closing.

Such reformatting has been advocated by a number of organizations for some time now. NAR and the Center for Responsible Lending recommended to HUD two years ago that it provide consumers with a summary GFE accompanied by a full GFE with detailed explanations of each subcategory of fees to help consumers understand more fully the services and accompanying fees for which they are being charged.[3] NAR reiterates this recommendation and its implementation prior to finalizing the proposed rule. Marrying the formats of these important documents would provide transparency to the transaction and obviate the need for the cumbersome and expensive "closing script" that provides information too late in the process to be useful to consumers.

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2 HUD's design consultant recommended, after the sixth and final round of GFE testing in 2007 to "Consider redesigning the HUD-1 to more closely match the look and organization of the GFE. This redesign will allow for easier cross-comparison between the two documents. Build on the look and functionality of the Settlement Script when considering a HUD-1 redesign." Summary Report, Consumer Testing of the Good Faith Estimate (GFE), U.S. Department of Housing and Urban Development, Office of Policy Development and Research, February, 2008. Prepared by: Kleimann Communications Group, Inc., Washington, D.C., p. 158.

3 See: Attachments: Drafts of the proposed NAR GFEs: 1. Draft Summary GFE (Attachment 1), and 2. Draft Full GFE (Attachment 2). Other organizations submitted their own GFE proposals. HUD chose not to match the formats as recommended by industry.

### 2. Disclosures

NAR believes that HUD's proposed GFE fails to achieve the right balance between providing necessary information and keeping it simple enough to be useful to the consumer. The proposal expands the current Good Faith Estimate (GFE) to four pages of text intensive disclosures, tables and instructions which will serve as a psychological barrier to many consumers who will feel overwhelmed with having to read, comprehend and act on this amount of information.[4]

It is certainly unclear whether consumers will understand the system proposed for the disclosure of discount points and yield spread premiums (YSP).[5] Calling YSP a "credit" to the borrower, for instance, without explaining it or making clear that it is tied to the interest rate may mislead or confuse a consumer. In addition, an incomplete explanation of the YSP without an accompanying explanation of lender compensation will prevent the consumer from fully understanding the complicated tradeoff of economic incentives negotiated between brokers and lenders and its relevance to the consumer.

NAR also believes it is imperative that the consumer has access to <u>all</u> relevant cost information. HUD's decision not to include all itemized costs in its revised GFE will result in consumers getting less than the full disclosure Congress intended in the original statute.[6] While HUD's intent in not itemizing all charges is to eliminate junk fees, the result will be just the opposite as the proposed rule creates the opportunity to bury additional, undisclosed fees into "packages" and prevents individual provider cost comparison to the detriment of consumers.[7]

### B. The Closing Script

The proposed "closing script" is proposed as an addendum to the HUD-1. The closing agent is required to prepare the script, explain inconsistencies between the GFE and HUD-1, and read the script aloud at closing. The stated purpose of the script is to address complaints from consumers that the information on the GFE doesn't match the information on the HUD-1 and that borrowers are unaware or unsure of their loan terms at closing.[8] NAR

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4 The Federal Deposit Insurance Corporation (FDIC) has stated its concern that HUD's proposed four-page GFE is too long and provides too much information for it to be understood and appropriately used by consumers, basing this observation on its participation in an interagency project to develop model privacy notices for consumers. The interagency testing concluded that additional information often makes a form less useful because the basic concepts are overlooked. FDIC's undated comment letter on FR-5180-P-01 – Request for Comment on the Real Estate Settlement Procedures Act, p. 2.

5 An FTC study recommended that the YSP and points not be disclosed as too confusing to the consumer. (Comments of the Staff of the Bureau of Consumer Protection, the Bureau of Economics, and the Office of Policy Planning of the Federal Trade Commission, April 8, 2008, In the Matter of Request for Comments on Truth in Lending, Proposed Rule, Docket No. R-1305, ppgs 14-15)

6 "Each lender shall include with the booklet a good faith estimate of the amount or range of charges for **specific** settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary." 12 USC 2604(*emphasis added).*

7 Individual breakouts of specific costs contained in the HUD-1 will not be seen by consumers until closing and will preclude comparison of costs, e.g. title services and lender's title insurance, homeowners insurance, optional owner's title insurance, tax services, flood certification, etc. The previously noted joint Summary and Full GFEs proposed by NAR and CRL (see footnote 3 and attachments 1 & 2) allows the consumer both a summary and a detailed look at the transaction as needed at the time of loan application.

8 73 Fed. Reg. 14050 column 1 (March 14, 2008).

believes that the closing script comes too late in the process to be of real value to the borrower and is flawed for several additional reasons.[9]

**1. The Script is Delivered Too Late in the Transaction**

The information in the script comes too late in the process. If borrowers are to really benefit from a full understanding of the terms of their loans, the script would be more appropriately provided by the lender at the time of commitment. It is the loan officer who offers the loan terms and is best able to explain them to the borrower early in the process, not the closing agent at the very end, when the borrower is focused on non-financial aspects of the transaction and is highly motivated to close.

**2. Legal and Practical Problems with the Script**

Closing agents are assigned legal responsibility for the loan without control over loan terms. It is not clear that HUD has the statutory authority to impose legal requirements on closing agents as proposed. As a result, this provision is likely to be litigated, creating uncertainty and delayed implementation. In addition, the proposed rule is ambiguous as to how a closing agent is to "explain" charges that change in the transfer from the GFE to the HUD-1 when he/she has no control of the charges; likely no knowledge of what led to changes; what to do when tolerances are exceeded; and how to read the closing script when consumers are non-English speaking or hearing impaired. The proposed rule also fails to provide guidance on how the closing script will be read aloud in states without table closings, or in escrow states, e.g. California, where mobile notaries conduct document signing, or in the case of electronic closings.

## II. PROVISIONS IN THE PROPOSED RULE ON COST REDUCTION ARE ANTI-COMPETITIVE AND WILL REDUCE THE QUALITY OF SETTLEMENT SERVICES

### A. Volume Discounts and Tolerances are Anti-Competitive

The proposed rule attempts to reduce settlement service costs by introducing government-directed pricing mechanisms in the form of volume discounts and tolerance provisions. NAR believes that the manner in which these provisions are implemented in the Good Faith Estimate will result in market interference that will have anti-competitive results, produce winners and losers, and violate the plain intent of Congress that RESPA was not intended to be a rate-setting statute. [10]

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9 It should be noted that HUD did not seek input from industry on the consequences of the closing script provisions as proposed which would have avoided many of HUD's mistaken assumptions and obvious implementation problems associated with the closing script.

10 The proposed rule makes few changes to provisions dealing with the elimination of kickbacks and referral fees, the one area where Congress permitted HUD to regulate for the purpose of lowering settlement costs. NAR believes RESPA's current Regulation X adequately covers this Congressional purpose and we applaud HUD for taking steps in recent years to expand enforcement of RESPA's anti-kickback provisions and encourage HUD to continue to step up enforcement of RESPA. RESPA was not designed to be a rate setting statute. As the Eleventh Circuit noted in <u>Freedman v Market Street Mortgage Corporation</u>, (March 20, 2008) "[i]n 1973, Senator Proxmire introduced S. 2288, a bill that would have . . . empowered [HUD] to "establish the maximum amounts of the

The proposed rule offers large lenders a competitive advantage in the mortgage application process. Volume discounts and tolerances, as structured as a part of the mandatory GFE, will dictate the manner in which consumers evaluate and select settlement service providers and their products. HUD's proposed GFE allows lenders (but not third party settlement services providers who do not issue GFEs) to "package" unnamed third party settlement services such as title, title insurance, appraisals and inspections into lump sum categories.[11]

The largest mortgage lenders will be able to apply the greatest pressure on settlement service providers to reduce prices in order to be included in the lender's "guaranteed" package. This will effectively and unfairly reduce the opportunity of independent third party service providers to get in front of consumers to sell their products and services.

Local third party providers will not be included in or be able to compete with large lender "guaranteed" packages because:

1. Large lenders will prefer to limit the number of third party providers in their packages which will favor affiliated or large independent settlement services providers, and

2. HUD-mandated tolerances are a part of the HUD-mandated GFE which is only provided by lenders. Lenders will correctly portray third party prices as non-guaranteed and thereby eliminate consumer motivation to consider a non-guaranteed or outside option.[12] NAR is concerned that this large-lender competitive advantage will drive smaller local providers out of business because they won't be able to compete on price or generate sufficient volume to be included in lender packages, and once excluded from a lender's guaranteed package, will not get another chance to sell their products and services to consumers.

### B. The Proposed Rule Ignores the Importance of Value to Consumers

The counteraction to reduced costs is likely to be reduced quality of services. Consumers willingly pay more to ensure a job is done right and businesses need to earn a reasonable return. The proposed rule fails to account for these fundamental laws of the market and fails to acknowledge that quality and value may be affected by HUD's cost reduction mechanisms.

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charges to be imposed upon the borrower and seller for services incident to or a part of a real estate settlement . . . which shall be designed to reflect the reasonable charges for necessary services . . . and to assure that settlement costs do not exceed such reasonable charges . . . ." See 520 F.3d at 1297. Senator Proxmire's bill was rejected. See also: S. Rep. No. 93-866 (1974), reprinted in 1974 U.S.C.C.A.N. 6546, 6548. *Cf.* Boulware v. Crossland Mortgage Corp., 291 F.3d at 268 (4th Cir. 2002) ("RESPA was meant to address certain practices, not enact broad price controls.").

11 NAR believes the statute was intended to require the identification of all specific settlement service providers, but HUD has determined to eliminate the requirement because it believes that consumers will use the GFE to shop among loan originators based on cost rather than the identity of individual settlement service providers. 73 Fed. Reg. 14038 column 1 (March 14, 2008). NAR believes this is a step backwards for transparency.

12 In addition, the proposed rule allows loan originators to charge a fee for providing a GFE serving as a further disincentive to seek additional options from third party settlement service providers not included in the lenders package. 73 Fed. Reg. 14036 column 1 (March 14, 2008).

NAR believes most consumers do not shop for settlement services or any other significant product based on price alone. Many consumers willingly pay more for the kind of enhanced services that ensure the job is done right and in a manner that best suits their needs. While NAR strongly supports HUD's interest in increased competition and lower prices, government's role should be limited to HUD's existing authority to eliminate kickbacks, enhanced enforcement efforts and permitting free-market forces to determine the right combination of price and value. HUD's attempt to achieve price reductions through regulation is contrary to the purposes of RESPA, artificially distorts market forces, promotes low-quality settlement services that jeopardize the value of the underlying property and faith in the real estate transaction, and is not in the homebuyers' best interest. The settlement is not just a mortgage transaction; it is most often fundamentally a real estate transaction. Quality settlement services are essential to an outcome that can be relied upon. It is therefore important to balance quality and price.

The current mortgage market crisis provides the best evidence needed to demonstrate that quality does matter. A thorough and professional appraisal offers assurance of the value of a property. The quality of a loan officer's review of a credit report can mean a borrower gets a better interest rate and/or the most appropriate loan for their circumstances. The quality of a title report helps ensure that the buyer has unencumbered ownership of the property purchased and that title risks to lenders and other parties in the transaction are minimized.

The housing market does not need more slapdash appraisals. It does not need loan officers who don't truly understand the differences among the array of mortgage products offered or cannot interpret a credit report, thereby preventing the consumer from obtaining the best mortgage for which they qualify. It does not need closing agents who don't know the customs and rules of the area in which they work.

If recent experience has taught us anything, it is that cutting corners in this business has led to shredded family dreams. The mortgages that have been most troublesome for consumers were the cheapest and easiest to close because they included no documentation, no income verification and limited appraisals. The proposed rule, with its extra-statutory mechanisms to lower costs, will only encourage the kind of service (or lack thereof) that have resulted in so many inappropriate mortgages and the problems we continue to see in the mortgage and housing markets.

Creating a system that promotes the lowest cost providers as HUD has done with its government-directed volume discounts and price tolerances will favor large lenders and will squeeze quality and local experience out of the system to everyone's detriment. When competition is based on price alone, consumers may receive poor service and more risk.

## III. "REQUIRED USE" AND "AVERAGE COST PRICING" PROVISIONS HAVE NEGATIVE UNINTENDED CONSEQUENCES

### A. "Required Use"

The proposed rule amends RESPA's "required use" definition to include "disincentives" to the current prohibition on "incentives" when they are contingent on a consumer using a referred provider. HUD exempts from this definition "an optional combination of *bona fide* settlement services to a borrower at a total price lower than the sum of the prices of the individual settlement services."

NAR believes the rule has at least two unintended consequences: First, the rule authorizes discounts only on the prices/services of the recommended provider. This would limit the kind of non-price/services promotions that joint venture owners currently and permissibly offer to promote affiliates. Real estate agents and brokers currently offer a variety of inducements to clients to promote their services and NAR believes HUD did not intend to eliminate a practice which benefits consumers. For example, a real estate agent or broker might offer a client a gift certificate to local business or a free home inspection. Second, the rule would allow a discounted combination of settlement services only to a borrower. As sellers often pay the majority of settlement costs in a real estate transaction, NAR believes sellers should not be precluded from receiving discounts as incentives.

### B. Average Cost Pricing

HUD proposes to allow "cost averaging" for loan originators. NAR believes there are problems with HUD's proposal which is intended to result in greater competition and lower costs to consumers. If HUD is going to allow this practice, it should be extended to both borrowers and sellers, to all settlement service providers <u>and</u> should be limited to small items such as courier fees and recording costs. By prohibiting settlement service providers other than loan originators to offer average cost pricing, the regulation improperly discriminates in favor of loan originators. By permitting average cost pricing to larger items such as appraisals, the consumer will end up paying more for an "average cost" if, for instance, the calculation includes a disproportionate number of expensive appraisals during a given six month period as defined under the proposed rule. As a result, this provision should be strictly limited to low-cost items on the HUD-1.

## IV. THE RULE SHOULD NOT BE FINALIZED UNTIL TILA AND RESPA DISCLOSURES ARE HARMONIZED

NAR strongly encourages HUD not to finalize the proposed rule until the Federal Reserve Board (FRB) and HUD harmonize two currently proposed sets of occasionally overlapping disclosures that will only result in consumer confusion. There are a number of jurisdictional, legal and practical questions which should be thoughtfully considered and addressed by the agencies <u>before</u> the regulations are finalized. If the agencies cannot resolve the existence of two sets of instructions, they should try to minimize duplicative information and/or information that is, or may appear to be, contradictory or confusing to the consumer, e.g. the timing of disclosures and lock periods.

## V. THE PROPOSED RULE UNDERESTIMATES THE COST OF IMPLEMENTATION AND OVERESTIMATES THE BENEFITS[13]

### A. Impact on Industry Structure

By HUD's own admission, the new RESPA requirements would fundamentally change the mortgage origination process. HUD's analysis, however, completely ignores the proposal's potential impact on the structure of the industry. This "partial equilibrium" approach brings the Department's estimates of costs and benefits into question.

Under HUD's proposal, loan originators (and mortgage brokers) will be asked to guarantee not only their own fees, but the fees of third-party settlement service providers. To manage the resulting risk, originators will inevitably seek out contractual arrangements (and pricing concessions) with one or more service providers. As originators seek to form these arrangements, there will be clear winners and losers throughout the mortgage and settlement services industries. While HUD seems to imply that the only losers will be inefficient or unscrupulous service providers, most commentators believe that, for a variety of reasons, small originators, brokers and settlement service providers will lose at the expense of larger entities.

The proposed regulations will also tend to favor larger lenders and brokers. Larger originators are in a better position to negotiate rates and to extract pricing concessions from third party settlement service providers. While this may be good for consumers in the short-term, the increased concentration that would inevitably result could eventually produce the opposite effect. For example, larger originators may use their market power to undercut their competitors, and then subsequently move to higher rates once their competitors have left the market. While large originators may not be able to pocket any portion of the discount, they will garner market share, allowing them to make additional profit in other areas. Regardless of the eventual impact, the number of active players in the market would undoubtedly decline.

While the Department admits that "a new business model is put in place for the mortgage industry," it makes no attempt to take these secondary effects into account in estimating the costs and benefits of the proposal. In fact, HUD dismisses the issue by stating that "it is difficult to provide comments on a market structure that does not yet exist."[14] Given the current turmoil in the mortgage market, NAR believes now is not the right time to implement a new regulation that would result in such structural change. At a minimum, this issue deserves to be given more than cursory attention from HUD before it finalizes its regulation.

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13 The following economic analysis is based on a report prepared for NAR by Dr. Ann Schnare, "The Estimated Costs of HUD's Proposed RESPA Regulations," June 3, 2008.

14 See U.S. Department of Housing and Urban Development, "RESPA: Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis FR-5180-P-01. Proposed Rule to Improve the Process of Obtaining Mortgages and Reducing Consumer Costs," Office of Policy Development and Research. P. 3-87.

### B. The Cost of the Good Faith Estimate

The Department also underestimates the costs of implementing the new GFE requirements. Among other things, HUD's proposed regulations will require the industry to modify its existing software programs, train staff on the use of the form, process and track multiple applications from multiple borrowers, underwrite GFE applications for borrowers who end up going to other lenders, and require originators to assume the additional risks and costs that are associated with the mandated tolerance levels on the GFE.

HUD estimates that the annual cost of the expanded GFE will be $44.50 per loan. However, in deriving its estimates, HUD either ignores or dismisses many of the factors noted above. This section highlights some of the major limitations of HUD's analysis, which include:

- Understating the total number of GFEs that would need to be issued and tracked;
- Ignoring the operational and hedging costs associated with the guarantee; and
- Ignoring the costs of the initial underwrite, including the costs of obtaining additional FICO scores.

Accounting for these and other factors would significantly increase the estimated costs of the GFE.

#### 1. The Number of Good Faith Estimates

This section will demonstrate that either HUD has seriously under-estimated the number of GFEs that will be issued under its new regulations or the regulations will not produce the amount of shopping behavior that the Department would like to achieve.

HUD assumes that roughly 1.7 GFEs would be produced for every completed mortgage origination. Thus, in order to produce 12.5 million loans (HUD's baseline estimate for a typical year), HUD assumes that originators would have to issue roughly 21.250 million GFEs (i.e., 1.7 GFEs per loan x 12.5 million loans.) The 1.7 ratio used by HUD is based on the observed relationship between loan applications and loan originations, as reported in HMDA data.[15] (The ratio is significantly higher than 1.0 due to the fallout that occurs when loan applications are either rejected or voluntarily withdrawn.) In effect, using a 1.7 ratio to estimate the number of GFEs that are associated with a given origination volume assumes that the new regulations will not affect the total number of GFEs that are issued in any given year (or, alternatively, that there will be just one GFE per mortgage application.)

However, there are a number of reasons that a higher ratio should be used. Assume, for example, that the revised GFE does not affect the fallout that occurs once a formal application has been received (i.e., that the ratio of mortgage applications to originations remains at 1.7.) Even if the average borrower obtained just two GFEs, the total number of GFEs in a typical year would rise from 21.3 million (HUD's estimate) to about 42.5 million

15 HUD, op. cit., p. 2-6.

(i.e., 2 GFEs per application x 1.7 applications per loan x 12.5 million loans.) While one could argue that better information provided to consumers would reduce the number of loans that were rejected or withdrawn after a loan application has been filed, even if the fallout rate were cut in half—a highly unlikely event—the number of GFEs that are issued in a typical year would be 33.75 million, or about 59 percent higher than the estimate used by HUD.[16]

Thus, it seems highly likely that the ratio of GFEs to loan originations that is embedded in HUD's projections (1.7) is far too low. Under the alternative assumptions presented above, the ratio of GFEs to originated loans would more likely range between 2.7 and 3.4 even if one assumes that the average consumers obtains just two GFEs. These higher ratios would translate into proportionally higher compliance costs.

In deriving its estimates, HUD assumes that the annual costs of the revised GFE primarily relate to processing and tracking the applications.[17] If one assumes that 21.250 million GFEs would be issued in a typical year, average costs per originated loan would be $44.50—the estimate produced by HUD. However, if one assumes that between 34 and 43 million GFEs would be issued, the average annual cost per originated loan would rise to $71 to $89, respectively.

While the ratios that are used to derive these various estimates are admittedly somewhat arbitrary, one thing seems clear: either HUD has seriously under-estimated the number of GFEs that will be issued under its new regulations or the regulations will not produce the amount of shopping behavior that the Department would like to achieve.

### 2. The Operational and Hedging Costs of the GFE

As noted above, HUD's estimates of the on-going costs of the GFE are primarily based on the amount of additional time it will take to process the application and produce the revised GFE form. HUD ignores or dismisses the operational and hedging costs that would be associated with this new requirement, including the costs of hedging the interest rate that is offered on the GFE.

Under the proposed regulations, the originator's fee (excluding the YSP) and certain components of closing costs must be guaranteed for at least 10 business days (subject to a 10 percent tolerance level that is applied to the sum of all applicable third-party costs.) However, HUD allows the originator to establish the lock-in period for the interest rate. Until the rate is locked, all interest-related charges, including the yield spread premium, are allowed to float.

Conceivably, the originator could choose a lock-in period that is considerably shorter than the 10 business days required for other components of the GFE in order to minimize its hedging costs. While this would defeat one of the major objectives of HUD's proposal—namely, to fix the mortgage terms for at least 10 business days in order to facilitate the

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16 Cutting the fallout rate by half would result in a ratio of 1.35 loan applications for each originated loan. Assuming that each borrower obtains 2 GFEs before a applying for a loan—and that it there are 1.35 applications for every loan—results in 2.7 GSEs per origination.

17 As described in more detail below, HUD either ignores or dismisses the additional underwriting, operational and hedging cost that would be associated with the new guarantees.

shopping process—HUD does not address this issue in its RIA. Instead, HUD asserts that its decision to reduce the guarantee period from 30 to 10 business days would eliminate any significant operational and hedging costs that were associated with its 2002 proposal.

However, even a relatively short lock-in period for the interest rate on the GFE could add significant costs to the originator over and above the hedging costs that now occur once a formal application has been received. Suppose, for example, that the originator set the lock-in period to 10 business days—a move that would certainly make the offer much easier for consumers to understand and would be consistent with HUD's objectives.[18] According to our estimates, the cost of the hedge would be about 4 basis points (i.e., 0.04 percent) of the dollar value of requested loan.[19] If one assumes that 3.7 GFEs are issued for every loan that gets originated, the initial interest lock would cost about 13.6 basis points per loan (i.e., 4 bps per GFE x 3.7 GFEs per origination.) On a $200,000 mortgage, this would add about $272 to the cost of the loan. Even if one uses HUD's assumptions regarding the ratio of GFEs to originations, the average cost of the interest rate hedge would be about $180 per loan (i.e., 4 bps per GFE x 1.7 GFEs per origination.)

### 3. Multiple Underwriting

HUD has also not factored in the additional costs of underwriting the GFE. While it notes in its RIA that the originator would be required to update the credit report once a formal loan application has been received[20], it makes no attempt to account for this additional step in its cost analysis. In effect, HUD assumes that the initial screening that would occur when the GFE is issued would simply replace the initial screening that would otherwise occur once a formal application has been received. This argument might make some sense if one accepts HUD's premise that its new regulations will not affect the number of GFEs that are ultimately issued. However, the argument falls apart if one assumes that HUD's regulations will lead to significant increases in the total number of GFEs.

For example, if one assumes that the ratio of GFEs to originations is 2.7 instead of 1.7, loan originators would have to pull at least one additional credit report for every mortgage origination (i.e., 2.7 – 1.7). According to HUD, the average credit report costs about $25.[21] This additional expense would increase the Department's estimated cost of the GFE ($45 per loan) by 56 percent. Furthermore, the additional underwriting step would undoubtedly add to total processing time. If one assumes that preliminary screening will take about 10 minutes to complete, the total cost of the initial underwrite would rise to about $30 per loan—$25 for the initial credit pull and another $5 for the underwriter's time (valued at

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18 HUD's revised GFE has multiple dates for the offer: one for the origination fee and third party settlement costs; one for the quoted interest rate; one for the settlement date; and one for the number of days that the loan must lock before closing. The multiplicity of dates could well lead to borrower confusion.

19 The value of the hedge can be estimated by comparing differences in the rates that Fannie Mae and Freddie Mac are currently offering for loans with different delivery periods. On May 15th, the interest rate spreads on Fannie Mae and Freddie Mac 30 and 60 day deliveries were about 8 basis points. Guaranteeing the interest offered on the GFE for 10 business days (i.e., 12 to 14 calendar days) would cost about half of this amount, or roughly 4 bps.

20 HUD, op. cit. p. 3-70.

21 HUD, op. cit. p. 3-95.

$31.14 per hour.)[22] If one assumes that the ratio of GFEs to originations is even higher—for example, 3.4—the additional underwriting costs would add about $52 to the cost of a typical loan.

### 4. Alternative Estimates of Annual Costs of GFE

Exhibit 1 summarizes how changes in HUD's assumptions could change the estimated cost of the GFE. The columns reflect different assumptions regarding the ratio of GFE applications to loan originations, which affect the number of GFEs that would be issued in a typical year. The first column assumes that the new regulations do not affect the total number of GFEs that are issued (i.e., HUD's assumption) and that the ratio of GFEs to total loans is 1.7. The second and third columns present alternative estimates based on ratios of 2.7 and 3.4, respectively.[23] As described in an earlier section, such higher ratios are not unreasonable, particularly if consumers actually use the GFE to assist them in their shopping process.

**Exhibit 1: Estimated Annual Cost of the GSE per Loan**

| | **Number of GFEs Per Originated Loan** | | |
|---|---|---|---|
| | **1.7** | **2.7** | **3.4** |
| **Processing Costs** | $ 45 | $ 71 | $ 89 |
| **Hedging Costs**[24] | $136 | $216 | $272 |
| **Initial Underwrite**[25] | 0 | $ 30 | $ 52 |
| **Added Cost per Loan** | $181 | $317 | $413 |

As illustrated by the chart, accounting for hedging and underwriting costs, and applying more realistic assumptions regarding the expected number of GFEs, would have a dramatic impact on the estimated costs of the GFE. Instead of the $45 estimated by HUD—the number presented in the upper left hand cell of the chart—projected costs could easily range from about $300 to $400 a loan. Moreover, even these higher estimates may be conservative. For example, they do not include any legal costs associated with the litigation risk that would inevitably arise from a "guaranteed" GFE.

### C. The Costs of the Closing Script

HUD also underestimates the cost of the proposed closing script, which would provide little, if any value to the consumer. By the time the consumer comes to closing, it is

22 HUD uses different hourly wages to value the originator's time. In its estimates of efficiency gains, HUD values the time saved by originators at $72 per hour. However, in its estimates of GFE costs, it uses $31.14 per hour. To be conservative, we use the lower figure here.

23 The 2.7 ratio assumes that the average consumer obtains 2 GFEs and that the fallout rate from application to origination is reduced by half (i.e., to 1.35). The 3.4 ratio assumes that the average consumer obtains 2 GFEs and that the ratio of applications to originations remains the same (i.e., 1.7).

24 Assumes that the interest rate offered on the GFE is good for 10 business days and that the average loan amount is $200,000.

25 The estimates assume that an applicant's credit report is pulled only once, when the GFE is approved. This may be unrealistic given the time that could elapse between GFE and loan application. Costs would be higher if one assumes that credit scores would have to be pulled again when the borrower actually applies for a loan.

far too late to change the terms of the loan. And if discrepancies in closing costs are found, there is no established process to resolve such issues or to enforce the guarantees established by the GFE.

Implementation issues aside, HUD assumes that preparing and delivering the closing script will take about 45 minutes of the closing agent's time, which would double the amount of time typically required to close a loan. HUD estimates that this additional step would add about $54 to the cost of the loan, or about $1.20 for each additional minute that the title agent spends in preparing and delivering the closing statement.

While HUD calculates the cost of this requirement on the settlement agent's part, it either dismisses or ignores the costs to the other participants at the closing table, including the borrower, the borrower's spouse, the real estate agent, and in some states, two or three attorneys. HUD claims that its requirement will impose no additional costs on borrowers, since they would otherwise be left on their own to review and compare the GFE to the fees recorded on the HUD-1 form. However, even if one accepts this premise, there are likely to be additional professionals at the closing table who will have to sit through a longer settlement process.

HUD estimates that it will take about 15 minutes to read the closing script and answer any questions. Assuming that the opportunity costs for everyone present would be about the same as the closing agent's time, the cost of the closing script would rise by about $18 for each additional person involved. For example, if one assumes that three additional people are present at closing, the cost of the closing script would double to $108—$54 for the closing agent's time (45 minutes) and another $54 for the time of the three other attendees combined (3 x 15 minutes, or 45 minutes.)

HUD also fails to recognize the impact that increasing the amount of time at closing would have on other related costs. Most closings occur at or near the end of the month. Roughly doubling the amount of time that it would take to complete the transaction would create additional demands on space to handle the same volume of loans. Yet such additional costs are not considered in the Department's analysis. Nor does the Department consider the legal and regulatory risk that now must be borne by the closing agent. In effect, HUD's proposal would have the closing agent act as the consumer's representative and serve as the "RESPA police." Aside from legal questions regarding whether closing agents other than attorneys can play such a role, the requirement would expose the closing agent to additional legal and regulatory risk, which would once again increase the costs of closing.

The Department also fails to document the benefits that flow from the closing script. By the time the borrower reaches the closing table, it is highly unlikely that he or she will walk away the transaction unless serious misrepresentations or issues are uncovered. For example, according to the Department's estimates, typical charges for title services and other third party fees come to about $1841.[26] Thus, a variance of greater than $184 would cause a potential RESPA violation. Indeed, in two of the examples presented in the Federal Register,

26 According to the Urban Institute, total title fees and other third party charges had medians of $1267 and $574, respectively. See Federal Register, Vol. 73, No. 51, March 14, 2008, p. 14106.

differences of $14 to $15 could potentially bring the closing process to a halt.[27] It is highly unlikely that anyone involved in the settlement process would walk away at this point in the process. Someone—either the closing agent or the real estate agent—would undoubtedly reach into their pockets to pay for an excess that was the responsibility of the loan originator.

While HUD has allowed for fees that exceed the tolerance level to be justified and resolved at the closing table, the most likely party to resolve any discrepancies—the loan originator—would typically not be present. If the lender were required to be available by phone at the time that the script were read, this would add another $18 to the estimated cost of this provision (assuming that the value of the originator's time was the same as the closing agent's.)

In short, HUD estimates that the closing script would add about $54 to the average cost of a loan. However, more reasonable assumptions would yield costs that are probably at least double this amount. Thus there is a strong chance that all anticipated cost reductions will be offset by the additional origination costs imposed. In other words, all of these measures to ostensibly allow people to better shop for a mortgage will lead to price increases in the underlying mortgage, erasing any benefit and yielding only additional bureaucracy and confusion.

### D. Guidance

Almost one year ago in July of 2007, NAR submitted, at the behest of HUD's General Counsel, a list of questions to HUD seeking clarifying guidance on a number of RESPA provisions. To date, HUD has not answered the questions it encouraged NAR to submit. This type of event is all too common with regard to RESPA guidance and NAR has no reason not to expect this will continue under a new rule.

To address the vacuum left by HUD's lack of guidance to the industry, for the past five years NAR has worked diligently to expand its own RESPA education initiative which now includes biannual RESPA seminars, printed guides and brochures, a RESPA DVD including a narrated PowerPoint and video answers to frequently asked questions, a RESPA website and a soon to be launched RESPA online course for continuing education credit at Realtor® University. Additional projects are in development. In the meantime, NAR continues to seek guidance from HUD in its effort to provide NAR members with the most complete and up-to-date RESPA guidance to ensure compliance.

Before HUD embarks on fundamental changes to RESPA, it should answer the legitimate questions of industry and the public with regard to the existing rule. In so doing, it should track the text and intent of the statute and Congress scrupulously. HUD should not rewrite the law in its rulemaking and interpretations. While a particular practice or procedure may not make sense to the agency, the relevant question is always whether the practice violates the clear meaning of the statute. If it does not, it is solely up to Congress to change the statute and its meaning.

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27 In one example, the GFE estimated third party closing costs at $642, while actual costs came in at $715. The difference ($78) exceeded the 10 percent tolerance level by $14 (i.e., $78 - $64.) See Federal Register, op. cit., p. 14079. In another example, third party costs were estimated to be $809, but came in at $905. The difference ($96) exceeded the 10 percent tolerance level by $15 (i.e., $96 - $81.) See Federal Register, op. cit., p. 14091.

## CONCLUSION

NAR believes that HUD has been well-intentioned in its efforts to modernize the Real Estate Settlement Procedures Act. The proposed rule, however, is cumbersome, confusing, goes far beyond what was envisioned after HUD's public roundtables, and not likely to yield benefits in the real world. HUD should withdraw all elements relating to price controls and focus on simply reforming the Good Faith Estimate to make it clearer and more understandable. The Good Faith Estimate should contain a summary page with key loan terms and conditions as well as a summary of the other settlement costs and an additional page that tracks the HUD-1 closing document so that consumers can compare what they were promised and what they receive at closing.

Sincerely,

Richard F. Gaylord, CIPS, CRB, CRS, GRI
President

Attachments:

1. NAR Draft Summary Good Faith Estimate
2. NAR Draft Full Good Faith Estimate

## Summary of Guaranteed Good Faith Estimate (Discussion Draft)

| | |
|---|---|
| **Name & Address of Borrower:** | **Name & Address of Lender or Originating Company:** |
| **Property Location:** | **Date:** |

| **LOAN TERMS** | |
|---|---|
| **Interest rate: fixed ☐ adjustable ☐** | **%** |
| **If adjustable, maximum yearly increase**<br>**and maximum total increase** | **%**<br>**%** |
| **Loan Amount** | **$** |
| **Principal and Interest**<br>**Estimated Taxes**<br>**Estimated Insurance** | **$**<br>**$**<br>**$** |
| **Total Estimated Monthly Payment** | **$** |
| **If adjustable, maximum yearly increase**<br>**and maximum total increase** | |
| **$**<br>**$** | |
| **Loan Duration** | **years** |
| **If loan does not fully pay off,**<br>**amount still owed when loan ends** | **$** |
| **Prepayment penalty: ☐ yes ☐ no** | |
| **How computed:** | |
| **Maximum amount:** | **$** |



| **SETTLEMENT CHARGES - Summary of Attached Good Faith Estimate**<br>"Series" numbers correspond to line designations on the Good Faith Estimate and the HUD – 1 Settlement Form | |
|---|---|
| **Series 800 - Lender Fees:**<br>**(Origination fee, discount fees, etc.)** | **$** |
| **Series 800 - Mortgage Broker Fee** | **$** |
| **Series 800 - Fees in Connection With Loan:**<br>**(Appraisal, Credit Report, Etc)** | **$** |
| **Series 900 - Required Advance Payments:**<br>**(Advance interest, insurance, etc.)** | **$** |
| **Series 1000 - Reserves (Escrow) Required at Closing:**<br>**(Property insurance and taxes, etc.)** | **$** |
| **Series 1100 - Title Charges**<br>**(Title search, title insurance, attorney fees, etc.)** | **$** |
| **Series 1200 - Government Fees**<br>**(Recording fees, taxes, etc.)** | **$** |
| **Series 1300 - Additional Settlement Charges**<br>**(Survey, pest inspection, warranty, etc.)** | **$** |
| **TOTAL SETTLEMENT COSTS – Cash Required at Closing:** | **$** |

## Guaranteed Good Faith Estimate (Discussion Draft)

| Name & Address of Borrower: | Name & Address of Seller: | Name & Address of Lender or Originating Co. |
|---|---|---|
| | | |

| Property Location: | Settlement Agent: | |
|---|---|---|
| | Place of Settlement: | Settlement Date: |

**Total Loan Amount:** **Interest Rate:** **Term:**

### Settlement Charges

**801. Origination Fee: These are lender fees to cover the administrative costs in processing the loan. They are often expressed as a percentage of the loan and can vary among lenders.**
**802. Loan Discount: Points or discount points are a one-time fee by the lender or broker to pay for a particular interest rate. Each "point" is equal to one percent of the mortgage amount.**

**Other Items Payable in Connection with the Loan: These are fees that the lender charges to process, approve and make the mortgage loan.**

| Series 800 fees are guaranteed for 30 days from date this document is signed. | | | Paid by Borrower |
|---|---|---|---|
| 801. Loan Origination Fee | % | to: | $ |
| 802. Loan Discount | % | to: | $ |
| 803. Appraisal Fee | | to: | $ |
| 804. Credit Report | | to: | $ |
| 805. Lender's Inspection Fee | | | $ |
| 806. Mortgage Insurance Application Fee | | to: | $ |
| 807. Assumption Fee | | | $ |
| 808. Flood Certification Fee | | to: | $ |
| 809. Mortgage Broker Fee | % | to: | $ |
| 810. Tax Service Fee | | to: | $ |
| 811. Processing Fee | | to: | $ |
| 812. Underwriting Fee | | to: | $ |
| 813. Wire Transfer Fee | | to: | $ |
| 814. | | | $ |



**900. Items Required By Lender To Be Paid In Advance: Interest here is assessed from the date of closing to the end of the month. If no date has been set at the time of issuance of this document, an estimate is provided. The actual amount at closing will be the amount of days remaining in the month times the daily rate of interest based upon the rate of the mortgage. Premiums (lines 902-904) represent advance payment for required insurance.**

| Series 900 Fees are only estimates. If amounts change, a revised document will be issued. | | | | Paid by Borrower |
|---|---|---|---|---|
| 901. Interest from ___________ | to _____________ | @$ | /day | $ |
| 902. Mortgage Insurance Premium for | _____________ | months to | _____________ | $ |
| 903. Hazard Insurance Premium for | _____________ | months to | _____________ | $ |
| 904. Flood Insurance Premium for | _____________ | months to | _____________ | $ |
| 905. VA Funding Fee | | | | $ |

**1000. Reserves Deposited With Lender (Escrow Account Deposits): These fees identify the payment of taxes and/or insurance and other items that must be made at settlement to set up an escrow account. The lender is restricted in the amount that can be collected. The individual item deposits may overstate the amount that can be collected.**

| Series 1000 Fees are only estimates. If amounts change, a revised document will be issued. | | | Paid by Borrower |
|---|---|---|---|
| 1001. Hazard insurance | _____________ months | @$ _____________ per month | $ |
| 1002. Mortgage insurance | _____________ months | @$ _____________ per month | $ |
| 1003. City property taxes | _____________ months | @$ _____________ per month | $ |
| 1004. County property taxes | _____________ months | @$ _____________ per month | $ |
| 1005. Annual assessments | _____________ months | @$ _____________ per month | $ |
| 1006. | _____________ months | @$ _____________ per month | $ |
| 1007. | _____________ months | @$ _____________ per month | $ |
| 1008. | _____________ months | @$ _____________ per month | $ |

# Guaranteed Good Faith Estimate (Discussion Draft)

## Continued (Page 2)

1100. **Title Charges**. The following fees are not charged by your lender, but by the title company and/or other providers of title-related services you decide to use. The services identified are either required in connection with the loan or can be expected in your transaction. The estimates shown are based on:

the lender's experience in the community where the property is located, or

estimates provided by [ Name of Title Company ], a company [ ] affiliated
[ ] not affiliated with the lender.

You are free to shop for these services and are not required to use any particular title company.

| Series 1100 Fees are only estimates. | | Paid by Borrower |
|---|---|---|
| 1101. Settlement or closing fee | to: | $ |
| 1102. Abstract or title search fee | to: | $ |
| 1103. Title examination fee | to: | $ |
| 1104. Title insurance binder | to: | $ |
| 1105. Document preparation fee | to: | $ |
| 1106. Notary fees | to: | $ |
| 1107. Attorney's fees | to: | $ |
| 1108. Title insurance binder | to: | $ |
| 1109. Lender's coverage | $ | $ |
| 1110. Owner's coverage | $ | $ |
| 1111. Commitment fee | to: | $ |
| 1112. Endorsement fee | to: | $ |
| 1113. Wire fee | to: | $ |
| 1114. Electronic doc. Fee | to | $ |
| | | |
| | | |

**1200. Government Recording and Transfer Charges: These fees may be paid by you or by the seller, depending upon your agreement of sale with the seller. The buyer usually pays the fees for legally recording the new deed and mortgage (line 1201). Transfer taxes, which in some localities are collected whenever property changes hands or a mortgage loan is made can be quite large and are set by state and/or local governments. City, county and/or state tax stamps may have to be purchased as well (lines 1202 and 1203).**

| Series 1200 Fees are only estimates. If amounts change, a revised document will be issued. | | | | Paid by Borrower |
|---|---|---|---|---|
| 1201. Recording fees: | Deed $ | ; Mortgage $ | ; Releases $ | $ |
| 1202. City/county tax/stamps: | Deed $ | ; Mortgage $ | | $ |
| 1203. State tax/stamps: | Deed $ | ; Mortgage $ | | $ |
| 1204. | | | | $ |
| 1205. | | | | $ |

| **1300. Additional Settlement Charges:** | | |
|---|---|---|
| 1301. Survey | to | $ |
| 1302. Pest inspection to | to: | $ |
| 1303. Home Warranty Fees | to: | $ |
| 1304. Elevation Certificate | to: | $ |
| 1305. | | $ |
| | **Total Costs to Close this Transaction:** | $ |

**Loan Officer** **Date**

**Applicant** **Date** **Applicant** **Date**