COMMENTS
On
RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers

Department of Housing and Urban Development
24 CFR Part 3500
[Docket No. FR-4727-02]
RIN 2502-AH85

The **National Consumer Law Center**[1] submits these comments on behalf of its low income clients as well as the following *national* organizations which represent low and moderate income consumers:

- **Consumer Federation of America**
- **National Association of Consumer Advocates**
- **Consumers Union**
- **U.S. Public Interest Research Group**[2]

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[1] The **National Consumer Law Center** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eleven practice treatises and annual supplements on consumer credit laws, including *Truth In Lending,* (4th ed. 1999) and *Cost of Credit: Regulation and Legal Challenges* (2nd ed. 2000), and *Repossessions and Foreclosures* (4th ed. 1999) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers.

NCLC has been writing about the exploding problem of predatory mortgage lending to since the 1980's. NCLC has advised and trained hundreds legal services and private attorneys on litigation strategies to deal with such loans, and provided extensive testimony to Congress regarding necessary protections to be included in federal law, including the Home Ownership and Equity Protection Act, as well as recent proposals to address predatory lending. Since the passage of HOEPA, NCLC has continued to work with a broad coalition of consumer and community groups and with various federal agencies to create a comprehensive solution to abusive mortgage lending practices, NCLC was a co-author of AARP's Model Bill on Predatory Lending, and has assisted advocates in many states in efforts to pass this bill on a state level.

These comments are written by NCLC attorneys Margot Saunders, Elizabeth Renuart and John Rao.

[2] The **Consumer Federation of America** is a non-profit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

Consumers Union is the author of Consumer Reports.

The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

These comments are also submitted on behalf of the low income clients of the following statewide and local legal services programs in urban and rural areas throughout the United States:

- **Legal Services of the Southern Piedmont, Inc**. (serving Charlotte, N.C. and the surrounding seven counties)
- **Land of Lincoln Legal Assistance Foundation** (serving sixty-five counties in southern Illinois)
- **Atlanta Legal Aid Society, Inc.** (serving metropolitan Atlanta and the surrounding five counties)
- **Florida Legal Services, Inc**. (a statewide legal services program in Florida)
- **Legal Aid Society of Northwest North Carolina** (serving Winston-Salem, N.C. and the surrounding five counties)
- **Legal Aid Foundation of Los Angeles** (serving metropolitan Los Angeles, California)
- **Michigan Poverty Law Center** (the state support program for legal services programs in Michigan)
- **Texas Rural Legal Aid, Inc.** (serving 68 counties in Texas)
- **Legal Aid Society of Dayton, Inc.** (serving 17 counties in west central Ohio)
- **Legal Assistance Foundation of Metropolitan Chicago** (serving Cook County, Illinois)
- **Miami Valley Fair Housing Center** (serving Montgomery County, Ohio)
- **Legal Aid Society of Milwaukee** (serving Milwaukee County, Wisconsin)
- **Mountain State Justice, Inc.** (representing clients throughout West Virginia)
- **Legal Services of New Jersey** (a statewide legal services program in New Jersey)
- **Legal Aid Society of Hawaii** (serving all of Hawaii)
- **Appalachian Research and Defense of Kentucky, Inc.** (serving eastern Kentucky)
- **Community Legal Services of Philadelphia** (serving Philadelphia, Pennsylvania)

In addition, these comments are submitted on behalf of **Honorable Marian B. Tasco of the Philadelphia City Council,** who is the author and prime sponsor of the recently-adopted Philadelphia anti-predatory lending ordinance and who represents the 9th Council District of the City of Philadelphia.

We wish to commend the Secretary for the dramatic approach to RESPA[3] reform advocated in these Proposed rules. Clearly, the Department has recognized that the current state of RESPA's consumer protection is a murky mess. For example, to the extent that RESPA's current regulations provide rules that protect consumers, these rules are generally unenforced or are unenforceable by the courts. Some changes must be made, and it is HUD's responsibility to

[3] The Real Estate Settlement and Procedures Act ("RESPA"), 12 U.S.C. § 2601, *et seq*.

articulate the means by which this important statute will effectuate its purpose of protecting consumers in the mortgage settlement process.

The stated goals and orientation of the Proposed Rule are wonderful – to protect consumers. We credit the hard work and creativity of HUD staff in the conception of this Rule. We applaud the many positive features of these proposals, and request that HUD accept these comments in the spirit in which they are offered – as constructive so as to assist HUD in achieving its goals of creating a regulatory regime under RESPA that is truly protective of consumers – which is the purpose of RESPA.

There are real complexities in these new proposals, with dramatic impact on determining compliance with the Truth in Lending Act and the Home Ownership and Equity Protection Act. We will be happy to provide more detailed suggestions on how to address the problems we identify in these comments. Indeed, we stand ready to work with the Secretary and his staff to assist in making this complex and far reaching proposal effectively protective of consumers.

There are several overarching concerns and a myriad of important details which must be worked through to ensure that the Rule does in fact protect consumers, instead of simply providing a shield behind which mortgage originators can hide inappropriate, unfair, and illegal activities. **While the overall concepts are good, there are significant changes in the details of the rules which must be made to prevent substantial harm to consumers:**

- While the basic idea of the Guaranteed Mortgage Package Agreement (“GMPA”) is good, it must be limited to loans in the prime market, coordination with the Federal Reserve Board is essential before the GMPA is permitted to replace the Good Faith Estimate ("GFE"), and for the GMPA to be meaningful the lender must provide a guaranteed rate and closing costs to the consumer which is conditioned *only* on the lender’s verification of the information provided by the borrower.

- While the proposal for the recharacterization of the yield spread premium as belonging to the consumer is excellent, for this to be meaningful, the regulation must be enforceable through RESPA’s section 8 and the consequences on TILA disclosures resolved.

- Many aspects of the GFE proposal are excellent; however, several specific provisions must be deleted and the new form must be substantially retooled.

In **Part One** of these comments, we address the overarching concerns relating to the Rule. **Part Two** provides more detail on these concerns. However, if given other opportunities, we will endeavor to provide more on our specific proposals on how to make the good ideas behind HUD’s Proposed Rule into reality and truly protective of consumers. In **Part Three** we answer the questions posed by HUD.

Part One: Major Concerns

1. These rules do not address predatory lending. As the Secretary has already noted in his testimony to the House Financial Services Committee on October 3, 2002, these rules do not provide the answer to predatory lending. It is imperative that HUD clarify that this Rule is not designed to address the problem of predatory lending and that other reforms are still needed. Indeed, HUD does not have the authority under RESPA to address predatory lending by itself in a global way. The rule is intended to facilitate shopping for mortgages and to promote competition. This laudable goal should be pursued. However, as victims of predatory mortgages are targeted by lenders who eliminate shopping opportunities, no amount of improvement to the RESPA rules will protect them. Protection from predatory lending is an essential effort that the federal government should move forward with expeditiously, in combination with this Proposed Rule under RESPA.

2. These rules must avoid facilitating predatory lending. The Guaranteed Mortgage Package Agreement is a creative and novel proposal which, if implemented properly, will enable mortgage shoppers in certain markets to shop more effectively. However, HUD must keep in mind that this shopping does not occur among all consumers – those who are today already the victims of predatory mortgages and those who will be targeted in the future. This submarket thrives in an atmosphere in which lenders and brokers target homeowners and experience little pressure to provide the best products. Indeed, the incentives run in the other direction – borrowers are steered to the worst products. The GMPA must not provide a new means for lenders in the subprime market to avoid liability for non-compliance with consumer protection law in that segment of the marketplace which most needs *more* substantive consumer protection.[4]

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 the Truth in Lending Act ("TILA").[5] It was HUD's intent to trade compliance with the specific requirements of RESPA's Section 8.[6] However, an *inadvertent* result of the GMPA

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[4]We have supported the concept of the GMPA in the past in the context of statutory change in the law. Amending the RESPA and TILA statutes would allow all the overlapping issues of disclosures under both statutes, enforcement, and protections against predatory lending, to be addressed together. Attempting to address the disclosure problems of RESPA only through regulation unfortunately creates serious implications for enforcing TILA requirements and removes existing protections against predatory lending. *See* Margot Saunders, Testimony Regarding the "Rewrite of Truth in Lending Act and Real Estate Settlement Procecures Act (Sept. 16, 1998), available on-line at http://www.consumerlaw.org/initiatives/predatory_mortgage/testimony.shtml.

[5]15 U.S.C. § 1601 *et seq*. Currently, compliance with TILA's required allocation of fees between amount financed and finance charge can be tested only by comparing the disclosure of specific fees provided on the RESPA HUD 1 with the statements of the disclosures provided on the TILA form. Though TILA generally requires the lender to provide the borrower with an itemization of the amount financed unless the consumer opts out, lenders need not give this itemization if they provide both the GFE and the HUD-1. Official Staff Commentary § 226.18(c)-4.

[6] 12 U.S.C. § 2607.

will be to conceal information needed to determine the accuracy of TILA disclosures as well, providing legal insulation from both federal laws. One of the effects of the bundling of loan fees under the Guaranteed Mortgage Package ("GMPA") will be that TILA compliance will no longer be discernable by a comparison of the TILA disclosure and the HUD-1.[7] High cost loans may be successfully camouflaged from challenge under TILA regulations, or even HOEPA compliance, as a result. Neither bank regulators nor others reviewing mortgage loans will be able to perform accurate compliance reviews.

There are two essential principles that must be met given this important interplay between RESPA and TILA in fashioning the GMPA.

- As the purpose of the GMPA is to encourage shopping in the open marketplace of competitive mortgage lending, the GMPA should only be provided to that section of the market which is most capable of using competitive pressures in the open marketplace to protect themselves – to the prime market.[8] This is essential. **To ensure that HUD's new GMPA does *not* facilitate and protect predatory loans from legal scrutiny, any loan that meets any one of the following triggers should *not* be permitted to be made as a GMPA:**

    - Any HOEPA loan
    - Any loan with a prepayment penalty.
    - Any loan with a guaranteed mortgage package price (the single fee) – which equals or exceeds 5% of the principal of the loan.

- Further, to ensure that the GMPA does not create havoc with compliance and enforcement of TILA, HUD should move forward on the GMPA portion of the Proposed Rule only after coordinating with the Federal Reserve Board to ensure that compliance with TILA maintains the current degree of transparency in home mortgage loans. As they can in the current legal environment, both regulators and consumers must be able to determine compliance with TILA simply by looking at the information provided on the documents required by TILA and RESPA.

3. <u>HUD must specifically require the substantive change it is proposing regarding yield spread premiums be in the *regulations* relating to RESPA's Section 8, not just as disclosures. Further:</u>

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[7]This situation may change if the Federal Reserve Board issues new regulations or new comments under TILA requiring otherwise. These comments evaluate the effect of the Proposed RESPA Rule on existing interpretations of TILA rules.

[8]These criteria are discussed in detail in Part 2, Section A(1)(c) through (e) of these comments.

- The regulations must require that the consumer be informed up-front just how much the mortgage broker will charge.
- The consumer must be provided the opportunity to choose how this payment will be paid from choices actually available to the consumer.

4. The new rules for the GFE, while basically good, must be tweaked to be fully protective of consumers:

- The language regarding the broker's relationship to the consumer is incorrect in many states and must be deleted.
- The comparison chart on the GFE form should be uniform and reflect actual terms available to the consumer.
- There is no longer any justification to exclude home equity lines from RESPA coverage, so the rules should require they be covered.
- The disclosures in section II of the GFE should include critical loan terms such as prepayment penalties and balloon terms.
- The credit from the lender must *not* appear simply as a credit against closing costs, rather it should appear as a cash credit in the 200 series of the HUD-1.

5. There must be effective enforcement mechanisms for an originator's failure to comply with all aspects of these new rules. Even perfect consumer protection rules will only work in the marketplace if they are enforced in a meaningful way. Lenders must have incentives to comply with the rules, because lack of compliance is too costly. The Proposed Rule does not currently include *any* mechanisms to punish transgressors. The proposal only provides that once the transgression is caught, the remedy is for the lender to provide what was promised all along. This rewards *lack of compliance* because the cost of being caught breaking the rules is the same as compliance. This is frankly absurd. HUD must provide a means to make it cost originators if they violate these rules – or else the rules are virtually meaningless. We propose several specific measures to make the new RESPA rules meaningful:

- Civil enforcement of each element under the rule is essential. This includes the requirements for treatment and disclosure of the yield spread premium, the new rules for the Good Faith Estimate, as well as for a lender's failure to keep the promises in the GMPA.

- HUD must remove its stated prohibition against enforcing violations of section 8 through class actions. The 2001 Statement of Policy explicitly requires a court's individual review of each transaction, eliminating the efficient enforcement mechanism of class actions. Once HUD's Proposed Rules provide the new rules of the road, there is no reason a court cannot evaluate and enforce the yield spread requirements in class reviews – as the only issue will be whether the mortgage broker actually gave the consumer the full benefit of the payment from the lender.[9]

- A lender's failure to follow the rules for the new Good Faith Estimate must be actionable in some manner, other than merely regulatory enforcement – as regulatory enforcement has shown that it is not sufficient to encourage the industry to comply with the law. Although the RESPA statute does not provide a private right of action in this regard, HUD can and should articulate that it believes the failure to comply with these rules is unfair and deceptive. This should enable some private enforcement under state and federal prohibitions against unfair and deceptive acts and practices.

- A lender's failure to follow the rules when offering a GMPA or to close on a loan thereafter that does not conform to the GMPA must presumptively violate RESPA's Section 8. The current proposal results in the lender losing its exemption from Section 8 coverage and only allows the consumer a potential contract action against the lender for not keeping the promises in the GMPA. This is completely ineffective. As attorney's fees are generally not available for breach of contract, few consumers will have the means to bring a case to court for the few thousand dollars which would be obtained in a contract action on most failed GMPAs. Further, consumers will not have the means to allege a *prima facie* case of a violation of Section 8 as the GMPA scenario dictates that neither the initial estimate, nor the HUD 1 will provide details on the payments of fees for services provided by third parties. Therefore, HUD must state that if a lender fails to comply with the promises made in the GMPA, there is a *presumption that the lender has violated Section 8.*[10]

Part Two: Details of Our Concerns

In this section, we will identify a myriad of specific details which must be addressed to transform this Proposed Rule from a good idea with dangerous – and unintended consequences – into a truly progressive consumer protection regulation. We will address the three aspects of the rule separately:

- The proposal for the Guaranteed Mortgage Package ("GMPA")
- The new proposal on how yield spread premiums should be treated and disclosed, and
- The Proposed new rules for the Good Faith Estimate ("GFE").

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[9]In Part 2, Section B(1) of these comments, we explain in more detail the justification for allowing enforcement of the rules on yield spread premiums in class actions.

[10]See Part 2, Section A(3)(e) for more details on how we view this presumption of a Section 8 violation will work for GMPAs.

A. The Issues Related to the GMPA

1. ***The GMPA Must Be Limited to Prime Loans***

a. HUD Must Avoid the Unintended Consequence of Creating a Safe Haven for Bad Loans

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 the Truth in Lending Act ("TILA").[11] While it was HUD's intent to trade compliance with the specific requirements of RESPA's Section 8,[12] clearly an inadvertent result of the GMPA will be to streamline the disclosures under TILA as well, providing legal insulation from both federal laws. One of the effects of the bundling of loan fees under the Guaranteed Mortgage Package ("GMPA") will be that TILA compliance will no longer be discernable by a comparison of the TILA disclosure and the HUD 1. As a result, high cost loans will be successfully camouflaged from challenge under TILA regulations, or even HOEPA compliance. Bank regulators and consumer attorneys will be unable to perform accurate compliance reviews. Without compliance checks, enforcement will be impossible, and there will be no incentive for lenders to comply with this essential consumer protection law.

As a result, **the single most critical point for the representatives of low and middle income consumers providing these comments is that HUD limit the GMPA to prime loans. If a subprime loans are permitted to be made through the GMPA structure, *predatory lending* will be facilitated and protected by the GMPA exemption.** To avoid the unintended consequence of creating a safe haven for bad loans, HUD should take the most cautious approach and limit the GMPA only to those loans available to consumers who are participating in the most competitive mortgage market.

While not all subprime mortgage loans are predatory, all predatory loans are subprime.[13] It would be far better – at least in the early days of determining how the GMPA will actually work in the marketplace – to exclude too many loans from the GMPA, rather than to include too many loans.

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[11] 15 U.S.C. § 1601 *et seq*. Currently, compliance with TILA's required allocation of fees between amount financed and finance charge can be tested only by comparing the disclosure of specific fees provided on the RESPA HUD 1 with the statements of the disclosures provided on the TILA form. Though TILA generally requires the lender to provide the borrower with an itemization of the amount financed unless the consumer opts out, lenders need not give this itemization if they provide both the GFE and the HUD-1. Official Staff Commentary § 226.18(c)-4.

[12] 12 U.S.C. § 2607.

[13] *See* Saunders and Ackelsburg, Testimony before the Senate Committee on Banking, Housing and Urban Affairs, regarding the Increase in Predatory Lending and Appropriate Remedial Actions, July 27, 2001, http://banking.senate.gov/01_07hrg/072701/aklsbrg.htm.

b. HOEPA Loans Can Be Mischaracterized, Yet Protected from Challenge in a GMPA

The Home Ownership and Equity Protection Act, passed in 1994,[14] does not cure the problem of abusive home equity lending. The law continues to allow high rate home equity loans to be made and does not regulate excessive interest rates or fees per se. Its coverage is limited, excluding loans with high rates and fees just under the trigger amounts, open-end home equity credit, and reverse mortgages.[15] Extraordinarily abusive loans can continue to be made without triggering HOEPA protections because lenders can easily circumvent HOEPA by charging rates and fees just under the HOEPA trigger amounts.

As a result, in many high cost loans, there is litigation regarding whether the fees charged by the lender have been properly allocated to the HOEPA points and fees trigger. Many loans are treated by lenders as non-HOEPA loans, only to be determined later by regulators or attorneys for consumers to have been wrongly excluded from HOEPA. Once it is shown that a loan should have been covered by HOEPA, but was not, considerable consumer protections then apply.[16] A lender who violates the requirements of HOEPA faces enhanced statutory penalties as well as rescission of the loan.[17] The protections of HOEPA are thus most often helpful to consumers when they have been breached – because they provide substantial assistance in avoiding foreclosure on loans which included abusive terms.

As is spelled out more fully below,[18] the HUD-1 required by RESPA satisfies the requirement under TILA that an itemization of the amount financed be made available to the borrower. This itemization is critical for determining not just TIL compliance but also whether the loan is covered by HOEPA. The GMPA would make it impossible for consumers - or regulators - to determine whether a loan presented as a non-HOEPA loan was actually a HOEPA loan.

This is why the GMPA cannot be permitted to mask the fees of loans which are anywhere in the neighborhood of HOEPA loans – else substantially abusive loans will be made under the

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[14]Codified at Section 129 (15 U.S.C. § 1639) and in Sections 31 and 32 of Z (12 C.F.R. § 226.31 and 226.32).

[15] 15 U.S.C. §1602(aa)(1).

[16]For example, only HOEPA loans require the extra disclosure required three days before closing, as well as limitations of the circumstances in which prepayment penalties can be charged (15 U.S.C. § 1639(c)), special requirements for payments made to home improvement contractors ((15 U.S.C. § 1639(i)), and prohibitions on extending credit without regard to the consumer's payment ability (15 U.S.C. § 1639(h)).

[17]15 U.S.C. § 1640(a) and 15 U.S.C. § 1635.

[18]See Part 2, Section A(2).

rubric of the GMPA, thus denying to consumers the ability to test these loans for compliance with the Truth in Lending Act and appropriate exclusion from HOEPA.

c. Criteria for Excluding Subprime Loans from the GMPA

While it may be difficult to define a subprime loan, we can define the *characteristics* of *predatory* loans. One thing we know is that HOEPA only covers a small percentage of subprime loans.[19] The HOEPA triggers suggested by HUD in the Proposed Rule do not provide nearly enough protection. Currently advocates estimate the bulk of predatory loans finance in the range of 5 to 8% of the principle of the loan for points, fees and closing costs.[20] HUD has already stated that financing more than 3% of points and fees is a sign of a predatory loan.[21] Further, in its regulations of the GSEs HUD has prohibited the provision of housing credits for loans in which more than 5% of the principal has been charged.[22] It is also important to note that many of the new anti-predatory lending laws passed by the states have used 5% points and fees as a trigger for coverage.[23]

Thus, to ensure that HUD's new GMPA does *not* facilitate and protect predatory loans from legal scrutiny, any loan that meets any one of the following triggers should *not* be permitted to be made as a GMPA:

- Any HOEPA loan.

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[19] Federal Reserve Board, Final Rule, Statement of Basis and Purpose, 66 Fed. Reg. 65604, 65607 (Dec. 20, 2001).

[20] This information is gleaned from the hundreds of loan documents reviewed each year by the attorneys providing these comments. See also Washington Department of Financial Institutions, Expanded Report of Examination for Household Financial Corporation III as of April 30, 2002, at 48 (finding that Household charged 7.4% in upfront costs on most loans), *available at* news.bellinghamherald.com.

[21] *See*, Joint HUD-TREASURY Report on Recommendations to Curb Predatory Home Mortgage Lending, June 20, 2000, at page 11. http://www.hud.gov/library/bookshelf18/pressrel/pr00-142.html. The agencies noted the dangers of financing high fees on homeowners:

> Financing points and fees may disguise the true cost of credit to the borrower, especially for high interest rate loans. Restricting the financing of points and fees for HOEPA loans would cause these costs to be reflected in the interest rate, enabling borrowers to better understand the cost of the loan, and to shop for better terms.

[22] *See* 24 CFR 81.16(b)(12) and 24 CFR 81.2. These regulations do allow third party fees paid for closing costs to be excluded from the 5% calculation. However, as these fees would not be itemized on the GMPA, excluding some fees would not be possible. It is also far better, at this point of the development of this new product to exclude too many loans, rather than to include too many, and limit enforcement of existing law on predatory mortgages as a result.

[23] *See, e.g.* N.C.G.S. S.L. 1999-332; Ga. Code Section 7-6A-1 *et seq.*; 2001 N.Y. A.B. 11856 (SN) (Oct. 3, 2002).

- Any loan with a prepayment penalty.
- Any loan with a guaranteed mortgage package price (the single fee) – which equals or exceeds 5% of the principal of the loan.

The reasons for adopting these criteria are spelled out below.[24]

In other words – in addition to HOEPA loans, any loan which has *either* a prepayment penalty, *or* the price for the GMPA is equal to or more than the 5% of the loan principal – must not be eligible for the exemption outlined in the Proposed Rule. Any lender making a loan with either of these criteria would still be required to itemize the fees paid to settlement service providers pursuant to the rules for the Good Faith Estimate. (See Appendix 3 for our *new* language for § 3500.16(e).)

Using 5% of the principal as the trigger for exclusion from GMPA eligibility will actually result in including loans with a very high up-front cost. According to various studies, closing costs on conventional mortgages rarely exceed 2% of the loan amount.[25] Using 5% as the trigger allows ample – perhaps too much? – room to ensure that all prime loans for which a GMPA might be appropriate would be eligible for the competitive benefits of the GMPA. However, this figure also ensures that loans which are not truly competitive are excluded from the exemption.[26]

d. GMPA Should Not Be Permitted for Loans With High Points and Fees

As predatory loans generally charge high points and fees it is essential that the GMPA not be permitted to be provided for these loans.[27] The most meaningful mark of a predatory loan is in

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[24]See Part Two, Section A(1)(d), (e).

[25]According to the Federal Housing Finance Board's "*Monthly Interest Rate Survey*," Table 1: Terms on Conventional Single-Family Mortgages, Annual National Averages, All Homes, *available at* www.fhfb.gov/MIRS/mirs_t1.xls, initial fees and charges average less than one point from 1995 through 2000 on conventional residential mortgages.

[26]For example, a loan of $150,000 would be permitted to have a GMPA package cost of $7,499. A $200,000 loan could have a GMPA price of $9,999. These up-front costs are actually much higher than most competitive, prime loans would ever charge for up-front closing costs. To the extent that the figure of 5% may represent too small a sum to compensate lenders for their up-front costs when making small loans (for example loans of less than $75,000), the 5% trigger could be adjusted upwards. However, just as this figure is adjusted upwards for smaller loans, the 5% trigger should also be adjusted lower for loans of larger amounts.

[27]It may be suggested by other consumer advocacy groups that instead of using the 5% points and fees trigger, the GMPA exclude loans which meet the definition of a subprime loan in the new Federal Reserve Board regulations under the Home Mortgage Disclosure Act. This definition states that any loan which has an APR of 3% or more higher than the Treasury Bill yield for a comparable term shall be considered a subprime loan. **We strongly urge HUD not to use this definition without also using the points and fees trigger.** An analysis of the math on long term mortgage loans will show that a lender can finance as much 8% of the principal amount of the loan without causing an increase in the APR of more than 1 percentage point.

the high amount of points and fees[28] financed by the borrower. The more the borrower is charged up-front, the more the immediate financial gain achieved by the lender. This is why many of these loans are not affordable to the homeowner – the lender has an incentive to make them non-performing loans. If that loan does not perform such that the homeowner is forced to refinance, it just means more profit for the lender at each refinancing. For the homeowner, it means more equity is stripped from the home each time.

Currently, a typical predatory mortgage transaction creates thousands of dollars of immediate profit to the lender upon sale of the loan to an investor. When the borrower refinances the loan, the lender sees a substantial profit, providing an incentive to the lender to encourage refinancings, regardless of whether the borrower can actually afford to repay the refinanced loan. If the lender only sees profit from the loan through the payments made on the loan, the lender must make sure that the borrower can repay – and has the unmistakable incentive to make sure that the borrower can afford the payments. This can only be accomplished by limiting the amount of up-front points and fees which are financed.

In addition, by limiting the financing of points and fees less equity is stripped from the home. Also, by ensuring that the cost of obtaining each loan is minimized, the borrower can always shop for a lower rate loan when his credit improves, or interest rates fall - just as is done in the prime market. This provides for more actual competition in this market, and encourages the subprime lender to make the interest rate on the loan competitive.

e. GMPA Should Not Be Permitted for Loans with Prepayment Penalties

Prepayment penalties also are the mark of a predatory loan, and lenders providing GMPAs should not be permitted to include prepayment penalties.

When a lender extends considerable expenses in the making of a loan, the lender does risk loss if the loan is prepaid before the regular payments on the loan allow the recoupment of these expenses. In the prime mortgage market, the effect of competition protects lenders: the low interest rate the borrower currently has discourages the borrower from prepaying the loan. Typical prime mortgage loans stay on the books for an average of five years. Thus only 2% of prime loans have a prepayment penalty.[29]

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[28] We include in our definition of fees the high costs of single premium credit insurance.

[29] See Freddie Mac, Frequently Asked Questions on Prepayment Penalties, *available at* http://www.freddiemac.com/singlefamily/ppmqanda.html.

The subprime market is a different story. Fully 70% of subprime loans have prepayment penalties because of lack of perceived options on the part of the borrowers.[30] In the subprime mortgage market, the brokers are generally the gatekeepers for the loans, and they operate on the reverse competition method of yield spread premiums. The higher the premium paid to a broker, the more likely the broker will match a lender up with an unwitting borrower. The hefty price paid to the broker in the yield spread premium is an expense that the lender must recoup in order to avoid a loss, especially considering that the same broker has an incentive to market aggressively another loan to the same borrower. Thus, the lender must charge prepayment penalties to protect itself from the costs incurred by yield spread premiums.

If prepayment penalties were disallowed, unreasonable yield spread premiums would not be paid by lenders, because they could not afford the risk. This would not mean that loans would not be made – they are made every day in the prime market without hefty premiums and prepayment penalties. As yield spread premiums are completely masked in the GMPA – unreasonable yield spread premiums should not be encouraged by allowing loans with prepayment penalties to be included in the exemptions offered by the GMPA.[31]

It is clear to many that prepayment penalties on subprime loans have virtually nothing to do with lowered interest rates.[32] It therefore cannot be argued that precluding loans with prepayment penalties will deprive most borrowers of a viable way to decrease interest rates.

2. *The GMPA Should Not Be Implemented Without Resolving Its Effect on TILA Compliance*

TILA and RESPA are connected in several ways. Overhauling RESPA as suggested will

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[30]*See* Gail McDermott, Leslie Albergo, Natalie Abrams, Esq., NIMS Analysis: Valuing Prepayment Penalty Fee Income Standard & Poor's, News Release, Jan. 4, 2001. *Also see*, North Carolina Coalition for Responsible Lending, Prevalence of Prepayment Penalties, available at http://www.responsiblelending.org/PL%20-%20Coalition%20Studies.htm citing data obtained in an interview with the Mortgage Information Corporation and the industry newsletter, *Inside Mortgage Finance*, and the following articles on conforming mortgages: "*Freddie offers a new A-, prepay-penalty program*," Mortgage Marketplace, May 24, 1999; Joshua Brockman, "*Fannie revamps prepayment-penalty bonds,*" American Banker, July 20, 1999.

[31]Subprime lenders claim that borrowers voluntarily choose prepayment penalties to reduce their interest rates. Borrower choice cannot explain, however, why some 70% of subprime loans currently charge prepayment penalties and only 2% of conventional loans do (almost all in California). The real reason is that conventional mortgage markets are competitive and sophisticated borrowers have the bargaining power to avoid these fees; borrowers in subprime markets often lack sophistication or are desperate for funds and simply accept the penalty that lenders insist that they take.

[32]*See e.g.* Amy Crew Cutts, *On the Economics of Subprime Lending*, FTC Roundtable: Economic Perspectives on the Home Mortgage Market, Washington, D.C. October 16, 2002, Slide 2.

create havoc to the balance currently struck between RESPA and TILA. [33] In transactions to which RESPA applies, TILA rules say that the lender need not give an itemization of the amount financed if it provides the both the GFE and HUD-1.[34] Mortgage lenders have consistently used the GFE and HUD-1 as a replacement for the itemization of the amount financed. [35]

The importance of the consumer receiving an itemization of the closing costs for TILA compliance purposes cannot be overstated. This is the only way both regulators and consumers can determine if the APR, finance charge, and amount financed disclosures are accurate. The effect of the Proposed GMPA disclosure is to eliminate the itemization of the closing charges, at least on any form provided under RESPA. Since the HUD-1 substitutes for the TILA itemization, the effect of using the proposed truncated HUD-1 will be that neither consumers nor regulators will be able to review the TILA cost of credit disclosures for accuracy.

HUD proposes that the HUD-1 contain a list of the finance charges that the lender used to calculate the APR. This suggestion does not cure the problems just described. Whether a particular lender violates the finance charge disclosure rules requires an independent review of all of the closing costs, not just those that the lender treated as finance charges. Under the proposal, regulators and consumers would be unable to make that independent review.

Given the interplay between TILA and RESPA, it is imperative that HUD not move forward on implementation of the GMPA unless TILA and HOEPA compliance can be enforced.

3. ***<u>Major Problems in the Structure of the GMPA</u>***

a. Goals of the GMPA

If designed properly, with all of the issues relating to compliance with TILA resolved, and limited to the prime market, the Guaranteed Mortgage Package could prove helpful for consumers who shop in a competitive marketplace for their mortgages. In such a market, the GMPA would facilitate the ability of consumers to compare mortgage products that are actually available to them. With automated underwriting, mortgage lenders can (and already do in some instances) easily provide consumers guaranteed information about closing costs, interest rate and points early enough so that they can shop and make informed choices in a quick and timely

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[33] Of relevance to this discussion, TILA requires the lender to give the consumer an itemization of the amount financed, including the sum of the prepaid finance charges. However, the lender need not give the itemization if the consumer opts out of receiving it. 15 U.S.C. § 1638(a)(2)(B); Reg. Z § 226.18(c).

[34] Official Staff Commentary on Regulation Z, § 226.18(c)-4.

[35] TILA and RESPA also intersect when the mortgage transaction involves the purchase, acquisition, or construction of the home securing the mortgage. In the purchase-money context where the mortgage loan is subject to RESPA, TILA requires that a good faith estimate of the TILA disclosures be given within 3 days of application (in effect, concurrently with the GFE). 15 U.S.C. § 1638(b)(2); Reg. Z § 226.19(a)(2).

manner. Only this type of inclusive disclosure would clearly meet the purposes of RESPA and offer American homeowners a real opportunity to choose the best loan available for their individual needs.

Under the current scheme of mortgage financing, very few consumers know with certainty the interest rate or the total points and closing costs they will be charged for a mortgage loan before they have to pay the fees for application, credit report, appraisal, etc. Instead, consumers must generally pay a fairly sizeable sum to apply for a mortgage loan, the full cost of which they will not know until some later time. The effect of the current industry practice is that even sophisticated consumers find it next to impossible to ensure that they are receiving the best loan that fits their needs. Moreover, unscrupulous brokers and lenders have a virtually free hand to increase the junk fees, points and/or interest rates on the loans.[36] Essentially, mortgage borrowing today is like what some folks call "buying a pig in a poke." You pay before you know what you're getting.

The better system is one in which the consumer can apply, at no charge, to the several lenders receiving the credit report, answer any additional questions the lenders requested, and then receive from the lenders a guarantee of a loan at a specific rate, with a fixed amount of points charged, and a guarantee of the full amount of closing costs to be charged.[37] This guarantee should be subject *only* to two contingencies: 1) that the information supplied by the consumer regarding income and assets could be verified; and 2) that the value of the collateral – the consumers' residence – was sufficient to secure the loan. Under this method, consumers would actually know the full price for a mortgage loan before they paid for it.

b. The GMPA Should State the Minimal Requirements for the Loan Offer

Assuming that HUD clarifies that "final underwriting" only means verification of information provided by the consumer – and requires that all of the credit qualifications of the consumer be approved *prior* to the offer of the GMPA, the GMPA should indicate the minimum requirements the consumer must meet. The GMPA will be based on information provided by the consumer on income, value of home, other assets, and similar information. The preliminary underwriting performed by the lender is based on the consumer's information and the consumer's actual credit status (as determined from credit reports). However, the GMPA will offered contingent of the consumer fitting certain preconditions, rather than needing every detail provided by the consumer to be exactly correct.

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[36] The numerous class action lawsuits challenging the payment of yield spread premiums to mortgage brokers is a primary example of consumers who have found they received mortgage loans which were more expensive than they should have.

[37] All closing costs charged by the lender to close the loan would be included in this guarantee. Some expenses would be excluded from the guaranteed closing costs package, such as certain truly optional expenses like owner's title insurance, as well as expenses unrelated to the loan itself like hazard insurance and property taxes.

For example, if the consumer provides information indicating annual income of $70,000 a year, and the terms of the loan offered in the GMPA require annual income of $60,000, the GMPA should state this. So if this consumer actually had annual income of $69,000, the GMPA should still be valid. If the consumer's information turns out to be incorrect in a *de minimus* amount, that should not alleviate the lender's obligations under the GMPA.

c. Section 8 Exemption Is Not Justified without a Clear Guarantee

Unfortunately, the Guaranteed Mortgage Package outlined by HUD in these Proposed Rules *only seems* to be describing a program like this, but the crucial elements of exactly what is promised, and what is left open to later decision – "final underwriting" – are not addressed. Yet, for the GMPA to be meaningful – and the exemption from section 8 liability to be justified – these issues must be clarified.

We have long recommended to HUD that it design a form for consumers to use when applying to lenders. Consumers could fill out this form once, and send it along with any other information a particular lender requires to a number of lenders. Each lender then conducts a credit underwriting of the consumer's application, based on the consumer's *actual* credit, and the information provided by the consumer about income, value of the home, other assets, etc. The GMPA must then be offered to the consumer contingent only upon the lender's verification of the information provided by the consumer. Unless HUD clarifies the meaning of "final underwriting" to mean just this, the entire GMPA has minimal value for consumers – only offering lenders a way of avoiding compliance with Section 8 of RESPA, and virtually all of the important provisions of TILA.

The bottom line is that it is completely unnecessary for HUD to provide an exemption from section 8 liability to create the incentive in the marketplace to offer the guaranteed interest rate and guaranteed closing costs. There is little in current law that would stop a lender from providing these guarantees now. We do agree with HUD's principle that removing the barrier of Section 8's prohibition of volume based discounts would allow lenders to shop for settlement services and thus reduce costs. However, HUD can remove the barrier this places on the marketplace without creating the problems that will result from the exemptions from RESPA and TILA. All HUD need do is remove the current regulatory barrier for volume based discounts by requiring that the value of volume based discounts be passed along to consumers. This seems a far simpler solution that the current construct for the GMPA.

Indeed, it seems quite likely that HUD need do nothing to facilitate this type of guarantee and fixed price for closing costs. At least one large lender – ABN AMRO – seems to be currently already providing this product quite successfully. This lender is providing the product, with all the guarantees that we advocate (guarantee of the interest rate as well as points and closing costs) and is doing it without the exemption from section 8 liability, and with full compliance with the Truth in Lending Act.[38]

d. Affiliated Business Arrangements Must be Disclosed in the GMPA

HUD proposes to eliminate the need for an affiliated business disclosure in the GMPA context in all situations except where the borrower is referred to a packager by a person not otherwise participating in the GMPA who is an affiliate of the packager or any participating service provider.[39]

A number of closing costs are considered "points and fees" for HOEPA purposes if the fee is paid to a service provider who is affiliated with the lender.[40] Congress passed HOEPA many years after RESPA and reasonably relied upon the disclosure requirements in other laws, such as RESPA, when crafting HOEPA. The affiliated business arrangement disclosure is critical in determining whether a loan is a HOEPA loan.

If the affiliated business arrangement disclosure is not given in a transaction where required, the ability of consumers and regulators to determine whether a loan is a HOEPA loan and to determine compliance with both HOEPA and TILA is seriously undermined.

e. A Lender's Failure to Provide the Promised Loan Must Create a Presumption that Section 8 Has Been Violated

As we have said above, although we like the ideas behind the GMPA, we are not sure that it is necessary for HUD to issue an exemption from Section 8 to facilitate offers of guaranteed rates and closing costs by mortgage lenders. However, assuming HUD proceeds with its plan to provide this mighty incentive to the marketplace by excusing these providers from strict compliance with Section 8, it must effectively hold these lenders to the promises made in the GMPA. It is completely ineffective to provide that a lender's failure to keep the undertakings made in the GMPA simply causes the lender to lose the exemption from Section 8. **If the GMPA is not abided by, the consumer has no way of determining whether a Section 8 violation has occurred, and no way of alleging one in a legal complaint.** HUD must provide that a lender's failure to keep the promises made in the GMPA to the consumer results in a *presumption* of a violation of Section 8.

Unless there is a heavy penalty for a lender's failure to abide by the promises to the consumer, there is no incentive on the lender to keep those promises. Simply allowing the consumer to sue in state court on a contract theory is meaningless – at best the consumer will win

[38] *See* www.mortgage.com.

[39] Proposed Reg. X § 3500.16(e)(2).

[40] 15 U.S.C. §1602(aa)(4)(C)(iii).

what the consumer was entitled to all along. The unethical lender has nothing to lose this way – it only needs to comply with the contract in the small percentage of cases in which it is caught.

The value of the exemption from Section 8 compliance is a very high price for consumers to pay to encourage a new practice in the marketplace (especially one which is already occurring). This price must be paid only for a truly enforceable, consumer friendly product. A lender's failure to abide by the commitments made in the GMPA must result in a presumption of a Section 8 violation.

f. Other Points Regarding the GMPA

- *HUD is Correct to Require Guarantees of Interest Rates Along with Closing Costs.* Some parts of the mortgage industry are strongly pushing HUD to transform the GMPA into a package of closing costs instead of a package of all closing costs and points and interest rate. HUD has correctly refused to allow a section 8 exemption for a lender's offer of one rate for closing costs. After all, as HUD has recognized, a lender who offers a guarantee for the closing cost package, without also guaranteeing the points and the rate, has no impediment to simply increasing the points or the rate after the consumer is locked into using the lender because the closing cost package has been purchased. Further, nothing in the law prohibits a closing cost package from currently being offered.

- *GMPA Price Must Include Single Premium Credit Insurance and Debt Cancellation Contracts.* As has been recognized by the Federal Reserve Board, single premium credit insurance and debt cancellation contracts are a significant source of equity stripping in mortgage loans.[41] It is important to note that, despite intense opposition from the credit industry on this point, that the Federal Reserve Board chose to include all single payments for these products in the point and fee trigger for HOEPA loans, regardless of whether the credit insurance is considered voluntary. As the Board pointed out, despite the fact that credit insurance is often *documented to be* voluntary, because of sales tactics and packing, most consumers believed that it was required.[42]

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[41]Federal Reserve Board, Final [HOEPA] Rule, Supplemental Information, 66 Fed. Reg. 65604, 65607, 6560-9-10 (Dec. 20, 2001).

[42]As the Federal Reserve Board noted:

> The comment letters and testimony at the hearings raised a number of concerns about single-premium credit insurance, such as excessive costs, high-pressure sales tactics, consumers' confusion as to the voluntariness of the product, and ``insurance packing.'' The term ``packing'' in this case refers to the practice of automatically including optional insurance in the loan amount without the consumer's request; as a result, some consumers may perceive that the insurance is a required part of the loan, and others may not be aware that insurance has been included.
>
> In response to the reported abuses, the Board proposed to include in the fee trigger premiums paid at closing for optional credit life, accident, health, or loss-of-income insurance and other debt-protection products; such premiums are typically financed.

Id at 65609.

- *Creditors Must Not be Permitted to Make Two Loans to Avoid the Limitations or Protections of the GMPA.* A typical mode of avoiding the strictures of HOEPA is for a lender to make two loans to the consumer for the same transaction. One loan will be for the principal amount sought by the consumer, and it will appear on the papers reflecting it to be a moderately priced and fair loan. But this loan may be accompanied with a second loan, generally made on the same day and termed a second mortgage on the property, which is entirely for the closing costs due to the lender. When the two loans are evaluated together, it is clear that had the entire transaction been consummated in one loan, the strictures of HOEPA would have applied and the lender has failed to accurately disclose the cost of the loan under TILA.[43] Lenders must be expressly prohibited from attempting to gain the exemption from Section 8 liability by using this or any other subterfuge. Indeed, **there should be a general prohibition in these rules against any attempts to evade limitations or the consumer protection purposes of the rules.**

- *The interest rate on the loan must be either locked by the consumer at the time the GMPA is offered or allowed to float only pursuant to a publicly discernable index.* This is a crucial point. Currently, consumers often choose to float their interest rates after application, which leads to considerable gaming of the yield spread by the lender. This is because once the consumer has committed to pursue a loan with a particular lender, the consumer has little ability to compare interest rates actually available to him from other lenders. The entire point of the GMPA is to ensure that the consumer understands exactly what the terms of the loan available to him or her are *before* the consumer is committed to pursue a loan with the particular lender. This all becomes meaningless if the consumer's rate is not locked. On the other hand, many consumers will want the option of committing to a particular lender, but believe that interest rates may fall between the time of application and loan closing. For these consumers, the lender can provide a readily discernable matrix, accessible to the public which is *not* consumer specific. For example, if the lender has different loan products available to consumers with different credit ratings, or loan to value ratios, the lender can inform the consumer that the GMPA is offered for a particular loan product. The consumer should be able to access the website, or a call in to a taped recording to determine at any time what the interest rate for the loan product qualified for. The critical point here is that the lender will not be able to change the rate of a particular loan based to an individual consumer.[44]

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[43] *See, e.g., Hemauer v. ITT Financial Services,* 751 F.Supp. 1241 (W.D. Ky. 1990); *In Re Buckles* 189 B.R. 752 (Bankr.D. Minn 1995); National Consumer Law Center, *Truth in Lending,* Sec. 4.9.1 (4th ed. 1999).

[44] The best example of how this might work is already available in the marketplace – *see* the information available to all viewers on mortgage rates from ABN AMRO on www.mortgage.com.

B. The Issues with the Proposal on Yield Spread Premiums

HUD has made good recommendations on how to deal with the cantankerous issue of lender payments to mortgage brokers. The Proposed Rule would amend 24 C.F.R. § 3500.7, to add a new subsection (d)(5) requiring that all yield spread premiums paid by the lender must be *disclosed in the GFE* as a payment to the borrower. This is helpful to consumers – as far as it goes. However, this proposed rule change is a significant benefit to the borrower which must be included, not only in that section of the rules relating to *disclosures*, but also in the substantive protections of the regulations interpreting RESPA's section 8,[45] that is, in 24 C.F.R. § 3500.14.

1. ***Yield spread premiums in the current marketplace***

Section 8(a) of RESPA prohibits any person from giving or receiving any fee, kickback or thing of value pursuant to any agreement incident to a real estate settlement involving a federally related mortgage.[46] This rather simple provision was the product of much debate in Congress and was created in 1974 because of the widespread recognition that referral fees and kickbacks were making the market place anti-competitive (home buyers were not being directed to a service provider who would provide them with the best deal, but instead to the provider who would pay the largest sum of money to the referring agent).[47] The rationale for this legislation was simple. Eliminate market-distorting incentives and homeowners would have real opportunity to obtain the most beneficial and cost efficient loan products available. While Section 8(a) of RESPA seems rational, fair and explicit, current participants in the home lending marketplace have gone to great effort to obfuscate the law and preserve their ability to receive and provide kickbacks at the great expense of American homeowners.

To date, yield spread premiums are generally paid by the lender to the broker solely in compensation for the higher rate loan. In other words, because the broker brings to the lender a loan at a higher rate than the consumer would otherwise qualify, the broker is paid a fee, or kickback. These fees are an extra fee that the broker is able to extract from the deal. In most cases, the borrower is not only paying an upfront broker fee, but is also paying a higher interest rate as a result of this kickback. As this practice clearly provides an incentive for brokers to obtain above par loans for consumers, the dynamics of the marketplace closely resemble the marketplace that Congress attempted to control with its passage of RESPA. This is what is going on in the marketplace today, and this is why the rule proposed by HUD is so sorely needed.

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[45] 12 U.S.C. § 2607(a); 24 C.F.R. § 3500.14(b).

[46] Reg. X §3500.14(b).

[47] For a detailed discussion of RESPA's legislative history see Statement of Prof. Howell E. Jackson, Harvard Law School, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Jan. 8, 2002, *available at* http://banking.senate.gov/02_01hrg/010802/jackson.htm.

Consumers who do business with mortgage brokers generally have the understanding that the brokers will provide them the loan at the lowest rate that the broker finds for them. Consumers have generally understood and agreed to a specific broker's fee to be paid directly by them – either in cash or by borrowing more – to the mortgage broker to compensate the broker for obtaining the loan. What consumers do not understand, and have not agreed to, is the mortgage broker receiving an additional fee from the lender. Extensive academic analysis has proven this observation to be true.[48]

Because of extensive litigation flowing from the industry's continued refusal to comply with the mandate of RESPA, in 1998, Congress issued a directive to HUD to write a Statement of Policy.[49] Despite the issuance of the 1999 Policy Statement, the industry continued as before – lenders continued to pay broker fees without evaluating either the services provided by the broker or whether the payment of the lender fee reduced the fees otherwise owed by the borrower. Because the benefit to the brokers and lenders was so great (higher fees for brokers, higher interest rates for lenders), the mortgage industry's strategy was to continue its illegal practice, pay off the few individual actions brought against it and mount a massive effort to fight class action cases challenging the payment of these fees, which might actually cost the industry real money and cause the industry to change its behavior.

Despite industry's behavior, the Eleventh Circuit ultimately held that consumers could join together in class actions and challenge this activity.[50] The industry reacted strongly to this case (*Culpepper II)* and pushed HUD to step in to clarify its policy statement. HUD accepted the invitation and issued its second policy statement on the subject on October 18, 2001. The crux of HUD's "clarification" comes on page 11, with the statement:

> HUD's position is that in order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually. . .[21]

In addition, HUD explicitly repudiated the decision in *Culpepper II* and stated its standard to be: the total compensation paid to the broker from any source (not just the lender-paid fee) must be for goods, services, or facilities. Unfortunately, the effect of HUD's 2001 Policy Statement had the intended impact on the payment of lender paid broker fees. Providing the "clarification" of the 1999 Statement as sought by the mortgage industry has had the effect of

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[48] *Id.*

[49]"The conferees expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement." See the Conference Report on the Departments of Veterans Affairs and Housing an Urban Development, and Independent Agencies Appropriations Act, 1999, H.R. Conf. Rep. No. 1050769 at 260 (1998).

[50]*Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001).

completely eliminating class actions as a form of redress for illegal lender paid broker fees.[51] Now, without class actions as a means to litigate the legality of these fees, the industry has no incentive to change its practices or even to comply with a new regulation – because there are insufficient legal resources in this nation to represent consumers in individual actions involving claims of only a few thousand dollars.

HUD's Proposed Rule on the treatment of yield spread premiums can be helpful – as far as it goes. But it does not go far enough. It is couched entirely in the context of a disclosure – and there is no private right of action under RESPA for violating its disclosure provisions.

As the Secretary has indicated, the goal is to change the current practices of allowing yield spread premiums to operate simply to increase the profit of mortgage brokers and lenders while providing little or no benefit to consumers. Given the statements of the Secretary, and the extensive testimony at the recent Senate Hearings,[52] the lack of correlation between the fees paid to a mortgage broker on a given loan and the amount of work performed by the mortgage brokers on that loan should be an accepted fact at this point. However, for HUD to make the Secretary's promise[53] a reality, several more decisive steps must be taken.

- HUD must *substantively* change the regulations regarding payments of the yield spread, not just the sections relating to disclosures.

- Before any payment is made to the broker, the borrower and the mortgage broker must enter into a *binding fee agreement*[54] regarding the total compensation, however denominated, to be paid to the broker.

- The borrower must be offered a choice of how to pay the broker fee, whether in cash, by borrowing more, or by increasing the interest rate and having the lender pay the broker fee.[55]

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[51]This has been the exact decision of several courts, including *Glover v. Standard Fed. Bank,* 283 F. 3d 953 (8th Cir. 2002); *Shuetz v. Banc One Mortgage Corp.,* 292 F.3d 1004 (9th Cir. 2002)*; Heimmermann v. First Union Mortgage Corp.,* ___ F.3d ___, 2002 WL 31067330 (11th Cir. Sept. 18, 2002).

[52]*See* Hearing on "Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums." January 8, 2002. http://banking.senate.gov/02_01hrg/010802/index.htm .

[53] Regarding this new rule, the Secretary said: "The new policy will make clear that it is illegal for a settlement service provider to mark-up fees when it is making a payment to another settlement service provider, unless it provides additional value to the homebuyer in the process, or when a provider does no work for the fee and charges an unreasonable amount." *See* HUD No. 01-105, October 15, 2002, "Martinez Moves to Protect Homebuyers; Calls for Simplified Mortgage Process."

[54]See attached Exhibit B, Model Broker Fee Agreement.

[55]See attached Exhibit C, Model Choice of Compensation Agreement.

- This choice should be offered after loan approval but before the settlement.

- The amount the broker is paid must be the same whether paid by the borrower or the lender. The amount paid the broker by the lender reduces, by the exact amount, the amount owed by the borrower to the mortgage broker.

- The total amount paid by borrower and lender must be reasonable compensation for goods, services and facilities actually provided.

These principles accomplish several things. First, the consumer knows upfront how much the mortgage broker will charge. Second, the consumer is given the opportunity to choose how this payment will be paid. Third, and most importantly, the broker compensation remains the same regardless of method of payment. This point is crucial, because it eliminates any anti-competitive incentive the broker has to place the borrower in a loan with an interest rate greater than that for which the borrower would otherwise qualify. In other words, whether the borrower chooses a below par loan, a par loan, or an above par loan with a yield spread premium, the broker compensation will remain the same. This is not how the system works today and it must be changed.

HUD's current proposal on how to treat yield spread premiums is a variation of these principles. However, as currently configured, they are neither clear enough to offer real protections to consumers, nor are they enforceable by consumers. For example, under the new proposal it is not at all clear how and when does the consumer actually exercise the choice of whether to *use* the yield spread premium. The proposed information to be included in the GFE does not necessarily include loan terms which are actually available to the consumer. It is not clear how the consumer should indicate the choice actually made.

We strongly recommend that HUD make good on the Secretary's promises and make the yield spread premium a useable – and enforceable – credit for the consumer. This can best be done by requiring two separate agreements to be executed between the consumer and the broker, one at the beginning of the relationship in which the broker states the total amount of compensation to be received for the loan, and another when the loan has been approved in which the consumer is informed of the various options by which he/she can pay the broker's fee and other closing costs, and the consumer exercises that option. Appendix 1 provides examples of how the regulations in Section 3500.14 should be rewritten to accomplish these principles, as well samples of both agreements to be required between brokers and consumers.

2. *<u>Necessary Coordination with Federal Reserve Board regarding the Potential Effect on TILA Disclosures of the Borrower "Credit"</u>*

We have two concerns regarding the *disclosure* of the lender's credit to the borrower to offset closing costs:

- we want to ensure that it does not have the effect of creating a method for lenders to camouflage the appropriate allocation of fees between finance charge and amount financed under TILA, and

- we want to be sure that consumers understand where the money comes from, and how it is being applied.

We believe the best way to address both of these concerns is for HUD to require that the lender's credit be treated similar to a deposit – to reduce the total amount due from the consumer. HUD should create a new line for this credit – which we believe should be called a *borrower's credit* in the 200 series on the HUD 1 form.

When the lender's fee is used by the consumer to reduce the mortgage broker's fee, or to reduce both the broker's fee and other closing costs, it should have *no* effect on the issue under TILA of whether certain charges are properly counted in the amount financed or the finance charge. To insure this, the lender's credit must be treated as a deposit by the consumer – and disclosed as in THE 200 series of the HUD-1. As disclosure of the full amount of the broker's fee (including all income from the loan) will drive up the principal of the loan, this *borrower's credit* should be used to reduce that principal. No matter what, the credit should not appear on the lines in the 800 to 1300 series of the HUD forms, because that will mask their payment and further confuse the consumer.

However, as HUD has already recognized,[56] treating the lender's credit as a deposit has an effect on the TILA disclosures that brokers may feel places them at a disadvantage when the disclosures on their loans are compared equivalent loans from retail lenders. (See discussion below.) We feel this disadvantage is negligible, as most consumers will be comparing the *terms* of the loans (i.e. the length and the amount of the payments) which have a more immediate effect, and these terms will always be the same.

If the lender's yield spread premium is not treated as a credit, offsetting the total amount otherwise owed by the consumer, significant confusion and lack of clarity will result. It will cause difficulty ascertaining whether TILA finance charge calculations have been appropriately determined, and it will allow some loans which should be characterized as HOEPA loans to be masked as non-HOEPA loans. It is essential that HUD not permit the yield spread premium to be treated as a cash credit against closing costs, as suggested by the proposed GFE disclosure. This method of disclosing the yield spread would create havoc with TILA and HOEPA computation rules regarding the finance charge and points and fees trigger if lenders believe that they can subtract the yield spread from any particular closing cost or from all of the origination costs. The purposes behind the TILA rules regarding the disclosure of the most important cost of credit terms, the finance charge, amount financed, and APR, will be completely undermined unless

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[56]As reflected by the analysis on this question in HUD's Economic Analysis, Chapter 5.

HUD clarifies the proposal to specify that the lender's yield spread premium is always to be treated as a deposit, and disclosed as such on the front of the HUD 1 on line 201.

In addition, HUD must work with the Federal Reserve Board Staff to issue Commentary making it clear that the yield spread premium does not offset the amount of any charge that is considered a finance charge under TILA rules or a point and fee under HOEPA rules.

Presently, all charges imposed by the creditor directly or indirectly and paid by the consumer directly or indirectly as an incident to or condition of the extension of credit is a finance charge.[57] The remainder of the statute and Regulation Z list exceptions to this broad finance charge rule. However, points and similar origination charges, such as underwriting fees, processing fees, and the like, are always finance charges. The total of the finance charges, as defined under TILA, is subtracted in full from the loan principal and the result is disclosed as the amount financed on the TILA disclosure. Additionally, the total of these finance charges plus interest to be earned over the life of the loan is placed in the "finance charge" box. The relationship between the amount financed and the finance charge on an annual basis based upon the actual term of the loan is the annual percentage rate. This is disclosed in the APR box on the TILA disclosure. The APR is higher than the contract interest rate because it takes into account certain closing costs that are considered "finance charges." The higher the amount of finance charges, the greater will be the difference between the APR and the interest rate. Conversely, the lower the total of the finance charges, the smaller will be the difference between the APR and the interest rate. These are the most important disclosures required by TILA and have assisted borrowers in shopping for over 30 years. If lenders subtract the yield spread from the "origination charges" as is suggested by the proposed GFE and use the difference when calculating the finance charge for TILA purposes, the APR will be understated. This result be devastating to the purposes of the TILA,

Further, consider the potential harmful effect upon HOEPA loans. "Points and fees" under HOEPA include fees that are considered finance charges under the above-described TILA rules as well as additional closing costs if they are unreasonable, the lender kept any part of the fee, or the fee was paid to an affiliate, all broker fees, and, after October 1, 2002, all single premium credit insurance or debt cancellation charges.[58] If lenders interpret HUD's treatment of yield spread premiums to mean that they are to be credited against charges that are otherwise points and fees for HOEPA purposes, many loans will fall below HOEPA coverage. High cost loans will then fly under the HOEPA radar screen to the harm of the homeowners since HOEPA protections would not apply.

Presently, yield spread premiums are not counted towards the finance charge because they are paid by the lender to a broker under a separate agreement and are already reflected in the

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[57] 15 U.S.C. § 1605(a); 12 C.F.R. § 226.4(a).

[58] 15 U.S.C. § 1602(aa)(4); Reg. Z § 226.32(b)(1)(iv).

finance charge disclosure as part of the interest to be earned over the life of the loan.[59] These premiums are, arguably, counted towards the points and fees trigger because those rules differ from the finance charge rules.[60] This scenario should not be changed or affected in any way by HUD's actions on the RESPA front.

If HUD proceeds with the notion that the yield spread premium should be viewed as akin to cash to the consumer to be used to reduce the loan, HUD should make clear in the Supplementary Information accompanying any final rule that any credit to the consumer has the same relationship to the calculation of the finance charges and points and fees as yield spread premiums do now. Further, the cash credit should appear on or about line 201 on the HUD-1 as a borrower deposit or credit to ensure its proper treatment for TILA and HOEPA purposes, rather on page two of the HUD-1.

3. ***HUD Must Always Refer to the TILA's interpretation of Cost of Credit Terms.***

HUD proposes to have lenders reveal the terms of loans in the GMPA which are governed by TILA and Regulation Z. These terms include the annual percentage rate, the total of payments, etc. If HUD does not specify in *its* rule that when lenders are providing this information in HUD forms that lenders must use the terms as they are defined by Regulation Z, the HUD disclosures will only be confusing and meaningless to consumers.

C. The Proposed Rules for the Good Faith Estimate ("GFE").

We applaud the bright line rules proposed by HUD to severely limit the gaming currently rampant in the marketplace on closing costs. The GFE should be a true reflection of actually anticipated costs, not an opportunity for lenders to mislead consumers – as it is currently. Lenders who make numerous loans do have the capacity to determine their own charges and those of settlement service providers that they choose and require.

1. ***Description of Originator Services Should be Modified to Avoid Conflict with State Law***

Section I of the GFE entitled "Our Services" contains the following statements: "We do not offer loans from all funding sources and we cannot guarantee the lowest price or the best terms available in the market. You should compare the prices in the boxes below and shop for the loan originator, mortgage product, and settlement services that best meet your financing needs." Both of these statements should be deleted from the GFE.

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[59] Official Staff Commentary § 226.4(a)(3)-3.

[60] Official Staff Commentary § 226.32(b)(1)(ii)-1. "Compensation paid by a consumer to a mortgage broker (directly or through the credit for delivery to the broker) is included in the calculation *whether or not the amount* is disclosed as a finance charge." (Emphasis added.) The Board has not definitively addressed this issue. *See* 65 Fed. Reg. 81438, 81442-43 (Dec. 26, 2000).

In many states, a broker can establish an agency relationship with a borrower through the broker's conduct or by written and oral representations.[61] The broker may have fiduciary duties of an agent to the borrower, which may include the duty to advise the borrower of disadvantageous loan terms in an offered loan or the duty of loyalty to the borrower that would require the broker to seek out a loan with favorable terms for the borrower. HUD's statement in the GFE therefore conflicts with obligations that may be imposed on brokers under state law. Moreover, this statement in the GFE will be used by unscrupulous brokers to defeat borrower claims that a fiduciary relationship was established or that the broker made misrepresentations about the loan terms or the broker's role.

2. *Use of the Term "Loan Originator" Should be Eliminated*

The GFE should not use the term "loan originator." This is not a term that borrowers are familiar with. More importantly, borrowers should know whether they are dealing with a broker or a lender and this identification should be disclosed on the GFE. One of the common complaints of victims of predatory lending is that they do not understand the roles of the various players in the origination process, or that they were deceived by an unscrupulous broker into believing that they were dealing with a lender or a lender's agent. HUD should require that the GFE clearly state whether the originator is a lender or a broker. It should also list the name, business address, and other identifying information of the lender or broker.

As a related matter, HUD should require in the case of a loan originated by a broker that before any payment is made to the broker and before the GFE is prepared, that the borrower and broker must enter into a binding fee agreement that specifies the total compensation to be paid to the broker. A reference to that agreement should be included in Section 1 of the GFE.

3. *Critical Loan Terms Should be Described In Section II of the GFE*

In its present form, the GFE fails to advise borrowers of critical loan terms in Section II. Terms such as prepayment penalties and balloon payments should be described on the first page of the GFE in Section II. These are important loan terms that borrowers often are unaware of until settlement and in many instances are not truly bargained for in exchange for a lower interest rate or some other loan terms. If the lender or broker is imposing a prepayment penalty or balloon payment in the loan being offered to the borrower, this should be disclosed up front before the borrower even turns to the second page to review other options in the comparison chart. Placing the disclosure of these terms on the second page after the comparison chart is not sufficient. There can be no effective comparison if borrowers don't know what they are getting in the initial offer.

[61] In addition, some states have passed legislation specifically regulating mortgage brokers and these laws may impose additional disclosure or substantive requirements.

4. *Description of Offered Options and Comparison Chart Should be Better Coordinated on GFE*

Section IV of the GFE, entitled "Options To Pay Settlement Costs And Lower Your Interest Rate," begins with a listing and description of four possible options labeled A-D. To improve the ability of borrowers to understand the options and effectively use the provided chart, the examples provided in the chart should also be labeled in the same manner. For example, the column showing the effect of a higher interest rate should be labeled: "Higher Interest Rate - Option C."

To further coordinate the listing of options with the chart, a column illustrating Option B, which refers to the option of borrowing additional funds to pay settlement costs, should be added to the chart. Borrowers should have the opportunity to compare this option, using actual figures, to the other available options.

5. *Comparison Chart on GFE of Available Loan Options Must be Based on Actual Loan Terms Offered to Borrower*

In the Proposed Rule, the Specific Instructions for completing the GFE in Section IV states that "loan originators shall use figures relevant to the borrower's transaction" when completing the chart. We are concerned that the term "relevant" is ambiguous and may encourage the use of generic, pre-printed charts based on brokers' and lenders' hypothetical loan programs. We urge HUD to clarify that the chart should be based on terms that are actually being offered to the borrower which are tailored specifically to the loan terms stated in Section II of the GFE. The first column of the chart labeled "GFE Terms You Selected" should correspond exactly with the figures listed in Section II and III of the GFE. The figures in the optional columns must reflect the actual terms the lender or broker is prepared to offer the borrower and not terms that may be included on pre-printed forms reflecting "relevant" terms from recent lender or broker loan programs. Without individualized figures based on the borrower's actual transaction, the chart will be of no value to the borrower and will actually prove to be confusing and misleading.[62]

In addition, the loan options illustrated on the chart should generally reflect terms of a loan program similar to that described in Section II of the GFE. For example, if the loan selected

[62] The importance of loan-specific terms in the chart is best illustrated by the complete failure of a similar disclosure tool, the Adjustable Rate Mortgage disclosure form given to borrowers under TILA. Rather than imposing an individualized disclosure requirement for each transaction, section 226.19 of Regulation Z permits the lender to disclose the impact of an ARM by using an historical example based on a $10,000 loan amount and not the actual amount being borrowed. In order to extrapolate how much the initial monthly payment may increase, a borrower must perform a mathematical computation, most likely with aid of a calculator. While this clearly presents problems for unsophisticated consumers, other consumers often do not take the time to perform the necessary calculation. In addition, Regulation Z does not require that the historical example be based on the actual margin used in the borrower's transaction but instead may be based on a margin that the lender has used during the preceding 6 months. By using a hypothetical loan example, the disclosure form is rendered useless.

by the borrower in Section II of the GFE is a fixed rate loan, the originator should not be permitted to fill in the chart showing a lower interest rate based on a variable rate loan product, particularly one with a lower "teaser" rate for the initial payment period.

6. *Content and Format of Comparison Chart Must be Uniform and Required by HUD to be Used By All Loan Originators*

This leads to an additional concern that it is not clear whether HUD is mandating a specific format for the chart. The Specific Instructions for completing the GFE in Section IV state that: "the originator must fill in the chart" and the "completed chart serves as an example for the loan originator of how to fill out the categories." This suggests that the chart must be identical in content and format to the chart contained on the GFE form. However, in Appendix A to Chapter 3 of the Economic Analysis, HUD states:

> The Department will not specify any specific worksheet that must be employed by originators. The examples are intended to provoke borrower questions on the subject if they have not otherwise been mentioned in the origination process. It will be left to originators to decide how to explain these options to the borrower.

Even though the GFE historically has not been an effective shopping tool because it is provided after the borrower has applied and paid an application fee, and the new GFE process may not dramatically improve this situation, borrowers should be able to readily make a comparison between offered loan options on GFEs provided by different loan originators. Uniformity in the content and format of the chart will promote this. Moreover, a required format will ensure that originators will provide the minimum information necessary for a borrower to understand the available options. HUD should clarify that a chart identical to the GFE form must be used.

On the other hand, if the statement in the Economic Analysis was intended to suggest that originators are permitted to supplement the GFE with other charts and worksheets to explain available options, HUD should clarify in the rule that additional materials or oral statements must be consistent with the GFE provided to the borrower and must be based on the actual terms being offered to the borrower.

7. *Affiliated Business Arrangement Disclosure and the GFE*

Section A of Attachment A-1 to the proposed GFE does not include a description of the relationship between the lender and any "shoppable" service providers. Regarding this absence, HUD states: "The Department proposes to forego the requirement that this listing also include the lender's relationship to the required provider."[63] We do not oppose this format so long as HUD clarifies that a separate affiliated business arrangement disclosure must be provided whenever these affiliations occur.[64] We think this is HUD's position as well. But the Department's intention is unclear given an inherent conflict in this statement and the fact that HUD is not proposing to amend § 3500.15 of Regulation X regarding affiliated business arrangements outside of the GMPA context. We strongly support the continuation of the current rule in the GFE context for several reasons.

First, transactions made in the current world of lending must include an affiliated business arrangement disclosure when the lender refers business to an affiliated service provider.[65] If the disclosure is properly and timely provided and the lender does not require the use of the affiliated business, the arrangement is exempt from Section 8 constraints. Where the lender requires the use of a particular service provider, affiliated or not, Section 8 constraints regarding the exchange of fees apply. Thus, the issue here relates to the "shoppable" services.

Under the statute, the disclosure must include the existence of this relationship and a written estimate of charge or range of charges. When disclosing the existence of the relationship, by necessity, the lender must describe the nature of the affiliation. Under its statutory authority, HUD created a form disclosure that requires an explanation of the nature of the relationship, including the ownership and financial interest, between the lender and the service provider. The proposed GFE and the Department's statement create some ambiguity regarding the agency's view of statutory mandate. If it is HUD's intent to eliminate the use of a separate affiliated business disclosure on the GFE, such action violates the statute. Since use of the proposed GFE does not exempt settlement service providers from Section 8 mandates, HUD lacks the authority to take this step simply by failing to include an additional column to describe the existence and nature of a relationship between shoppable service providers and the lender.

Second, as a matter of public policy, information about the affiliation between service providers is as important today as it was when Section 8 was enacted. Compliance with the affiliated business arrangement disclosure rules allows these affiliations to avoid the rigors of Section 8 regarding referral fees. Consumers and regulators need to know not only that there is an affiliation but also if commissions are paid or fees split (which should be revealed on the HUD-1). Without this information, Congress wisely understood that the exemption would swallow the Section 8 rules.

Third, some closing costs are considered "points and fees" for HOEPA purposes if the fee is paid to a service provider who is affiliated with the lender. Congress passed HOEPA many

[63] 67 Fed. Reg. 49134, 49149 (July 29, 2002). HUD is not proposing to amend § 3500.15 of Regulation X regarding affiliated business arrangements outside of the GMPA context.

[64] The current notice can be found at Reg. X § 3500, App. D.

[65] 12 U.S.C. § 2607(4).

years after RESPA and reasonably relied upon the disclosure requirements in other laws, such as RESPA, when crafting HOEPA. The affiliated business arrangement disclosure is critical in determining whether a loan is a HOEPA loan.

If the affiliated business arrangement disclosure is not given in a transaction where required, a consumer's and regulator's ability to determine compliance is undermined.

8. *Home Equity Lines of Credit Should be Subject to the Proposed GFE Rules*

HUD has proposed to retain the exclusion found in section 3500.7(f) for home equity lines of credit from the GFE requirements. The apparent justification for this exclusion has been that borrowers in these loan transactions are provided advance disclosures required by TILA. In addition, these loans were not as widely available as they are now. Borrowers often report, however, that these disclosures are not provided until settlement. More importantly, the TILA disclosures are inadequate and fail to satisfy the purpose of Section 5 of RESPA, which is to inform borrowers of the of amount of settlement charges they are likely to incur in a home secured loan. There is no reasonable justification for depriving consumers of this information simply because the loan is structured as a home equity line of credit, particularly if HUD is promoting the new GFE as a shopping tool to better inform borrowers of the options available to pay settlement costs.

In addition, there is substantial evidence that certain lenders are purposely structuring loans as home equity lines of credit to take advantage of the diminished disclosure requirements for these loans under both TILA and RESPA.[66] HUD should close this loophole that has been used by predatory lenders to hide the true costs of their loans from borrowers.

9. *Stated Broker Fee Must be Actual Rather Than Maximum Fee*

The stated mortgage broker fee must be the actual fee that the broker intends to charge, not the "maximum" the broker may charge. This difference is important, because having the maximum simply invites broker to accompany the written amount with a verbal statement to the effect that this is simply the "most he could charge, but his actual fee will surely be less." For the consumer to be able to use the statement of the broker's fee as a shopping tool, it must provide useful and accurate information about what the fee will be.

10. *HUD Must Always Refer to the TILA's Interpretation of Cost of Credit Terms*

HUD proposes to have lenders reveal the terms of loans in the GFE which are governed by TILA and Regulation Z. These terms include the annual percentage rate, the total of payments, etc. If HUD does not specify in *its* rule that when lenders are providing this information in HUD

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[66] Washington Department of Financial Institutions, Expanded Report of Examination for Household Financial Corporation III as of April 30, 2002, *available at* www.bellinghamherald.com.

forms that lenders must use the terms as they are defined by Regulation Z, the HUD disclosures will be only confusing and meaningless to consumers.

Part Three: Answers to HUD's Questions

The New Good Faith Estimate (GFE) Requirements

1. No. The language in the GFE is neither adequate, nor appropriate. The following two statements in the proposed form should be deleted: "We do not offer loans from all funding sources and we cannot guarantee the lowest price or the best terms available in the market. You should compare the prices in the boxes below and shop for the loan originator, mortgage product, and settlement services that best meet your financing needs."

In many states, a broker can establish an agency relationship with a borrower through the broker's conduct or by written and oral representations. The broker may have fiduciary duties of an agent to the borrower, which may include the duty to advise the borrower of disadvantageous loan terms in an offered loan or the duty of loyalty to the borrower that would require the broker to seek out a loan with favorable terms for the borrower. HUD's statement in the GFE therefore conflicts with obligations that may be imposed on brokers under state law. Moreover, this statement in the GFE will be used by unscrupulous brokers to defeat borrower claims that a fiduciary relationship was established or that the broker made misrepresentations about the loan terms or the broker's role.

2. Yes, the rule should provide the "unforeseeable circumstances" exception. However, this exception should be limited to situations that are neither within the control of the loan originator, nor reasonably foreseeable by the prudent loan originator.

3. The tolerances proposed are good and appropriate.

4. Volume based discounts are legal *so long as the value of the discount is fully passed on to the consumers.* This should be made absolutely clear. Volume based discounts that are paid to loan originators via methods other than discounts should still be prohibited.

5. We like HUD's proposals on the issues addressed in this question.

6. While we agree that subtotaling is helpful for consumers, that does not mean that itemization is unnecessary – there is no conflict between subtotaling itemized amounts. We believe greater itemization is necessary, not less. Full itemization is necessary to ensure that compliance with TILA and HOEPA can be determined.

7. While we applaud the basic ideas proposed in the new rules for the GFE, we believe they are executed in the wrong fashion. The lender credit should be reflected clearly only as a response to the borrower's express election, which should be evidenced by a separate agreement (*See comments on this issue in Part 2, Section B, above.)*

8. While we applaud the basic new ideas proposed, there is still substantial confusion that will result from the explicit new forms proposed. There is still much to be done to work derive the clearest forms.

9. We agree that it would be a good idea for the GFE and the HUD-1 to look similar and to contain the same sub-groupings. However, for the reasons explained above relating to the interaction of RESPA disclosures and determining compliance with the Truth in Lending Act, it is essential that all fees still be explicitly disclosed in the HUD-1. It would be absolutely terrible for consumers if only categories of services were to be listed on the HUD-1. That would essentially preclude enforcement of many aspects of TILA.

10. Absolutely not. No safe harbor is necessary for a broker is simply keeps the promises made in the GFE. *See Part 2, Section* B *for a full discussion on the new forms and regulatory enforcement scheme we propose for lender paid fees.*

Guaranteed Mortgage Package Agreements

11. No, no safe harbor is necessary to allow lump packages of settlement services to become available to borrowers. These are already being offered successfully in the marketplace. *See* ABN AMRO's web site – www.mortgage.com. Consumers gain no advantage from the safe harbor unless it really changes the products provided on the marketplace, and it is not clear that this will be the case. Consumers need the itemizations of fees provided on the HUD-1 to determine compliance not only with RESPA, but also with TILA and HOEPA. *See Part 2, Sections A(1)(b) and A(2) above for a full discussion of these issues.* It would probably suffice for HUD to clarify that volume based discounts are permitted, so long as they are passed through to the consumers. The prohibition against volume based discounts is the only clear regulatory inhibition on packaging closing costs today.

12. The safe harbor should not be as broad as currently proposed (*see comments, Part 2, Section A(3))*. It should certainly not be expanded.

13. *The interest rate on the loan must be either locked by the consumer at the time the GMPA is offered or allowed to float only pursuant to a publically discernable index.* This is a crucial point. Currently, consumers often choose to float their interest rates after application, which leads to considerable gaming of the yield spread by the lender. This is because once the consumer is committed to pursue a loan with a particular lender, the consumer has little ability to compare interest rates actually available to him from other lenders. The entire point of the GMPA is to ensure that the consumer understands exactly what the terms of the loan available to him or her are *before* the consumer is committed to pursue a loan with the particular lender. This all becomes meaningless if the consumer's rate is not locked. On the other hand, many consumers will want the option of committing to a particular lender, but believe that interest rates may fall between the time of application and loan closing. For these consumers, the lender can provide a readily discernable matrix, accessible to the public which is *not* consumer specific. For example, if the lender has different loan products available to consumers with different credit ratings, or

loan to value ratios, the lender can inform the consumer that the GMPA is offered for a particular loan product. The consumer should be able to access the website, or a call in taped recording to determine at any time what the interest rate for the loan product qualified for. The critical point here is that the lender will not be able to change the rate of a particular loan based on the individual consumer's change of status.

14. There is no justification for an exemption from the GMPA unless both the broker and the lender provide a promised interest rate as well as closing costs. The theory expressed in the question rightly reflects that by requiring an index disclosure, the broker would not be able to paid his fee – however, that does not justify the exemption from Section 8 compliance, it simply requires compliance with Section 8. The exemption from the most meaningful consumer protection in RESPA should not be provided unless it is absolutely clear that it is fully necessary to provide an incentive for a new product on the marketplace which will be so much more beneficial to consumers that the lost protections in both RESPA and TILA are justified. The index protection idea expressed in this question does not provide adequate benefits to justify the costs to consumers.

15. The exclusion for HOEPA loans is by no means adequate. To ensure that the GMPA does not facilitate and protect predatory loans from legal scrutiny, any loan that meets either of the following triggers should not be permitted to be made as a GMPA:

- Any loan with a prepayment penalty.
- Any loan with a guaranteed mortgage package price (the single fee) – which equals or exceeds 5% of the principal of the loan.

See Part 1, Sections A(1)(b) through (e) of these comments for a more thorough discussion of this essential point.

16.Yes.

17.Yes.

18. We believe that it is necessary for the lender to sign the GMPA before it is offered to the consumer. The foremost additional consumer protections needed to ensure that the GMPA works is that it be effectively enforceable – this would require that HUD establish a presumption that Section 8 has been violated if the GMPA is delivered as promised.

19. The current proposal for the GMPA outlines the correct approach for hazard insurance and reserves, so long as single payment credit insurance and debt cancellation agreements are *included* in the price for the GMPA. It should not be presumed that these products are truly optional. *See our comments, Part 2, Section A(3)f above, for more information on this issue.*

20. As expressed more fully in *Part 2, Section A(2)* of these comments, it is absolutely crucial that HUD not move forward with the GMPA until it fully coordinates with the Federal Reserve Board on the itemization of the charges *necessary to determine compliance with the Truth in*

Lending Act. If HUD fails to coordinate these regulations, predatory mortgages will not only be facilitated by this new rule, but also protected from legal scrutiny and enforcement of existing consumer protections.

21. We believe that the potential of mortgage insurance should be explained to the consumer in the initial GMPA along with its potential costs if the consumer's statement of the value of the residence would require it. The GMPA must explicitly state that if the estimated value of incorrect, as determined after the GMPA is offered by an independent appraisal, then the information about mortgage insurance may change.

22. The GMPA as currently outlined will make it next to impossible to enforce many of the new predatory lending laws in states such as North Carolina, Georgia and New York. However, that does not justify preemption – these laws provide significant and important protections for consumers. RESPA is the lesser important law, and its provisions should be implemented so as to facilitate compliance with these state consumer protection laws. Also, strong consumer protection laws regulating brokers and creating fiduciary duties to consumers should not be preempted. Any attempt by HUD to preempt consumer protections laws on the state level would completely the beneficial purposes of this regulation.

23. First it must be noted again, in response to this question that the GMPA is completely meaningless unless the definition of "final underwriting" in this regulation is limited to verification of consumer supplied information. The behavior described in the question – essentially performing a bait and switch of loans – should be explicitly prohibited in HUD regulations. Moreover, there should be specific prohibition against any activity which undermines the consumer protections of the GMPA.

24. No comment.

25. Both the GFE and the GMPA should contain provide conspicuous disclosures on the front page of these important loan terms: adjustable rates and balloon payments. GFEs should also provide information on the front page of prepayment penalties. As explained above, GMPAs should be prohibited for loans which include prepayment penalties.

26.As explained in considerable detail, HUD would be facilitating predatory lending if it allowed GMPAs to be provided for any loans other than prime, as defined in Part 2, Section A(1) of these comments. As explained in Part 2, Section C(8) above, the requirement for the GFE should be expanded to cover open end loans. There are now substantial upfront fees with open end loans, as well as many abuses.

27. No comment.

28. As we have stated, this is clearly one of the most important issues facing consumers of low and moderate means – *HUD must not proceed with these regulatory proposals until it is have coordinated with the Federal Reserve Board to ensure that the GMPA will not reduce the ability*

of regulators and consumers to determine and enforce compliance with the Truth in Lending Act and HOEPA.

29. HUD's rule must track the requirements of the Equal Credit Opportunity Act.

30. The new GFE must be constructed to ensure that lenders cannot bait and switch consumers between loan products.

Appendices

Appendix 1

Proposed Changes to RESPA Regulations Relating to Lender Paid Broker Fees:

Add following definitions to § 3500.2(b)

Total compensation received by a mortgage broker for bringing together a borrower and a lender to obtain a federally related mortgage loan for the borrower includes all payments made by the borrower directly to the mortgage broker in cash or in the form of any thing of value, all payments received from the proceeds of the loan, and all payments received from the lender or any other settlement service provider that are directly related to the brokering of the loan.

Par rate means the interest rate offered to a mortgage broker (through lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the mortgage broker.[67]

- **Add the following addition to § 3500.14(g).**
- **§ 3500.14(g)(4)**: The payment of a fee by a lender to a mortgage broker related to the making of a federally related mortgage loan shall not violate Section 8 of RESPA (12 U.S.C. § 2607) or § 3500.14 if all of the conditions set forth in this subsection are satisfied.[68]

(i) The mortgage broker agrees to represent the borrower, to act as the borrower's agent, and to get the most favorable mortgage loan that meets borrower's stated objectives.[69]

(ii) Prior to the preparation of the mortgage loan application or payment of any fee **by the borrower for any services related to the application or the loan**, whichever is first, the mortgage broker and the borrower **shall** complete and execute a Mortgage Broker Contract, in substantial conformity with the form in Appendix 2 to this part, that states clearly and conspicuously:[70]

  (A) the mortgage broker's total compensation, expressed both as a dollar amount and as a percent of the loan amount requested by the borrower;

  (B) the borrower owes any compensation to the mortgage broker only if the borrower

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[67] Source: HUD Statement of Policy 1999-1, 64 Fed. Reg. 10080, 10081 n.1 (Mar. 1, 1999).

[68] Source: Language mirrors Affiliated business arrangement exemption in 24 C.F.R. § 3500.15(b).

[69] Source: HUD Proposed Rule, 62 Fed. Reg. 53912, 53927 (Oct 16, 1997) (proposed Mortgage Broker Contract, Appendix 2). See also, Federal Reserve/HUD Joint Statement to Congress on RESPA/TILA reform (1998).

[70] Source: HUD Proposed Rule, 62 Fed. Reg. 53912, 53927 (Oct 16, 1997) (proposed Mortgage Broker Contract, Appendix 2). See also, Federal Reserve/HUD Joint Statement to Congress on RESPA/TILA reform (1998).

enters into a federally related mortgage loan with a lender to whom the mortgage broker referred the borrower; and

(C) the available methods by which the borrower can choose to pay the mortgage broker the total compensation in the Mortgage Broker Contract.

(iii) Following loan approval, but no later than five (5) business days before settlement, the lender and borrower enter into a Broker Funding Contract, in substantial conformity with the form in Appendix 3 to this part, that states clearly and conspicuously:

(A) the available methods by which the borrower can pay the mortgage broker the total compensation disclosed in the Mortgage Broker Contract;

(B) the par rate, the proposed interest rate, and the monthly payment (excluding escrow) of any method described in § 3500.14(g)(4)(ii)(A) when the lender offers to pay all or part of the total compensation to the mortgage broker through funds resulting from an interest rate higher than the par rate for a mortgage loan with otherwise equivalent terms and fees;

(A) that the borrower may select one of the methods described in § 3500.14(g)(4)(ii)(A).

(i) The total compensation paid to the mortgage broker compensates the broker for goods, services, and facilities and is reasonably related to the value of such good, services, and facilities.

(ii) Any fee paid by the lender to the mortgage broker for the federally related mortgage loan reduces, dollar for dollar, the amount owed to the mortgage broker by the borrower pursuant to the Mortgage Broker Contract described in § 3500.14(g)(4)(ii) and must be paid at or before the settlement.

(iii) The borrower receives a copy of the Mortgage Broker Contract described in § 3500.14(g)(4)(ii), and the Broker Funding Contract described in § 3500.14(g)(4)(iii) on the date each is signed by the borrower.

(iv) The mortgage loan, the Mortgage Broker Contract, and Broker Funding Contract do not contain provisions that waive or restrict the borrower's right to enforce the provisions of RESPA and these regulations or other rights related to the mortgage through judicial process.

3. **Add Supplementary Information regarding applicable date.** These amendments apply to mortgage loans entered into on or after January 1, 2003 [or other date in the future].

4. **Add Appendix 2, Model Mortgage Broker Agreement**

5. **Add Appendix 3, Mortgage Broker Method of Compensation Agreement**

Appendix 2
Model Mortgage Broker Agreement

Mortgage Broker Fee. You are duly authorized to assist me in obtaining a home mortgage loan. If you successfully assist me in obtaining a home mortgage loan, your total compensation from any and all sources will be:

$_____________

This amount equals _______________% of the total I wish to borrow of _________.

Method of Broker Fee Payment. I understand that after I am approved for a loan, I will be given a choice as to how I will pay your total compensation.

1. ***If I want to receive the lowest interest rate for which I qualify,*** I will pay you in full directly either in cash or from the proceeds of the loan.

2. ***If I want to minimize the amount that I directly pay you,*** I will authorize the lender to pay all or some of your total compensation on my behalf. If I choose to have the lender make this payment, I understand that, in order to repay the lender, I may receive a higher interest rate than I otherwise would qualify.

Mortgage Broker Responsibilities:

You will represent my interests. You will act as my agent. You will attempt to get me the most favorable mortgage loan that meets my objectives

Termination. This agreement will continue until one of the following events occurs:

- I fail to receive loan approval;
- My loan closes;
- I terminate your services;
- ____________ days expire from the date of this agreement without any of the foregoing occurring.

Signing this contract does not obligate me to obtain a mortgage loan through this mortgage broker, nor does it constitute mortgage loan approval.

* * Applicant______________________ Date__________________

* * Applicant______________________ Date__________________

_________________________________ Date__________________
Mortgage Broker Signature
Mortgage Broker License No. (where applicable) ________________________

Appendix 3

Mortgage Broker Method of Compensation Agreement

You have previously agreed to pay your mortgage broker $_____ for assisting you in arranging a loan with our mortgage company.

We have now approved you for a loan in the amount of $________ at an interest rate of ________.

If you are interested in accepting this loan, you can now lock in your interest rate and choose the method by which your mortgage broker will be paid.

You have the following three choices:

1. I choose to pay the mortgage broker $______ on the day of settlement from my own funds and/or from the loan proceeds.

   I will directly pay the broker $ ____, and obtain a loan with an interest rate of ___%.

2. I choose to have the mortgage lender pay the mortgage broker its entire fee of $______. **I understand that by having the mortgage lender pay the entire broker fee, my interest rate will be higher than the interest rate I would otherwise qualify for**.

   I will directly pay the broker $ 0, and obtain a loan with an interest rate of ___%.

3. I choose to pay the mortgage broker $______ on the day of settlement from my own funds and/or from the loan proceeds and have the lender pay the remainder of the fee in the amount of $_____. **I understand that by having the mortgage lender pay a portion of the broker fee, my interest rate will be higher than the interest rate I would otherwise qualify for**.

   I will directly pay the mortgage broker $_____ , and obtain a loan with an interest rate of ___%.

Your signature on this document does not obligate you to complete this loan

________________________ ________________________

Borrower's Signature Date

Appendix 4

Proposed changes to § 3500.16 Guaranteed Mortgage Package – Safe Harbor

(New language is in **bold.)**

. . . .

(e) *Exclusions from safe harbor.*

. . .

(3) The Guaranteed Mortgage Package safe harbor shall not be available where **any of the following occur:**

> **(A)** the rate or fees of a Federally related mortgage loan make the loan subject to the Home Ownership Equity Protection Act (HOEPA)**;**
>
> **(B) a federally related mortgage loan includes any penalty for prepayment of all or part of the principal of the loan;**
>
> **(C) the price for the Guaranteed Mortgage Package for the services referred to in subsection (c) do not equal or exceed 5% of the principal amount of a federally related mortgage loan.**