

November 2, 1998

The Honorable Marge S. Roukema
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Banking and Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Ms. Roukema:

Thank you for your questions regarding our concerns about mortgage reform. I hope that my answers provide some helpful information.

The subject of mortgage reform is complex and evolving. The consumer community has spent a great deal of time trying to formulate reasoned positions on the intricate issues involved. We have tried to articulate principles that would a) facilitate the mortgage shopping process, b) reduce costs and confusion to consumers, and c) reduce instances of abusive, unaffordable mortgages. The written testimony that I provided to your committee for the September 16, 1998 hearing was our joint attempt at presenting these principles in a cohesive, comprehensive package. However, there are still a number of specific issues to be addressed.

Your first question goes to whether the settlement cost portion of the package should be separated from the loan portion of the transaction, and sold as separate piece. There seems to be two questions on this issue: 1) whether we think it is a good thing for the closing cost package to be split off from the loan package and sold separately at all, and 2) assuming there is some packaging of costs, whether relief from Section 8 of RESPA should accompany those elements that are within the package.

Alone among all the participants in the mortgage reform process, the large mortgage lenders have been pushing hard for a change in the law which would mandate a guaranteed closing costs "package," without a guarantee for rates and points. In this way, the lenders could market their loans based on the closing cost package. *Consumer advocates have opposed the closing cost package by itself because it would be like marketing tires to car buyers before they purchase the car:* a borrower would likely apply for a loan based on the guaranteed closing cost package, without receiving any guarantee of the interest rate or points.

We believe, that encouraging borrowers to apply for loans based only the closing cost package would end up costing borrowers in at least two ways: 1) if the actual closing costs incurred by the lender for the loan exceeds the anticipated amount, there would be nothing to prevent the lender from increasing the interest rate or the points charged on the loan to make up for the difference; 2) in fact, there is nothing to prevent the lender from increasing the price of the loan to borrowers who have already paid so much money to apply for the loan, that they cannot afford to go elsewhere for their home loan.

We know the title insurance industry, as well as other providers of closing services, have serious concerns with this approach as well. We understand that they are concerned that the large lenders will self insure, or do other practices which will have the effect of underpricing many of the independent providers of closing services, only to squeeze them out of the market. The result would be that the overall market for that service would be less competitive, which would doubtfully be of any benefit for consumers. We share these concerns, but our primary focus remains on the up front and long range costs of mortgage loans for consumers. It does not make sense to us for only one — relatively small — piece of the mortgage price to be made readily available for shopping purposes, when all pieces are really necessary to compare the costs of a mortgage.

The costs of a mortgage to consumers includes three distinct elements: 1) the interest rate charged on the extension of credit, 2) the closing costs charged by the lender, and 3) the points charged by the lender to "buy down" the interest rate. If only one of these elements is purchased by the consumer before any of the other elements are, the consumer is locked into a loan product without knowing — or agreeing to — all of the prices for it. For these reasons, the

representatives of consumers are firmly against allowing the closing costs to be provided as a separate element for the loan without the lender also providing the other two elements — points and rate.

Further, there is really no reason why all three elements of the loan cannot be provided by the lender at the same time. Consider the information that is available from just one of the many mortgage loan shopping services provided over the Internet: If you look up the Internet site: www.homes shark.com, you will find that interest rate, points, closing costs, annual percentage rate, and monthly payment for as many as eight different lenders are provided to shopping consumers. Consumers can choose between low closing costs, low interest rate or low points as options to search for. (It is important to note that neither closing costs, nor rates are guaranteed by this lender, and I have no idea whether this mortgage broker is good, and delivers on its promises or not.) However, the format for disclosures and information provided is instructive that shopping with all three pieces of information readily available is clearly extremely helpful. Attached for your interest are copies of sample mortgage shopping requests submitted.

The second part of your first question, is whether relief from RESPA's Section 8 is justified for bundled service. As we believe that closing costs should not be bundled alone, Section 8 relief would not be appropriate just for settlement service providers.

However, we do think that relief from Section 8 provisions is warranted for settlement services *and for mortgage brokers* if closing costs, points and rates are guaranteed. In fact, I have had discussions with the NAMB representatives and MBA representatives in which we *all* have agreed that the best — and simplest — way to resolve the thorny issue of the legality of lender paid mortgage broker fees would be to provide for a guarantee of rate, points and costs early enough in the shopping process to allow consumers to truly compare different loan packages for which they qualify.

As long as a borrower must pay a significant sum of money (and the several hundred dollars generally required to apply for a mortgage loan is significant to many) *before* a guaranteed loan price is provided to the consumer, there is nothing to prevent a broker from increasing the price of the loan over what the consumer would have qualified for from the lender. Under the current system, mortgage brokers have an incentive to increase the price of the loan to the consumer, because the higher the price of the loan, the greater the profit to the broker. Further, consumers have very little way to protect themselves, because they cannot realistically simultaneously apply for more than one loan at a time. Merely guaranteeing closing costs will do nothing to change this.

However, if the consumer could shop for several loans at the same time, and receive firm price quotes which were contingent only on objective criteria (such as income and value of the house), than it would not matter what the broker was paid by the lender. The borrower would be able to compare firm price quotes from one lender with firm price quotes from another lender. The amounts that the lender paid to the broker, the appraiser, and others would not matter, because they would not affect the price of the loan to the consumer. The rationale for Section 8 prohibitions against kick backs would no longer be necessary. In effect, the market would be providing the protections to consumers that it cannot provide today.

Your next question is about whether the bundled cost approach would truly simplify the mortgage process and streamline the disclosures provided to the consumer. Again, I refer you to the information provided on the website "homes shark.com." All the information that the consumer really cares about during the shopping process is provided in this simple, comparative format for each loan amount and term: the full amount of the closing costs, the interest rate, the point, the annual percentage rate, and the monthly payment. The issue that has been raised about whether the consumer will receive comparable services from one lender versus another is a bit misleading — the only services a consumer receives from a lender is the loan.

The appraisal, credit report, survey and similar "services" are done for the benefit of the lender, not the consumer. Consumers who are purchasing homes should have their own home inspections performed which are entirely independent of the appraisal for the loan. It is misleading to consumers for them to believe that the appraisal is a service for which they receive the benefit. Appraisals are for lenders, not for consumers. (This does not mean that if a consumer pays for an appraisal, the consumer should not receive a copy.) Some lenders may choose to do their own appraisals. Some may choose to appraise simply by relying on property tax valuations. Those decisions are merely

questions to satisfy the lender's underwriters. They should not be considered a reduction in services to the consumer.

There are some related products and services which will be affected by a change in the system to the guaranteed costs and rate. For example, owner's title insurance may be impacted because some lenders may self insure rather than purchase lender's title. If this happens, presumably the cost of the stand alone owner's title might go up incrementally. We are not sure this would be the case. But even if it were to be, that seems a small price to pay for the vast improvements in the overall system of mortgage lending.

Your last question asks if the bundled approach were not adopted, how we could change the process so that the consumer gets better information at an earlier date, as well as a fairly priced product? Again, we think the key is getting reliable information to the consumer as early as possible. As HUD and the Federal Reserve Board implicitly recognized in their Joint Report, either we make the radical change, and require some guarantee on the costs before payment of any fees, or we make incremental changes and at least tighten up the disclosures that are made.

If you choose to go the moderate route, and not require guaranteed rates and closing costs before payment of an application fee, than the approach proposed in the Joint Report makes good sense: Tighten up the reliability of the Good Faith Estimate and other disclosures made just after application. Industry will argue that forcing lenders to provide a GFE with only a limited tolerance for inaccuracies is just another way of providing a guarantee, and they cannot afford to do this on some loans, especially in rural areas. But this argument ignores several crucial points: 1) It is only in the last few years that the lenders have unbundled all of the incremental costs. It used to be that almost all of these costs were borne by the lender and simply paid for from the interest recovered on the loan. There is no reason that the excess costs — over the GFE — cannot be recouped in the same way, as a cost of doing business. 2) These costs are much more clearly within the control of the lender than the borrower; it is the lender that is incurring them, and it is the lender that is generally choosing the provider for the services engendering the costs. If the risk of excess costs has to lie on one party or the other, it makes much more sense for those risks to lie on the party with the most control over them: the lender.

I hope these answers are helpful. I would be happy to come meet with you and/or members of your staff to discuss these issues further at any time. I am sure representatives from the other consumer groups in town that have been involved with mortgage reform would be interested in meeting with your staff as well. I have attached a list of the names and telephone numbers of the other advocates who have been involved in the process of producing a cohesive, pro-consumer proposal, as well as participating in the ongoing discussions with the mortgage industry.

Thank you for your interest in our views.

Sincerely,

Margot Saunders
Managing Attorney

Consumer Advocates in Washington, D.C. who have been involved with the mortgage reform process:

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