

*HUD Final RESPA Rule
National Consumer Law Center's Summary Analysis¹
December 5, 2008*

I. RESPA Rule Overview: Helpful Steps Forward, Harmful Rules, and Major Abuses Untouched

The new Good Faith Estimate Form recently promulgated by HUD—mandatory effective January 1, 2010—offers greater consistency and increased clarity in disclosure of settlement costs and loan terms. Unfortunately, the form omits the key price disclosure for mortgage loans, the APR, overemphasizes the relatively minor cost of settlement charges at the expense of an emphasis on interest and loan terms that provide the bulk of the cost of mortgage loans, and is actively misleading in its disclosure of broker compensation. The rule also fails to take on two pervasive problems in the mortgage market: products so complex few borrowers can understand them and broker profiteering at the expense of borrowers. Nor does the rule, despite its steps in that direction, significantly restrict lenders and service providers from using good faith estimates to bait and switch.

A. The Good: Helpful Steps Forward

- Streamlined disclosure of settlement costs
- Standardized disclosure of settlement costs
- Simple, clear disclosure of loan terms

B. The Bad: Harmful Rules

- Failure to disclose the APR
- Focus on settlement costs
- Misleading broker disclosure

C. The Ugly: Major Abuses Unaddressed

- GFEs used for bait and switch
- Complex loan terms
- Broker profiteering at borrower expense

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II. The Good: Helpful Steps Forward

- **Streamlined disclosure of settlement costs:** HUD has dramatically simplified and standardized the early disclosure of closing costs. The mandated format requires totaling of subcategories of costs, which should be helpful for borrowers trying to compare total costs. The disclosed settlement costs are required to be fixed for ten (10) days to permit borrowers to shop. If the borrower closes on the loan within the ten days, many settlement costs cannot change, while others can only change in the aggregate by 10%. HUD has also revamped the closing settlement statements, the HUD-1 and HUD-1A, to facilitate comparisons between the GFE and the final settlement statement.

This streamlined disclosure of settlement costs is a good thing from the perspective of most consumers. Hopefully, the Federal Reserve Board and Congress will follow HUD's lead and simplify the overly-complicated Truth-in-Lending finance charge definition. Without simplification of the finance charge, the settlement statements may no longer remain an adequate itemization of the amount financed for Truth-in-Lending purposes.

- **Standardized disclosure of settlement costs:** Currently, lenders are free to and do use a wide variety of formats and descriptions to disclose the good faith estimates of closing costs. HUD is now mandating a single format for the Good Faith Estimates (GFEs).
- **Simple, clear disclosure of loan terms:** Perhaps the best feature of both the revised GFE and the settlement statement is the disclosure of loan terms, including the maximum payment and the presence of balloon payments, negative amortization, and prepayment penalties.

III. The Bad: Harmful Rules

- **Failure to disclose the APR:** HUD has not required the disclosure of the key cost of credit, the annual percentage rate, on either the GFE or the settlement statement. The annual percentage rate, or APR, is the only number that combines both the interest rate and the fees and accounts for the fact that payments are made over time. This failure by HUD undercuts the utility of the GFE as a single shopping tool, undermines the effectiveness of the Truth-in-Lending disclosures, and underlines HUD's misplaced focus on settlement costs to the detriment of interest, the major cost component of any mortgage loan.
- **Focus on settlement costs:** The GFE consistently emphasizes total settlement charges. HUD was explicit in its desire to encourage borrowers to shop on settlement costs. The problem is that if borrowers shop on settlement costs they are likely to focus less on interest, which is always a bigger part of the loan. Thus, the GFE risks being either irrelevant to borrowers seeking price information or, worse, misleading to borrowers engaged in price shopping.
- **Misleading broker disclosure:** HUD's mandated broker disclosure is misleading. HUD quite rightly recognized that existing disclosures of lender-paid broker

compensation are inscrutable. However, HUD's insistence on characterizing lender-paid broker compensation as a credit to the borrower without any substantive regulation to make it so is nothing more than wishful thinking. Nor did HUD do any meaningful testing of the broker compensation disclosure; all of HUD's testing focused on having borrowers compare two loans that differed only by the total settlement costs, not along the three dimensions by which real-life loans typically vary: loan terms, interest rate, and total settlement costs. HUD relies for disclosure of the nuances of lender-paid broker compensation on an innovative and interesting tradeoff box. Yet the tradeoff box also relies on the mischaracterization of lender-paid broker compensation as a credit to the borrower, does not capture the full range of reasons for lender-paid broker compensation, and is optional for lenders to complete.

Additionally, the specific cost of the consumer's mortgage broker disappears, since both lender and broker-paid fees are added to the "origination" charge. As a result, consumers cannot tell how much, in fact, their broker is getting. Bundling the cost of many services into the origination charge creates significant hurdles for supervisory agencies and consumers when checking for compliance with the Truth-in-Lending Act.

IV. The Ugly: Major Abuses Unaddressed

- **GFEs used for bait and switch:** The GFE gives the appearance of providing a binding shopping document. However, there is no requirement of an interest rate lock. Even the settlement costs are only locked for ten business days, or two weeks. Borrowers may find when they complete their shopping that terms have changed. Both the generous aggregate tolerances and the ability of lenders to correct errors in disclosure up to 30 days after closing mean that borrowers cannot rely on the numbers disclosed on the GFE. Finally, Congress has not provided for a private right of action for failure to provide the GFE. Until Congress corrects this oversight, borrowers seeking redress for an originator's violation of federal law must piggyback their RESPA claims on state law claims, with varying proof requirements, statutes of limitation, and damage standards.
- **Complex loan terms:** HUD's disclosure of loan terms is, in places, so dense as to be confusing and in other places overly simplistic. Sometimes HUD's mandated language is both confusing and overly simplistic. For example, HUD's three sentences on the final settlement statement disclosing interest rate changes cannot be completed clearly and truthfully for most of the adjustable rate mortgages sold in the last ten years.² The problem is not fundamentally with HUD's disclosure: the

² The first sentence, "The first change will be on ___ and can change again every ___ after _____," would require a crystal ball to complete truthfully, since most contracts only provide that the rate *may* change, and if rates drop, stay the same, or increase only slightly, there will be no change in the rate paid by the borrower. The second sentence, "Every change date your interest rate can increase or decrease by ___%," presumes a uniformity lacking in the mortgage market. For most subprime ARMs, the initial rate is the floor, so that at least at the first change date, there can be no decrease. For most option ARMs, there is no cap on increases at change dates, and for most hybrid ARMs, there is a different cap at the initial and subsequent change dates. The third sentence, "Over the life of the loan, your interest rate is guaranteed never to be lower than ___% or higher than ___%," would be misleading

problem is with the complexity that Congress and banking supervisors have allowed to develop in mortgage products, far beyond what can be clearly disclosed. Thus, without addressing the underlying complexity of the loans, HUD's new disclosure regime unsurprisingly fails to be clear and truthful.

- **Broker Profiteering at Borrower Expense:** Virtually no one who commented on HUD's proposed mortgage broker compensation disclosure believed it was clear, correct, or justified by HUD's testing. Again, the problem is not fundamentally with the language of the disclosure (although the language of the disclosure certainly could be improved and may complicate review for Truth-in-Lending compliance). The problem is that mortgage broker compensation is complex, confusing, and often needlessly expensive for borrowers. HUD's own studies indicate clearly that lender-paid broker compensation more often than not contributes to overpricing of all aspects of the loan: the broker fee, the settlement costs, and the interest rate. That this overpricing is particularly prevalent for African Americans and Latinos underscores the fundamental need for substantive limits on lender-paid broker compensation.

HUD also removed the origination caps on FHA loans, the federally-insured loans designed to serve the most vulnerable borrowers in the market. Removing the cap on origination costs seems at odds with HUD's stated purpose of lowering settlement costs and restricting broker profite