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Before the

Committee on Small Business

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Hearing on

"The Real Estate Settlement Procedures Act (RESPA) and Its Impact on Small Business"

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Chairwoman Velazquez, Ranking Member Chabot and members of the Committee, my name is David G. Kittle, CMB, and I am Chairman-Elect of the Mortgage Bankers Association (MBA).[1] Thank you for the opportunity to testify before the Committee today as you consider HUD's recent proposed rulemaking concerning the Real Estate Settlement Procedures Act (RESPA) and its impact on small business.

I have been in the mortgage lending business for 30 years and am currently President and Chief Executive Officer of Principle Wholesale Lending, Inc. in Louisville, Kentucky. It is a great privilege for me to testify today before this committee as both a small businessman and a mortgage banker.

In my capacity as an officer of MBA and throughout my career, I have worked with lenders of all sizes and business models from across the nation to develop MBA's policies on mortgage reform. Our membership of 2,400 companies spans small, medium and large mortgage bankers as well as hundreds of small businesses in ancillary industries including law firms, technology vendors, mortgage brokers and title companies.

Before I begin, please let me say, Madam Chairwoman and Ranking Member that, as you know, your hearing is particularly timely. MBA, other organizations and the public at large are very much engaged in considering HUD's RESPA proposal published for public comment on March 14, 2008[2] with comments due by June 12. We at MBA have been carefully reviewing the rule and are grateful for the efforts of 148 members of the House that successfully requested an extension of the comment period.

Also, let me say that MBA commends this Committee for its ongoing efforts to carefully consider the impacts of regulatory initiatives on small business and reform of the mortgage process, in particular. While simplification of the mortgage process and reform of both the RESPA and the Truth in Lending Act (TILA) requirements is a first priority of MBA and the mortgage industry, MBA does not believe improvements should unduly harm small businesses. MBA believes that small businesses operate effectively in all aspects of the mortgage process and should continue to do so. At the same time, MBA also believes that unnecessary charges and abuses of consumers be they by large or small businesses are a stain on the industry and a burden on consumers seeking to achieve and maintain the American dream of homeownership.

The rule, as proposed by HUD, however, will have significant effects on small businesses and other businesses as well. The effects of the proposed rule would include:

1) Retooling – Extensive system changes, training and other initial costs;

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] The proposed rule (73 Fed. Reg. 14030 (March 14, 2008)) would amend Regulation X, under the RESPA statute, (12 U.S.C. §2601)

2) New disclosure requirements going forward – A more extensive GFE, a HUD-1 which is not fully comparable to it, and a new closing script all of which will necessitate additional time and resources resulting in ongoing costs; and

3) Litigation risks – A considerable number of new obligations that, in some cases, may conflict with other statutes and regulations, which present new liability and can be expected to result in additional costs.

These concerns must be balanced against statutory requirements and other alternatives, but MBA considers them significant.

I. BACKGROUND

A. The Statute

RESPA was enacted in 1974, for the stated purpose of effecting "certain changes in the settlement process for residential real estate that will result –

> (1) in more effective advance disclosure to home buyers and sellers of settlement costs;
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> (2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;
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> (3) in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and
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> (4) in significant reform and modernization of local recordkeeping of land title information.''[3]

Section 4(a) of RESPA[4] requires the HUD Secretary to develop and prescribe ''a standard form for the statement of settlement costs which shall be used… as the standard real estate settlement form in all transactions in the United States which involve "federally related mortgage loans.'' The law further requires that the form ''conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement..."[5]

Section 5 of RESPA[6] requires the HUD Secretary to prescribe a Special Information Booklet for borrowers. Sections 5(c) and 5(d) of RESPA require each lender to provide a Good Faith Estimate (GFE), as prescribed by the Secretary, within three days of loan application, and that the GFE state ''the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement..."

Section 8(a) of RESPA[7] prohibits persons from giving and from accepting ''any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that [real estate settlement service business] shall be referred to any person."[8]

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[3] 12 U.S.C. §2601(b).
[4] 12 U.S.C. §2603(a).
[5] Ibid.
[6] 12 U.S.C. §2604.
[7] 12 U.S.C. §2607(a).
[8] Ibid.

Section 8(b) of RESPA prohibits persons from giving and from accepting ''any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.''[9]

Section 8(c) provides, in part, that ''[n]othing in [Section 8] shall be construed as prohibiting… the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed…"

Section 8(c) provides "Nothing in this section shall be construed as prohibiting… (4) affiliated business arrangements so long as (A) a disclosure is made of the existence of such an arrangement to the person being referred and, in connection with such referral, such person is provided a written estimate of the charge or range of charges generally made by the provider to which the person is referred… (B) such person is not required to use any particular provider of settlement services, and (C) the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship, or (5) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture…."[10]

HUD's RESPA regulations, Regulation X,[11] implement the statute including, among other provisions, the requirements for the GFE, to be provided at or within three days of application, the settlement information booklet and the HUD-1 Settlement Statement (the HUD-1) as well as the anti-kickback and affiliated business provisions.

B. Past Reform Efforts

Though the law was enacted in 1974, as early as the 1980's, the Reagan Administration is reported to have considered reform of RESPA to simplify the mortgage process. In 1992, HUD amended its RESPA rules to implement amendments to the law to permit affiliated businesses (formerly termed "controlled businesses") in accordance with the requirements of section 8(c)(4).[12] Also in 1992, under an opinion of the HUD Office of General Counsel and then through HUD's 1992 rule revisions, HUD required the disclosure of mortgage broker fees in table-funded transactions.[13]

In 1996, Congress required HUD and the Board to simplify and improve RESPA and the TILA disclosures and, if necessary to make recommendations to Congress to do so.[14] In 1998, as a result, HUD and the Board reported to Congress and made recommendations to establish a firmer GFE and to provide an exemption to RESPA to permit guaranteed packages of mortgage services.[15] About the same time, after considerable litigation and consumer complaints that payments by lenders to mortgage brokers amounted to illegal kickbacks, HUD conducted a

[9] 12 U.S.C. §2607(b).
[10] 12 U.S.C. §2607(c)(2).
[11] 24 C.F.R. §3500.
[12] 67 Fed. Reg. 49134 (July 29, 2002).
[13] August 14, 1992 legal opinion by Frank Keating, General Counsel, HUD.
[14] See Section 2101 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009.
[15] Personal Responsibility and Work Opportunity Reconciliation Act, Pub. L. No. 104-193 (August 22, 1996).

negotiated rulemaking and issued a proposed rule concerning the legality and disclosure of mortgage broker fees, which were not finalized.

In 1999 and 2001, in the face of continuing litigation concerning the legality of mortgage broker fees, HUD issued policy statements clarifying its position on the issue that also included a call for improved disclosure.[16] Industry groups supported the policy statement.

In 2002, nearly six years ago, HUD proposed to reform its disclosure requirements under RESPA to: (1) provide an exemption from Section 8 of RESPA for guaranteed mortgage packages; (2) revise its good faith estimate requirements to establish tolerances for those not seeking the mortgage package exemption; and (3) improve the disclosure of mortgage broker fees. As a result of opposition to the rule from the title, mortgage brokerage and (ultimately) the mortgage lending and real estate brokerage industries, HUD withdrew its proposal in 2004.

In 2005, HUD conducted a series of seven roundtables to solicit the views of industry and consumer groups regarding RESPA reform, including small businesses.

C. The Current Proposal

Over two years later, HUD issued its proposed rule on March 14, 2008. The new rule would:

(1) Establish a four-page standard GFE form;

(2) Impose tolerances to limit increases in GFE estimates at closing;

(3) Revise requirements for disclosure of mortgage broker fees as ‘the credit or charge for the interest rate you have chosen,” as quoted in the proposed GFE;

(4) Make changes to the HUD-1 intended to facilitate comparison between GFE and HUD-1 charges;

(5) Establish a new script to be read to borrowers at settlement concerning final loan terms and settlement costs;

(6) Revise regulations to permit certain average-cost pricing and volume discounts;

(7) Clarify “required use” requirements to restrict disincentives to use of non-affiliates;

(8) Make technical amendments to the RESPA rules; and

(9) Permit a 12 month implementation period for the new GFE.

The proposal also announces that HUD intends to seek legislative changes to: (1) authorize the Secretary to impose civil money penalties for violations of section 4 of RESPA (the Settlement Statement), section 5 (the GFE and Special Information Booklet), section 6 (servicing), section 8 (kickbacks, referral fees and unearned fees), section 9 (title insurance), and section 10 (escrows); (2) require delivery of the HUD-1 to the borrower three-days prior to closing; and (3)

[16] *See* RESPA Statement of Policy 1999-1, 64 Fed. Reg. 10080 (March 1, 1999), and Clarification of RESPA Policy Statement 1999-1, 66 Fed. Reg. 53052 (October 18, 2001).

expand and make uniform the statute of limitations applicable to governmental and private actions under RESPA.

II. MBA's VIEWS ON THE RESPA PROPOSED RULE

Since HUD last issued its proposed rule in 2004, the real estate industry and the mortgage system have experienced a crisis of a magnitude that was largely unexpected and has been nearly unprecedented. While the crisis has resulted in pervasive dislocation and hardship for consumers and businesses alike, its benefit has been to again bring into focus what has been working in the mortgage system and what must be improved.

Notably, this crisis has many victims and causes. The causes range from economic conditions, excess capacity and escalating real estate prices to outsized investor and borrower appetites. The victims include more than borrowers themselves but also include future borrowers, communities and the economy at large.

While MBA does not believe that the lack of transparency in the mortgage process is the main cause of borrower difficulties, or that its improvement is the only solution, greater transparency could help stem abuses. The sheer volume and opacity of disclosures today allows abusers to hide in plain sight. Long before the current market crisis, MBA consistently supported simplification and much greater financial literacy for consumers in the mortgage market. MBA now believes that problems in the industry are a good reason to redouble efforts in both these areas.

Greater transparency would better empower consumers to understand and pick among the range of choices available from the mortgage market based on their own financing needs and risk appetites while at the same time allowing them to shop and compare offers.

MBA applauds HUD's continuing efforts at improving RESPA disclosures to simplify the mortgage process. At the same time, MBA also applauds the Federal Reserve's efforts to improve mortgage broker fee disclosure[17] as well as its recognition that TILA disclosures need updating to reflect the increased complexity of mortgage products.[18]

Having evaluated HUD's and the Board's proposals, thus far, however, it is clear that there are considerable variations between the Board and HUD's approaches to reform. Mortgage broker fee disclosure is an excellent example, where the Board proposes a clear agreement between broker and consumer while HUD's approach is far from direct. Also, HUD's proposed summary of loan terms discloses many of the terms of credit which are the Board's province under TILA but, at the same time, discloses only the note rate of the loan and not the annual percentage rate (APR). This will prove confusing to both consumers and industry.

Considering these variations, the costs of changes to accommodate new requirements and, most importantly, the unmistakable need for borrowers to better understand both the terms of their loans as well as their costs, MBA strongly believes that HUD's efforts should not be

[17] 73 Fed. Reg. 1672 (January 9, 2008).

[18] "The Board recognizes that [TILA] disclosures need to be updated to reflect the increased complexity of mortgage products. In early 2008, the Board will begin testing current TILA mortgage disclosures and potential revisions to these disclosures through one-on-one interviews with consumers. The Board expects that this testing will identify potential improvements for the Board to propose for public comment in a separate rulemaking." 73 Fed. Reg. 1673 (January 9, 2008).

finalized at this time and should be combined and harmonized with the Board's efforts to reform its TILA disclosures. Indeed, MBA strongly believes HUD and the Board should work together to develop, reissue and finalize joint rules to simplify both the RESPA and TILA disclosures.

MBA believes that only through comprehensive reform can consumers take advantage of better transparency and lower costs. MBA requests that both HUD and the Board involve industry and consumer advocates to help shape the proposals and utilize consumer testing to ensure that improvements increase consumer understanding. Separate and conflicting efforts will create more confusion for consumers and increase costs for everyone involved.

If HUD determines to go forward and finalize the proposed rule independently, MBA believes the effort should be pared back considerably and put on a timeline that would match the Board's efforts. However, assuming HUD goes forward with the rulemaking, MBA preliminarily plans to submit the following comments to HUD:

A. HUD's summary of loan terms should be excluded from the GFE for now and should instead be developed in conjunction with the Board;

B. MBA supports improvement of the GFE and HUD-1 and harmonization between the forms, it therefore has strong concerns about HUD's approach;

C. The proposed GFE is far too long and would overload the borrower with unnecessary material, counter to HUD's and MBA's goal of increasing transparency. MBA believes HUD should instead adopt a one-page GFE or, possibly, a combined TILA-RESPA form with the Board's concurrence;

D. MBA supports revision of the GFE to explicitly disclose mortgage broker charges and complement the Board's proposed mortgage broker fee agreement;

E. While MBA appreciates HUD's efforts to establish a GFE application to facilitate shopping, this aspect of the rule should not be finalized until it is made clear how this change will interface with other laws;

F. While MBA would consider supporting limits on increases in fees from lenders and mortgage brokers from the time of application until settlement, it has serious concerns about HUD's proposal to limit lenders to a zero tolerance and make them responsible for the charges of third party providers;

G. The proposed changes to the HUD-1 to refer to the new GFE fail to achieve the objective of making the GFE and HUD-1 harmonized and readily comparable;

H. Implementation of a "closing script" to be read at closing and to be signed by the borrower presents several concerns, and further underscores the lack of comparability between the documents;

I. MBA supports HUD's proposal to clarify that lenders and brokers can use average cost pricing for settlement services within any class of transactions, with some modifications;

J. While MBA supports HUD's proposal to clarify the legality of volume discounts, MBA believes the proposal is too restrictive;

K. Concerning the proposed revisions to prohibitions against requiring the use of affiliates, MBA believes it would be sufficient for HUD to reaffirm that it may scrutinize discounts to ensure that they are *bona fide* rather than depriving borrowers of certain discounts altogether;

L. MBA generally supports HUD's efforts to update its RESPA regulations concerning mortgage servicing transfers and escrows and to explicitly recognize the applicability of ESIGN[19] to RESPA;

M. MBA will consider supporting HUD's legislative proposals as they are developed in the context of the enforcement and the authorities of others; and

N. MBA supports an implementation schedule that would link implementation of this rule to the Board's forthcoming TILA reform rule for any aspect of this rule that requires retooling or systems changes.

III. HUD and the Board Should Coordinate on Comprehensive RESPA-TILA Reform

As I have indicated, MBA strongly supports simplification of the mortgage process. Nevertheless, having evaluated HUD's and the Federal Reserve Board's efforts thus far, MBA believes that HUD's efforts should not be finalized at this time, but HUD rather should work in concert with the Board's efforts to reform TILA.

RESPA and TILA are the primary laws Congress enacted to provide information to consumers concerning mortgages.[20] They cover different aspects of the same transaction. RESPA is intended to provide consumers information on their closing costs and TILA is intended to provide consumers information on their costs of credit. RESPA and TILA disclosures are provided to most borrowers at the same time.

Problems in the mortgage market indicate that while some borrowers may have made bad choices, the difficulties of others, in part, may have involved confusion concerning adjustments to mortgages rather than merely the costs for their loans.[21] Others may have entered into products they did not understand. Better information on both credit terms and loan costs, as well as better information on mortgage broker compensation, would better empower borrowers and protect them from abuse. The need for improvements in both understanding credit and settlement costs gravitates toward both HUD and the Board working together in the reform process so that both RESPA and TILA disclosures are compatible.

Piecemeal, s*eriatim* reform of the RESPA disclosures, followed by reform of the TILA disclosures, would be exceedingly costly to businesses both small and large and ultimately to consumers. New disclosures along the lines HUD proposed will require substantial retooling of systems and considerable expenses for training, compliance and staffing. Changes to TILA can be assumed to result in similar costs. Since the mortgage crisis has led to tightened and more costly credit for lenders and borrowers alike, these very considerable expenses would occur at just the time that the industry and consumers can least afford them. Moreover, if the efforts of

[19] Electronic Signatures in Global Commerce Act, 15 U.S.C. §7001-7031.
[20] The Truth in Lending Act covers credit in addition to mortgages: "It is the purpose of this subchapter to assure a meaningful disclosure of credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices" (TILA §102, 15 U.S.C. §1601).
[21] MBA data of the third quarter of 2007 showed significant percentages of investor properties among all loan types in several states: Arizona 22 percent; California 16 percent; Florida 22 percent; and Nevada 22 percent.

the agencies are not compatible they will confuse consumers and increase the costs to industry and consumers even more.

HUD's own Regulatory Flexibility Analysis estimates that the total one-time costs to the lending and settlement industries of the new GFE and HUD-1 alone will be $570 million, $390 million of which are estimated to be borne by small business.[22] HUD estimates that the total recurring costs are estimated to be $1.231 billion annually or $98.74 per loan. While MBA believes these costs are underestimates, even if they were accurate the costs of TILA reform, following after these costs are incurred, can be expected to present at least an invoice of a similar size for retooling, retraining, re-staffing and other costs to the industry. If, on the other hand, RESPA and TILA changes were accomplished together, it is reasonable to anticipate that economies could result in costs approximating those for just the GFE and HUD-1. MBA believes HUD and the Board should work together to reduce costs to small and large businesses and consumers.

At the same time, hasty efforts at mortgage reform should not be justified based on current market difficulties. While it is clear that borrowers are experiencing higher default and foreclosure rates today than they have in recent years, the great majority of loans and borrowers in the nonprime market are performing well, as are the vast majority of prime loans. The area of greatest concern has been nonprime adjustable rate mortgage (ARM) loans and particularly hybrid ARMs (which employ an extended introductory rate period with an adjustable rate feature at the end of the introductory period) which are generally no longer available in today's market to these borrowers.

As mortgage applications have risen over the last two decades, so too have the percentage of families realizing – and successfully sustaining – the dream of homeownership. This is due to several main factors including lower interest rates (which are at historically low levels – even today), risk-based pricing and a host of industry efforts and innovations. According to the Board's own Flow of Funds data, the value of residential real estate assets owned by households has increased from $10.4 trillion in 1999 to $20.1 trillion as of the first quarter of 2007, and aggregate homeowner's equity now is $9.6 trillion. Unnecessarily increased costs that might stem from unwise reforms should not be allowed to undermine the objective of sustainable homeownership.

IV. If HUD Goes Forward Independently

Once again, MBA strongly reiterates that HUD and the Board should work together in the interests of industry and consumer alike. However, if HUD decides to finalize the proposed rule without such coordination, MBA believes the rule should be pared down and several significant changes should be made before a final rule is published. These recommendations will be detailed in the comment letter MBA will be submitting to HUD before the deadline for public comments on the proposed rule.

A. HUD's summary of loan terms should be excluded from the GFE for now and should instead be developed in conjunction with the Board.

MBA commends the "Summary of Your Loan Terms" proposed by HUD at the beginning of HUD's proposed GFE. It believes that, much like the so-called "Schumer block," that has been

[22] 73 Fed. Reg. 14102 (March 14, 2008).

extremely useful to credit card shoppers, such a summary could provide borrowers key information to better understand mortgages and to shop among them.

Nevertheless, MBA believes that the summary HUD proposes is illustrative of the need for HUD and the Board to work together. A useful summary must include information on the cost and terms of the credit being extended, as well as a summary of attendant settlement charges. HUD's proposed summary discloses the "initial interest rate of the loan" but not the "annual percentage rate" or "APR." Notwithstanding, a borrower will be confronted with a TILA disclosure providing the APR. HUD's proposed form also discloses to the borrower whether the interest rate may rise, whether the loan has a prepayment penalty and whether the loan has a balloon payment, all of which are matters that are addressed on TILA forms.

MBA believes a better approach is for the Board and HUD to arrive at a combined summary form, utilizing the input of concerned groups and consumer testing. Considering that the Board is expected to move forward soon, until the Board's and HUD's efforts are coordinated, MBA believes that HUD should exclude the summary material. The Board and HUD should collaborate to develop and implement such a summary.

B. MBA supports improvement of the GFE and HUD-1 and harmonization between the forms, it therefore has strong concerns about HUD's approach.

MBA believes as a general matter that the proposed GFE is far too long and will be largely ignored by consumers. The proposed changes to the HUD-1 also fall far short of making the GFE and HUD-1 correspond, we believe, at least in part, necessitating the use of a "closing script" to be read by the closing agent and signed by the borrower. MBA believes that a better approach would make the GFE provided at application correspond to the HUD-1, obviating the need for the closing script altogether.

C. The proposed GFE is far too long and would overload the borrower with unnecessary material, counter to HUD's and MBA's goal of increasing transparency. MBA believes HUD should instead adopt a one-page GFE or, possibly, a combined TILA-RESPA form.

A key portion of HUD's proposal is the establishment of a standard four-page GFE form.[23] The form would disclose:

(1) in a summary, the loan details specifying the loan amount, term, interest rate, initial payment, rate lock period, whether the amounts for principal, interest and mortgage insurance can rise, whether the loan has a prepayment penalty or a balloon payment and whether the loan includes a monthly escrow payment for taxes and insurance;

(2) the costs in ten cost categories including

(a) lender and mortgage broker charges known as "our service charge;
(b) the YSP or points as "credit or charge for the interest rate chosen," and then "adjusted origination charges;"
(c) required services selected by the originator;
(d) title services and title insurance;
(e) required services the borrower can shop for;
(f) government recording and transfer charges;
(g) reserves or escrow;

[23] See proposed GFE form at 73 Fed. Reg. 14095-8.

(h) daily interest charges;
(i) homeowner's insurance; and
(j) optional owner's title insurance;

(3) advise the borrower of the relationship between the interest rate and the borrower's settlement costs; and

(4) various other information for borrowers including how to apply for the loan, estimated taxes, flood and property insurance premium information, a shopping chart, and information about lenders receiving additional fees by selling the loan at a future date.

While MBA appreciates HUD's effort to create a comprehensive document to help the borrower shop and better understand the mortgage process, MBA believes the resultant document is far too long and would overload the borrower with material that ultimately would be ignored and therefore counterproductive to HUD's and MBA's own consumer protection objectives.

As indicated, RESPA requires that lenders provide a "good faith estimate" of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as developed by the Secretary in conjunction with a Special Information Booklet prescribed by HUD.[24]

While MBA does not object to the grouping of the amount or ranges of specific services on the GFE in a manner that is comprehensible and comparable, the form itself should be modified so it is mainly a list of charges with minimal supplementary material. MBA believes most of the material on the form, except the costs, should be moved to explanatory materials, such as the Special Information Booklet.

If HUD moves forward using its proposed GFE, MBA has numerous comments regarding the proposed GFE form which will be provided in its comment letter to HUD. These include, but are not limited to:

a. The term "originator" and "origination" services should not be used on the form. Instead the terms "lender" and "mortgage broker" should be used. The latter terms are, or should be understood by borrowers to reflect the differing roles in the transaction of these entities. As an appendix to this testimony, MBA is providing an MBA paper discussing the differences between mortgage bankers and mortgage brokers which should guide the use of this nomenclature;

b. The information concerning how long the costs and interest rate are open to borrower acceptance needs greater clarification and could be provided in accompanying materials. If this material is included in the GFE form and the accompanying rule instructions should make clear that the interest rate in the GFE may be available until a specified hour and date. Rates frequently change several times a day. If the point concerning the estimated settlement charges is included in the GFE, the form, the rule and accompanying instructions should make clear that the estimate for some of these charges may not vary from this GFE, considering that only some of these charges are subject to tolerances (see below). If the point concerning when the loan must be closed is included on the form, it should note that the date will not finally be set until the borrower actually

[24] The "good faith estimate" and the booklet are authorized under Section 5 of RESPA (12 U.S.C. §2604).

applies for a loan and that such date may be governed by the rate lock chosen by the lender and borrower;

c. As indicated, while MBA believes that a "Summary of Your Loan Terms" could be useful, the summary should be removed from the GFE and coordinated with the Board;

d. The use of term "Adjusted Origination Charge" at the bottom of the first page is not helpful to consumers. It introduces new concepts in an atmosphere where it is difficult for the consumer to understand the costs themselves;

e. Similarly, on the top of the second page, MBA does not regard the introduction of the new term "Our service charge" to cover both lender and broker fees as helpful to the lending industry or to the consumers we serve;

f. All of the material on page three, advising on how to shop, which charges can change at settlement and the trade-off chart can be moved to explanatory materials;

g. Similarly, all of the information on page four, with the possible exception of how to accept the GFE, should be moved to accompanying materials. A description of the homeowner's financial responsibilities, how they should get more information, and how to use a shopping chart, while well-intended, needlessly lengthens the form and risk its disregard by the borrower; and

h. Finally, MBA does not believe the material on whether the loan is sold is at all helpful to borrowers or relevant to the GFE.

Two years ago, MBA developed, with its members, its own proposed GFE form which it presented to HUD on a few occasions. In HUD's Economic Analysis, HUD critiqued the form.[25] In large measure, HUD objected to the presentation of the yield spread premium (YSP) and supported its own approach. HUD also expressed concerns about the presentation of some items on the forms.

MBA does not support HUD's approach to broker disclosure and is in the process of modifying its proposed GFE and HUD-1 to address the mortgage broker fee agreement that the Board has proposed and other regulators are requiring. MBA is also working through HUD's other objections. MBA is developing a revised GFE and revised HUD-1, which MBA expects to submit to HUD with the comment letter on this proposed rule. As soon as it is revised further, MBA also plans to provide it to associations across the industry and to supplement it with a model summary and a draft mortgage broker fee agreement.

MBA maintains that a form along the lines of the MBA GFE form is much more useful than the proposed GFE. It has the virtue of being much shorter and arrived at by those who make mortgage loans and day-in and day-out are presented with consumer questions. It also has the virtue of being readily comparable to a revised HUD-1, also developed by MBA and presented to HUD. MBA believes the use of these comparable forms would obviate the need for the closing script and reduce costs to small and large businesses.

[25] Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis: Proposed Rule to Improve the Process of Obtaining Mortgages and Reduce Consumer Costs (March 14, 2008).

As indicated, HUD's own Regulatory Flexibility Analysis estimates that the total one-time costs to the lending and settlement industry of the new GFE and HUD-1 alone will be $570 million, $390 million of which are estimated to be borne by small business.[26] HUD estimates that the total recurring costs are estimated to be $1.231 billion annually, or $98.74 per loan. While MBA believes that there will be retooling costs associated with implementation of its shorter GFE and HUD-1, it believes that its forms cover less ground and will be easier for borrowers to understand, resulting in fewer questions and concerns directed to industry. MBA believes these differences will translate into lower initial –and much lower recurring– costs for businesses large and small, as well as for borrowers.

D. MBA supports revision of the GFE to explicitly disclose mortgage broker charges and complement the Board's proposed mortgage broker fee agreement.

In the Board's recent TILA proposal, the Board proposed to require that mortgage brokers enter into agreements with consumers before the broker is paid by the lender or the consumer setting forth the mortgage broker's total compensation and other information on the relationship between the broker's compensation and the interest rate. Notably, Office of Comptroller of Currency (OCC) examiners have been requiring disclosures along these lines by federally regulated institutions since April 1, 2008 pursuant to the OCC's Advisory Letter 2003-3.

MBA has long supported the straight forward disclosure of mortgage broker fees along the lines the Board proposes as the best way to protect consumers and finally resolve this issue which has bedeviled businesses of all sizes as well as consumers for years. Recently, legislators have sought to limit or eliminate YSPs. While MBA strongly supports the value of YSPs and other fees paid by lenders to brokers to help defray borrowers' closing costs, MBA believes that to serve this purpose and avoid the unwitting steering of consumers by mortgage brokers to higher rate products, consumers must be advised of payments to mortgage brokers by lenders based on the interest rate.

MBA strongly believes the new GFE, therefore, should include provisions making it compatible with the mortgage broker fee agreement the Board has proposed and similar agreements required by federal regulators. HUD's proposed GFE and HUD-1, on the other hand, would revise the requirement for disclosure of yield spread premiums from lenders to mortgage brokers as "a charge or credit for the interest rate chosen." This amount would be subtracted from the lender and brokers' "service charge" to arrive at the "adjusted origination charge."

While MBA appreciates HUD's efforts to clarify the function of a YSP in relation to the interest rate, HUD's approach to mortgage broker disclosure, in MBA's view, would be unclear to borrowers. In fact, it further obfuscates the issue by disclosing discount points as charges in the same block as YSPs.

MBA believes that by adopting a new terminology for mortgage broker fees, the costs occasioned by this change for lenders, brokers and other ancillary businesses large and small will be enormous. If allowed to occur, the costs that would be occasioned by consumer confusion would also be enormous for industry.

[26] 73 Fed. Reg. 14102 (March 14, 2008).

In this vein, MBA opposes the use of the term "originator" and also opposes changes to the definition of "mortgage broker" in the rule, which confuse the respective functions of mortgage bankers and mortgage brokers.[27]

From the preamble to the proposed rule and the economic analysis,[28] MBA understands that HUD's approach was shaped by concerns from mortgage brokerage industry advocates and the Federal Trade Commission (FTC) that that the form should provide a "level playing field" between brokers and lenders. But MBA believes that both of these assertions are incorrectly premised and typify confusion about brokers' and bankers' respective functions.

Lenders and brokers perform distinct functions in the marketplace and are perceived differently by consumers. They are not the same players; they do not play the same game, and applying the same rules to them is ill-advised. Mortgage brokers act as middlemen to arrange mortgages; mortgage bankers lend money. Consumers regard brokers as shopping for them and they tend to stop shopping when they use brokers. On the other hand, consumers regard bankers as sources of their own loan products whose prices they shop and compare. Brokers and bankers have different incentives and regulations, and brokers present greater risks of consumer steering.

Specifically, considering that consumers regard brokers as middlemen shopping for them, it is wholly appropriate for the consumer to know if the broker is also receiving a fee from the lender based on the consumer's choice of a higher rate. Armed with compensation information, and other information on the relationship between the interest rate and settlement costs, the consumer can make informed choices and avoid steering and abuse.

In order to make clear the differences between mortgage bankers and mortgage brokers and policy recommendations, as indicated, MBA has just published a policy paper on this subject to assist policy makers, which it is presenting to this committee as an appendix. It comprises a careful analysis of the differences between these two businesses, why they warrant different regulatory treatment and MBA's recommendations on appropriate policies.

E. While MBA appreciates HUD's efforts to establish a GFE application to facilitate shopping, this aspect of the rule should not be finalized until it is made clear how this change will interface with other laws.

A significant complication that lenders will face in light of these proposed amendments stems from the proposed revisions to the definition of "mortgage application." The proposal would replace this definition now found in RESPA's implementing regulation, and would establish two new definitions that, in effect, would bifurcate the mortgage application process into two distinct phases – the "GFE application" phase and the "mortgage application" phase. The proposal is much more than a mere change of language, however. The impact of this redefinition has repercussions that extend well beyond RESPA, and may significantly alter legal and regulatory responsibilities under other laws and/or engender great confusion if not clarified.

[27] "Today's proposed rule also streamlines the current regulatory definition of 'mortgage broker.' Under the proposed definition, 'mortgage broker' means a person (not an employee of the lender) or entity that renders origination services in a table funded or intermediary transaction. The definition would also apply to a loan correspondent approved under 24 CFR 202.8 for FHA programs. The proposed definition would eliminate the current exclusion of an 'exclusive agent' of a lender from the definition of 'mortgage broker.' The current definition essentially excludes some persons who perform the same services as mortgage brokers as defined in 24 CFR 3500.2." 73 Fed. Reg. 14043 (March 14, 2008).

[28] See 73 Fed. Reg. 14030 (March 14, 2008).

Specifically, changes in the definition of "application" impact TILA and "Regulation Z,"[29] the Equal Credit Opportunity Act (ECOA) and "Regulation B,"[30] Home Mortgage Disclosure Act (HMDA) and "Regulation C,"[31] Fair Credit Reporting Act (FCRA) rules, and Section 311 of the Fair and Accurate Credit Transactions Act of 2003 (FACTA)[32] concerning the risk-based pricing notice.

While the preamble to the rule indicates that conversations with the Board have clarified that the initial TILA disclosure will be provided along with the GFE in response to the GFE application, the preamble also indicates that whether a GFE application triggers ECOA or HMDA requirements has not been resolved. In order to save businesses large and small considerable costs, these ambiguities must be resolved before the rule is finalized or the GFE application concept should be removed from the rule.

F. While MBA would consider supporting limits on increases in fees from lenders and mortgage brokers from the time of application until settlement, it has serious concerns about HUD's proposal to limit lenders to a zero tolerance and make them responsible for the charges of third-party providers.

The proposed rule would prohibit lenders and brokers from exceeding the amount listed as "our service charge" on the GFE absent unforeseeable circumstances at time of closing. The charge or credit for the interest rate chosen, if the interest rate is locked, also cannot be exceeded absent unforeseeable circumstances.

The proposed rule would also prohibit the sum of all the other settlement services subject to a tolerance from increasing by more than 10 percent. Such services include originator-required services where the originator selects the third party provider, originator-required services where the borrower selects from a list of third party providers identified by the originator, and optional owner's title insurance.

While MBA opposes unjustified increases in settlement costs at closing, the establishment of tolerances, in general, and restriction to a zero tolerance, in particular, for lender fees are legally questionable under RESPA. Section 5 of RESPA requires a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary."[33] While HUD asserts that the basis for its ability to impose tolerances is grounded in its ability to define the term "good faith," MBA does not believe that, considering the legislative history of the statute, there is clear basis for tolerances and particularly a "zero tolerance."

MBA does not believe lenders can or should be held responsible for the costs of third-parties when lenders have no ability to control these costs. As more fully discussed below, the current proposal for volume discounts will not facilitate consumer-beneficial pricing arrangements. Lenders will not enter into volume discount arrangements if doing so causes them to face additional liability. MBA also believes that the establishment of a 10 percent tolerance overall on third-party charges recommended by the lender will likely prove counterproductive as long as

[29] 12 C.F.R. §226.
[30] *See Federal Reserve Board Regulation B Official Staff Interpretations,* 12 C.F.R. § 202.2(f), Supp. I, comment 2.
[31] 12 C.F.R. § 203.2(b).
[32] Pub. L. No. 108-159 (December 4, 2003).
[33] 12 U.S.C. §2604(c).

the lender is held liable for violations of the tolerances; lenders will simply not have the incentive to make any recommendations to the consumer of beneficial services.

Additionally, MBA believes the establishment of a tolerance for government recording and transfer charges is unwarranted and presents unnecessary risks to lenders and to mortgage brokers.

While MBA appreciates the provision for relief from tolerances for unforeseeable circumstances including acts of God and exceptions for other circumstances, there must be further clarification of these provisions, which will be further detailed in MBA's comments.

Finally, MBA does not believe there is a basis for RESPA rules requiring that when a loan application is rejected, and the tolerances are inapplicable, the borrower must be notified within one day. A one-day limit is also unreasonable considering other workload constraints and, in MBA's view, will present a particular hardship to small mortgage bankers and brokers. Moreover, before the rule is finalized, it must be harmonized with other provisions of law governing notice of denial (e.g., ECOA).

G. The proposed changes to the HUD-1 to refer to the new GFE fail to achieve the objective of making the GFE and HUD-1 harmonized and readily comparable.

MBA does not believe that the changes to the HUD-1 in the form of minor revisions and references to the GFE are sufficient to make the forms comparable. In fact, MBA believes the introduction of the new closing script, which is intended to describe the relationship of the costs and terms on the GFE to those on the HUD-1, is, MBA believes, an admission that the forms are not comparable. HUD indicates in its economic analysis that the GFE and HUD-1 are comparable. Considering that the GFE and HUD-1 forms are not truly comparable, MBA believes the recurring cost estimates for implementation of the GFE and HUD-1 are actually too low.

H. Implementation of a "closing script" to be read at closing and to be signed by the borrower presents several concerns, and further underscores the lack of comparability between the documents.

As a general matter, MBA does not believe that the closing script proposed by HUD, as an addendum to the HUD-1A, is well founded. MBA believes its use raises legal concerns, is costly and its benefit to the consumer at closing is unclear.

Notwithstanding the characterization of the script as an addendum to the HUD-1or 1-A, MBA regards the script as an additional form to be prepared by the settlement agent, read to the borrower and signed at settlement which compares the loan terms and settlement charges on the GFE to the HUD-1.

RESPA requires the HUD Secretary to develop and prescribe a standard form for the statement of settlement costs which shall be used (with such variations as may be necessary to reflect differences in legal and administrative requirements or practices in different areas of the country) as the standard real estate settlement form in all transactions. While RESPA explicitly authorizes several other disclosures, the authority for establishing a closing script, which is in effect an additional disclosure, is not evident.

Just as important, MBA believes that the script will add unnecessary costs to the closing process and will do little to help the borrower. HUD itself estimates that the script will add 45 minutes of additional time per closing and estimates that cost at $54 (derived from a $150,000 salary.) HUD also says the costs in a normal year (based on 12.5 million originations) would be an estimated $676 million. It is not apparent, however, in reaching what MBA regards as an unusually low estimate, HUD considered the overhead costs and the additional time for the lender, broker and others to assist in developing the script.

There also is no apparent consideration of the borrower's time. In this vein, MBA strongly believes that closing is far too late to read this script, and that better results would occur if the borrower was provided a HUD-1 that he could compare to his GFE the day before settlement. Over the last few years, MBA, the American Land Title Association and the American Escrow Association have been working closely to develop uniform closing instructions, in part, to assure that borrowers in fact would receive their HUD-1 a day before closing. MBA believes that, enhanced by a comparable GFE, this effort may hold much greater promise than the script to inform borrowers of closing costs and facilitate comparison with the GFE.

Finally, MBA must point out that the use of such a script presents logistical problems in eMortgage and escrow state transactions that will either make these transactions unworkable and/or simply increase the paper required for borrower review. Considering that settlement agents must read the script, the script's use may be impossible in states where there are statutes prohibiting the unauthorized practice of law. Finally, use of the script may even raise privacy concerns.

I. MBA supports HUD's proposal to clarify that lenders and brokers can use average cost pricing for settlement services within any class of transactions, with some modifications.

MBA supports HUD's proposal to clarify that lenders and brokers can use average cost pricing for settlement services with some clarifications and modifications. MBA believes that with such modifications and clarifications, considering the benefits of average cost pricing, this aspect of the rule should be finalized even if the entire rule is not finalized. In such event, HUD should issue a policy statement or an interpretive rule in this regard.

Specifically, the proposal would allow the average price for settlement services to be determined and disclosed based on either (1) the actual average price for the service on all loans closed by the loan originator in a geographic area over the averaging period; or (2) the average price based on a tiered price contract for the service if the projected number of loans used in the calculation is equal to the actual number of loans actually closed during the averaging period. These averages must be calculated based on a recent period of six consecutive months.

HUD regards average pricing mechanisms as benefiting consumers and MBA agrees. The regulatory risk presented by insisting on precise dollar pricing in tiered pricing arrangements only serves to discourage such arrangements and deprive consumers of lower prices.

MBA would add, however, that before this provision is finalized under a rule or an interpretative rule, the rule should be further clarified. For example, the term "class of transactions" should be defined further using factors such as loan types, geographic regions, etc. Also, the documentation requirements should be carefully reviewed to ensure that they do not impede use of this provision by requiring unnecessarily burdensome documentation.

J. While MBA supports HUD's proposal to clarify the legality of volume discounts, MBA believes the proposal is too restrictive.

MBA supports HUD's proposal to clarify that volume discounts are not prohibited, but does not believe it goes far enough. If it is modified, MBA believes that it should be issued as a clarification whether or not HUD goes forward with this rulemaking.

In its proposal, HUD would amend its definition of "thing of value," defining violations of Section 8's anti-kickback and referral fee provisions, to exclude "discounts negotiated by settlement service providers based on negotiated pricing arrangements," provided that no more than the reduced price is charged the borrower and disclosed on the HUD-1 and HUD-1A.

Negotiated discount arrangements for services and materials result in lower costs to consumers and are therefore consistent with RESPA's purposes of lowering settlement costs in particular. These arrangements achieve this objective in other industries, such as the automobile industry, and MBA does not believe RESPA was intended to or should impede similar discounting in the settlement services industry.

Nevertheless, by including the provision that no more than the reduced price can be charged to the borrower, MBA believes that there will be little incentive for lenders to enter into discount arrangements. Scrutiny to ensure that each and every dollar of discount is passed on to the consumer will make the exception uninviting. Moreover, such a restriction is unnecessary. Market competition will result in the consumer receiving the benefit of discounts. If HUD is insistent about maintaining this provision, at the very least it should make clear that "average cost pricing" can be employed in conjunction with volume discounts, such that only the average price need be charged to the borrower and disclosed on the HUD-1 and HUD-1A.

MBA also questions the idea that discounts can only be negotiated by a settlement service provider, arguably excluding builders. MBA believes this approach could deprive consumers of negotiated discounts on house prices offered by lenders that have joint ventures and marketing agreements with builders.

While MBA recognizes that some small businesses do not support volume discounts, MBA is confident that small businesses will continue to thrive in the marketplace for settlement services as they do today and RESPA need not deprive consumers of cost savings.

K. Concerning the proposed revisions to prohibitions against requiring the use of affiliates, MBA believes it would be sufficient for HUD to reaffirm that it may scrutinize discounts to ensure that they are *bona fide* rather than depriving borrowers of certain discounts altogether.

HUD proposes to change the definition of "required use" so an economic disincentive that a consumer can only avoid by purchasing a settlement service from an affiliated provider would be as problematic under RESPA as an incentive contingent on a consumer's choice of a particular provider. The proposed rule indicates that it is particularly directed to homebuilder affiliates but covers other affiliate situations.

MBA believes that the proposal in this area is too broad and may result in depriving borrowers of discounts that may indeed be *bona fide*. MBA believes it would be sufficient for HUD to indicate that under its current rules it may scrutinize discounts to assure they are *bona fide* rather than risking depriving borrowers of discounts altogether.

L. Technical Amendments – MBA generally supports HUD's efforts to update its RESPA regulations concerning mortgage servicing transfers and escrows and to explicitly recognize the applicability of ESIGN to RESPA.

MBA generally supports aspects of the proposed rule that would update the current RESPA regulations concerning the provision of the mortgage servicing disclosure statement within three days of a mortgage application and to remove outdated escrow provisions.

Specifically, these proposals would remove requirements in the current rules that required that applicants for mortgage loans be provided a disclosure describing the lender's historical practice regarding the sale or transfer of servicing rights and sign the mortgage servicing transfer disclosure. The proposal would also remove references to the phase-in period for the requirement of aggregate accounting for escrow accounts, which expired on October 12, 1997. Finally, the proposals would also make clear that that RESPA disclosures may be provided in electronic form as long as the consumer consents to receive them in accordance with the provisions of the Electronic Signatures in Global and National Commerce Act (ESIGN).[34]

These clarifications will conform the rules to current law and practice and thereby alleviate confusion in the real estate finance industry and among the consumers it serves, thereby reducing costs to companies large and small.

M. Additional Legislative Proposals Regarding RESPA – MBA will consider supporting HUD's legislative proposals as they are developed in the context of the enforcement and the authorities of others.

In its proposal, HUD announced that it intends to seek legislative changes to: (1) authorize the Secretary to impose civil money penalties for violations of section 4 of RESPA (the Settlement Statement), section 5 (the GFE and Special Information Booklet), section 6 (servicing), section 8 (kickbacks, referral fees and unearned fees), section 9 (title insurance), and section 10 (escrows); (2) require delivery of the HUD-1 to the borrower three days prior to closing; and (3) expand and make uniform the statute of limitations applicable to governmental and private actions under RESPA.

There currently are provisions under Section 6, 8, 9 and 10 of RESPA to enforce those provisions. Moreover, state and federal regulators assure that RESPA requirements are met. For this reason, as the proposals are developed, MBA will consider them carefully in the context of other authorities. MBA supports strong enforcement of lending laws but it does not believe increases in the patchwork of laws would serve consumers well.

Also, as indicated, MBA has been working to ensure that the HUD-1 is available one day prior to closing as part of its uniform closing instructions project. This effort can help assure borrowers all have an opportunity to view their HUD-1 the day before settlement. MBA is concerned, however, that requiring a disclosure three days prior to closing could unduly slow settlements and delay the provision of needed financing.

Additionally, in assessing extensions of the statutes of limitations, MBA is guided both by the need to protect against abuses while, at the same time, not unnecessarily attenuating litigation

[34] 15 U.S.C. §7001-7031.

risk. Undue increases in litigation risk increase the costs to businesses large and small, ultimately increasing costs to consumers.

Finally, in its proposal, HUD asks whether a provision should be added to the RESPA regulations allowing mortgage bankers and brokers to address a failure to comply with the tolerances for a limited time after closing. MBA strongly believes that such procedures should be developed to provide borrowers needed relief and decrease unnecessary litigation.

N. Implementation – MBA supports an implementation schedule that would link implementation of this rule to the Board's forthcoming TILA reform rule for any aspect of this rule that requires retooling or systems changes.

Although, MBA would prefer combination of the TILA and RESPA efforts, MBA believes the objective of minimizing costs can, to some extent, be achieved through an extended implementation period if HUD goes forward independently. In such event, MBA recommends that the implementation period for new forms and any aspect of the rule that requires retooling, systems changes or other significant costs should extend to 18 months after the rule's effective date or the implementation period for the Board's new rule, whichever is later.

V. CONCLUSION

The Mortgage Bankers Association supports efforts to make the mortgage process simpler, clearer and more transparent for consumers. Doing so will empower consumers and help fight predatory lending. The RESPA Rule released by HUD is not simplification. Public policy should help ensure that the problems we see in the market today do not happen again. Reforming the mortgage process is an important but difficult task. It is imperative that we get this right. That would require that HUD and the Board to work together to reform their respective disclosures under RESPA and TILA. If HUD goes forward independently, the rule should be pared down considerably and implemented on the same schedule as the Board's.

On behalf of the Mortgage Bankers Association, I appreciate the opportunity to present our views on these important issues. I look forward to your questions.

APPENDIX

Mortgage Bankers and Mortgage Brokers:

Distinct Businesses Warranting Distinct Regulation

MORTGAGE BANKERS ASSOCIATION

MORTGAGE BANKERS AND MORTGAGE BROKERS:

DISTINCT BUSINESSES WARRANTING DISTINCT REGULATION

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

Executive Summary

For many consumers, buying a house is the biggest financial investment they will make. The mortgage process, however, can be both complex and confusing, with a broad menu of loan offerings and a puzzling multitude of actors. Among those actors are mortgage bankers and mortgage brokers. While there is some superficial similarity in how they interact with consumers, mortgage bankers and mortgage brokers conduct very different businesses. These differences, however, are not well understood, creating confusion that can lead to inappropriate regulatory approaches.

To support policymakers working to improve the mortgage market, the Mortgage Bankers Association (MBA) has prepared this Issue Paper explaining the functional, financial, and regulatory differences between mortgage bankers and mortgage brokers. MBA believes that these differences warrant distinct regulatory approaches. Accordingly, policymakers and regulators must understand and properly consider these differences as they explore measures to increase transparency in the mortgage process, protect consumers from steering and abuse, and ensure that consumers are the beneficiaries of the lower homeownership costs that a free and fair market can produce.

Based on the distinctions set out below, this paper also proposes legal and regulatory changes that would provide borrowers with clearer information about mortgage brokers' responsibilities and compensation, improve brokers' financial accountability and strength, and ensure that loan originators are appropriately licensed and meet rigorous standards of professionalism.

Mortgage bankers and mortgage brokers perform different functions

■ **Brokers are intermediaries between borrowers and mortgage bankers.**

Mortgage brokers typically have access to the loan offerings of numerous mortgage bankers. They inform borrowers of loan choices, receive loan applications, and perform certain services, such as collecting documentation, and initiating credit and other reviews.

Mortgage brokers turn loans over to mortgage bankers for underwriting and funding.

■ **Mortgage bankers provide funds for mortgages.**

Mortgage bankers purchase and fund loans arranged by mortgage brokers and by other mortgage bankers. To do so, mortgage bankers use their own funds, funds they borrow, or funds they receive from secondary market investors. As part of the funding process, mortgage bankers are responsible for loan underwriting and, correspondingly, have a significant financial stake in a loan's performance.

Additionally, mortgage bankers often originate loans through their own retail sales force, informing borrowers about available loan products and working with borrowers through the lending process.

Mortgage bankers may also service loans, collecting and processing monthly payments and handling other ongoing customer service needs. Servicers, along with other mortgage bankers that sell loans into the secondary market, have ongoing responsibilities to investors.

Consumers have different expectations of mortgage bankers and mortgage brokers

■ **Consumers perceive brokers as "trusted advisors."**

Consumers working with mortgage brokers generally rely on the broker, as an intermediary with access to multiple mortgage bankers' products, to identify the best loan product(s) for them. Consumers expect that mortgage brokers are comparison shopping on their behalf.

Mortgage brokers frequently perpetuate this expectation by promoting themselves as "trusted advisors," even though brokers in most cases have no legal obligation to act in borrowers' best interests.

■ **Consumers look to mortgage bankers for information about their product offerings and the application process.**

When consumers work directly with mortgage bankers in obtaining a loan, they view the mortgage banker as a knowledgeable source of information about their own loan products and the mortgage process. Consumers generally will compare mortgage bankers' loan offerings with those of other mortgage bankers and/or mortgage brokers.

Mortgage banker and mortgage broker compensation differs

- **Brokers are paid to arrange loans and they receive compensation at the time the loan is made.**

A mortgage broker is compensated at the time a loan is closed through fees directly charged to the borrower (direct fees) and payments from mortgage bankers (indirect fees), which vary based on a loan's interest rate and/or other loan pricing terms. Indirect fees, known as yield spread premiums (YSPs), generally are greater when the loan's interest rate is greater.

YSPs, when used properly, can help borrowers pay their up-front closing costs, including broker fees, by building them into the interest rate. When a consumer does not understand the YSP, which is often the case, the risk is greater that the YSP will simply augment the broker's direct fees and saddle the borrower with a higher rate and monthly payment.

- **Mortgage bankers receive revenue in several ways throughout the life cycle of a loan.**

Mortgage banker compensation can come throughout the life of a loan from:

- Origination fees;
- Interest payments;
- Servicing fees;
- Proceeds from the sale of servicing rights; and/or
- Proceeds from the sale of a loan.

Differences between mortgage banker and mortgage broker compensation mean different financial incentives

- **Brokers' compensation has the potential to incentivize brokers to put borrowers into more expensive and/or inappropriate loans.**

Because broker compensation is directly tied to a loan's interest rate and brokers lack an ongoing financial stake in loan performance, brokers have a high incentive to get loans closed, maximize fees for origination, and move on to their next transaction. Furthermore, the current lack of understanding about YSPs makes it easier for some brokers to direct consumers toward loans with higher interest rates and other terms, such as prepayment penalties, that increase the loans' value to a mortgage banker or investor.

- **Mortgage bankers' financial successes are linked to loan performance, giving mortgage bankers a stake in borrowers' ongoing ability to repay their loans.**

Mortgage bankers also are financially motivated to make loans. Origination fees, however, are but one of several sources of mortgage banker revenue. Mortgage banker revenue can come from multiple revenue streams associated with managing various risks throughout the life of a loan, including the risk that the borrower defaults.

Whether they hold loans or sell them to investors, mortgage bankers generally lose money when loans default. As a result, mortgage bankers have a greater interest in ensuring that borrowers choose products that will give them long-term financial success.

Mortgage bankers and mortgage brokers are subject to different disclosure requirements, with broker fee disclosures inadequate for effective consumer shopping

- **Current disclosures do not adequately inform borrowers of the connection between a broker's compensation and a loan's interest rate or the terms of the mortgage selected.**

While Real Estate Settlement Procedures Act (RESPA) rules require mortgage brokers to disclose the amount of their direct fees received from the borrower and the amount of any YSP received from the mortgage banker, current YSP disclosures do not explain adequately the connection between the YSP and a loan's interest rate.

As a result, consumers lack sufficient information to effectively shop among brokers and mortgage bankers and their various loan offerings. Both the U.S. Department of Housing and Urban Development (HUD) and the Federal Reserve are concerned about this problem and are trying to address it through proposed regulations to clarify YSP disclosures and enhance consumer understanding of the connection between YSPs and interest rates.

- **Mortgage bankers' costs and fees related to origination — such as processing and underwriting fees, as well as discount points and origination fees — are disclosed as settlement costs.**

RESPA regulations do not require mortgage bankers to disclose loan officer compensation and payments the mortgage banker might receive, such as gains (or losses) on secondary market sales of loans. This difference is appropriate because consumers do not rely on mortgage bankers and their loan officer employees as "trusted advisors" in the same manner as they do with mortgage brokers. Additionally, payments related to a secondary market transaction are not always known with certainty at the time of settlement.

Barriers to market entry differ and are greater for mortgage bankers

- **Becoming a mortgage banker requires a significantly larger commitment of financial and other resources than becoming a mortgage broker.**

A mortgage banker must have capital to fund loans, or access to credit, such as through a warehouse line of credit. Moreover, to maintain and renew its license or charter, a mortgage banker must have a specified level of net worth and/or regulatory capital.

Mortgage brokers generally are not required to have funding sources or net worth except in nominal amounts.

Mortgage bankers and mortgage brokers are subject to different types and levels of regulatory oversight

- **Mortgage bankers are subject to greater supervision and regulation than brokers, and broker regulation is uneven across the nation.**

Mortgage bankers are subject to many complex state and federal laws that impose substantial penalties for noncompliance. Whether they are depository or non-depository institutions, mortgage bankers are routinely examined and audited by both federal and state regulators.

Mortgage bankers who sell loans to investors are subject to investor-required oversight. This oversight can include periodic reviews covering financial and business operations, origination practices, and financial safety and soundness. Similarly, mortgage bankers making loans insured by the Federal Housing Administration (FHA) are subject to oversight by HUD.

Mortgage broker licensing laws are uneven,[1] with brokers overall subject to less comprehensive and less demanding legal and regulatory oversight.[2]

Recommendations

The fundamental differences in consumer expectations, market incentives, and regulatory oversight call for distinct approaches to improving mortgage broker and mortgage banker regulation. Because improving consumer protection and enhancing market functions and transparency can be best

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1 See *State by State Tally of Mortgage Broker Rules,* www.bankrate.com, http://www.bankrate.com/brm/news/mtg/20010104b.asp

2 See Lloyd T. Wilson, Jr., *A Taxonomic Analysis Of Mortgage Broker Licensing Statutes: Developing a Programmatic Response to Predatory Lending,* 36 N.M.L. REV. 297 (Spring 2006).

achieved through proposals that recognize these differences and address areas of weak or ineffective regulation, MBA supports measures requiring that:

- Borrowers receive clear disclosures of brokers' responsibilities and compensation;
- Mortgage brokers who claim to be or act as borrower agents be treated legally as agents;
- Mortgage brokers have sufficient financial resources — through a national minimum net worth requirement — to provide protection to borrowers and mortgage bankers where necessary;
- Mortgage brokers be appropriately bonded to give consumers greater protection; and
- All loan originators, including mortgage brokers and mortgage bankers, be appropriately licensed and registered in accordance with rigorous standards.

The current turmoil in the mortgage market and the credit markets has spurred efforts by regulators and policymakers to examine the causes and identify the right approaches to protect consumers and improve market functions and transparency. MBA supports these efforts. Policymakers, however, should avoid broad brush efforts that do not consider the complexity of the marketplace and the differing roles and responsibilities of mortgage brokers and mortgage bankers. MBA believes that measures which improve the regulation of mortgage brokers and other loan originators by addressing specific regulatory and oversight weaknesses are likely to improve the market for consumers, mortgage bankers, mortgage brokers, and other mortgage professionals and not produce barriers to efficient market operations.

MBA looks forward to working with Congress, regulators, and its industry partners to improve the marketplace and to improve the housing industry's ability to serve America's homebuyers.

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Introduction

The past two decades have been unprecedented for the U.S. housing market. Homeownership has reached historically high rates, borrowers have had access to a greater variety of loan products and features than ever before, and the breadth and complexity of the mortgage markets have increased exponentially.

At the same time, the mortgage brokerage industry has emerged and grown tremendously. According to the National Association of Mortgage Brokers (NAMB), there are over 25,000 mortgage brokerages in the United States.[3] Close to 50 percent of residential mortgage loans in the U.S. market are originated by independent mortgage brokers.[4] At the height of the recent boom of the subprime mortgage market, 70 to 80 percent of nonprime loans are estimated to have been mortgage broker originations.[5]

Mortgage brokers have become key intermediaries in expanding access to mortgage credit, including for communities traditionally underserved by mainstream financial institutions. Through mortgage brokers, mortgage bankers have expanded product reach, and thus served larger numbers of consumers.

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3 http://www.namb.org/namb/About_NAMB.asp?SnID=1841827686. See also *Mortgage Brokers Fall on Tough Times,* USA Today (August 30, 2007).

4 MBA Research Data Notes, *Residential Mortgage Origination Channels,* September 2006.

5 Ibid.

Although mortgage bankers' and mortgage brokers' roles may be complementary, mortgage bankers and brokers perform distinctly different functions. The differences between mortgage banking and mortgage brokerage, however, are not well understood, possibly because mortgage bankers and brokers interact extensively in the mortgage process.

Some representatives of the mortgage brokerage industry have added to the confusion by proposing identical standards for mortgage brokers and mortgage bankers because both are "loan originators." They assert that there should be a "level playing field" on which brokers and mortgage bankers should compete for consumer business. MBA shares the goal of ensuring robust competition in the mortgage market place. However, a "one size fits all" approach to regulation is not the same as achieving a level playing field and ignores the fact that there are profound differences between the two industries warranting distinctive regulation.

This paper reviews the distinctions between mortgage bankers and mortgage brokers. The most critical distinctions are that mortgage brokers and mortgage bankers:

- Perform different functions and provide different services;
- Create vastly different expectations in borrowers;
- Are compensated differently;
- Have very different financial incentives;
- Face much different barriers to marketplace entry, with brokers facing very low barriers to entry; and
- Are subject to different regulatory requirements with bankers generally subject to more stringent regulation and oversight.

Considering the profound differences between mortgage bankers and mortgage brokers, this paper concludes with recommendations for regulatory improvements to enhance consumer understanding and information in the loan origination process, and to promote greater mortgage broker accountability.

Differences Between Mortgage Bankers and Mortgage Brokers

Mortgage Bankers and Mortgage Brokers Perform Different Functions in the Mortgage Process

Brokers Act as Intermediaries between Consumers and Mortgage Bankers

Mortgage brokers are independent intermediaries who bring together prospective borrowers and mortgage bankers. According to NAMB, a mortgage broker has "a working relationship with numerous banks and other mortgage bankers and provides the consumer with access to hundreds of options when it comes to financing a home."[6] Mortgage brokers tend to be small businesses and frequently have little capital.

Mortgage brokers help arrange loans, performing application-related services, such as requesting verification of the borrower's employment, requesting credit and other information, and compiling borrower documentation.[7] Brokers typically do not provide loan funds.[8]

Brokers can — and do — provide substantial benefits to borrowers and mortgage bankers and contribute to the efficiency of the mortgage industry. Brokers are an important distribution channel for

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6 http://www.namb.org/namb/Mission.asp?SnID=1411867994

7 Until recently, brokers often arranged for property appraisals. Freddie Mac and Fannie Mae recently announced several changes in their appraisal requirements, including a new policy that prohibits brokers from selecting or compensating appraisers. See http://www.fanniemae.com/media/pdf/030308_agreement.pdf

8 In most instances, the mortgage broker assigns the mortgage to the mortgage banker at settlement and the mortgage broker is paid for his or her origination services. This process is known as "table funding."

mortgage bankers' loan products and, in particular, can enhance mortgage bankers' ability to serve traditionally underserved borrowers and communities.

Mortgage Bankers Provide Mortgage Funds

Mortgage bankers lend money through various channels: directly to consumers through their own retail sales forces, by funding loans arranged by brokers or other mortgage bankers, and by purchasing loans originated by other mortgage bankers. In most cases, mortgage bankers offer their own products.[9] Regardless of the lending channel, mortgage bankers are responsible for underwriting the loan, which involves evaluating the borrower's credit worthiness and the value of the home.

Once a loan is funded, mortgage bankers — depending on their business models — pursue various paths. Some mortgage bankers hold the loans in their own portfolios; others sell the loan to a secondary market investor. Separately, a mortgage banker may service the loan or sell the servicing rights.

Mortgage banking is highly competitive — mortgage bankers compete with each other and at times, with mortgage brokers, for customers. Nearly 8,900 mortgage lenders reported under HMDA in 2006.[10] Mortgage bankers compete for consumers through price, products, and services. Mortgage bankers seek to offer attractive interest rates and loan terms and to develop innovative loan products and services to meet a variety of consumer mortgage needs. Additionally, if a mortgage banker services loans, they provide continuous customer service and support to borrowers during the life of the loan.

Mortgage bankers are organized in many forms, such as federal- and state-chartered banks, thrifts, credit unions, and other depository institutions, as well as non-depository mortgage companies. Mortgage bankers come in many different sizes, from small businesses to large multinational corporations.

Differing Functions of Mortgage Bankers and Brokers Lead to Vastly Different Consumer Expectations

The different functions and services of mortgage bankers and mortgage brokers lead consumers to have vastly differing expectations of each. Consumer expectations of mortgage brokers often do not match brokers' actions and responsibilities, which effectively limits the consumer's ability to protect his or her own interests.

9 Mortgage bankers sometimes function as mortgage brokers, offering the loan products of other, larger mortgage bankers. Where a mortgage banker performs the function of a mortgage broker, MBA believes that the banker should be subject to the same disclosure requirements as a broker.

10 Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "The HMDA Data," *Federal Reserve Bulletin,* December 2007. http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf

Consumers Perceive Brokers as Acting in the Consumer's Best Interest

Consumers expect mortgage brokers to act as independent advisors and work with various mortgage bankers to identify and evaluate various financing options and ultimately to arrange their loans. In their marketing, brokers often position themselves as "trusted advisors" who will shop among mortgage bankers and arrange for the best loan. A 2003 AARP survey of older borrowers who had obtained refinancings found that 70 percent of respondents with broker-originated refinance loans (compared with 52 percent of respondents with lender-originated loans) reported that they had relied "a lot" on their brokers to find the best mortgage for them.[11]

Brokers' legal obligations, however, do not match up with consumer perceptions. While a consumer expects a broker to act in the consumer's interests, unless state law[12] or written agreement exists to the contrary, brokers are not legally considered their customers' agents. Comments in the Federal Reserve Board's recent Truth in Lending Act (TILA) regulatory proposal,[13] which requires compensation agreements between brokers and consumers, address this point and the concerns it raises:

> "Several commenters in connection with the Board's 2006 hearings suggested that mortgage broker marketing cultivates an image of the broker as a 'trusted advisor' to the consumer. Consumers who have this perception may rely heavily on a broker's advice, and there is some evidence that such reliance is common…
>
> If consumers believe that brokers protect consumers' interests by shopping for the lowest rates available, then consumers will be less likely to take steps to protect their own interests when dealing with a broker. For example, they may be less likely to shop rates across retail and wholesale channels simultaneously to assure themselves the broker is providing a competitive rate. They may also be less likely to shop and negotiate brokers' services, obligations, or compensation up-front, or at all. For example, they may be less likely to seek out brokers who will promise in writing to obtain the lowest rate available."[14]

11 Kellie K. Kim-Sung & Sharon Hermanson, *Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans,* Data Digest #83 (AARP Public Policy Inst., Washington, D.C.), Jan. 2003, at 3, available at http://www.aarp.org/research/credit-debt/

12 A handful of state mortgage broker licensing laws — including Vermont, Kentucky, Minnesota, Maine, and North Carolina — create some level of agency-principal relationship between mortgage brokers and their customers. See Lloyd T. Wilson, *A Taoxonomic Analysis of Mortgage Broker Licensing Statututes: Developing a Programmatic Response to Predatory Lending,* 36 N.M.L. REV. 297, 325-339 (Spring, 2006).

13 Truth in Lending; Proposed Rule, 73 FED. REG. 1672, 1699 (request for comment January 9, 2008).

14 Ibid.

Consumers View Mortgage Bankers as Offering a Set of Products

When a consumer deals with a mortgage banker, he or she looks to the mortgage banker as a knowledgeable source of information about its' own products. Consumers expect a mortgage banker (through its employee loan officers) to explain the features of its loan product offerings and to provide assistance through the application and closing process. However, a borrower seeking to obtain a mortgage directly from a mortgage banker likely will research and compare different mortgage bankers' prices and products. As noted above, a borrower using a broker generally delegates the research and comparison of loan products to the broker.[15]

The Federal Reserve's recent TILA proposal reaches the same conclusion about consumer expectations and behavior:

> "The [Federal Reserve] Board is not aware of significant evidence that consumers perceive mortgage bankers' employees the way they often perceive independent brokers — as trusted advisors who shop for the best loan for a consumer among a wide variety of sources. Accordingly, it is not clear that a key premise of the proposal to restrict creditor payments to brokers — that consumers expect a broker has a legal or professional obligation to give disinterested advice and find the consumer the best loan available — holds true for creditor payments to their own employees."[16]

Compensation to Mortgage Bankers and Mortgage Brokers Differs, with Broker Compensation Presenting Greater Risks of Steering

Mortgage banker and broker compensation are based on the rate and terms of loans. However, mortgage banker and mortgage broker revenue and profit drivers are very different, reflecting the different services performed and financial risks borne by each:

- Mortgage brokers are paid solely for sourcing and facilitating loans, and they bear little — if any — ongoing financial risk.
- Mortgage bankers receive a variety of payments at the time of origination and after for performing a variety of services and managing a complex set of risks.

When coupled with ineffective consumer information about broker compensation, the "upfront" nature of broker compensation and its link to the borrower's interest rate pose greater risks of steering

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15 The tendency to rely (to the consumer's financial detriment) on a mortgage broker can be especially strong for borrowers either from traditionally underserved market segments or with blemished credit. See Kenneth R Harney, *Study of Loan Fees Shows All Borrowers Not Equal,* The Washington Post, July 19, 2003, at F01.

16 73 FED. REG. at 1699.

than the mortgage banking business's more varied and complicated revenue streams. Those banker revenue streams, as discussed below, are closely linked to loan performance.

Brokers Are Paid for Sourcing and Originating Loans and Bear Virtually No Financial Responsibility for Loan Performance

The most common compensation model for mortgage brokers is a combination of fees paid or financed by the prospective borrower at loan closing (direct fees) and fees paid to the broker by the mortgage banker (indirect fees). Direct fees are typically loan origination or similar charges paid by borrowers at settlement. Once the loan is funded, brokers bear little — if any — ongoing risk. Brokers bear some risk if there is fraud in the loan documents and for very early loan payoffs (typically, within the first 90 to 180 days),[17] but the extent of that liability generally is only as large as the brokers' fees.[18]

Indirect fees are payments from the mortgage banker to the broker for origination services and are based on the rate of the loan and/or other loan pricing features. These payments are commonly called "YSPs" or "yield spread premiums." The YSP is the present value of the difference between the interest rate that the broker obtained for the loan and the lowest rate the mortgage banker would have accepted for the specific transaction (the "par rate"). The greater the spread between the rate on the specific loan and the par rate, the greater the YSP. Loan pricing features that increase the value of a mortgage loan, such as prepayment fees, may also increase YSPs.

The mortgage broker receives the YSP from the mortgage banker. However, consumers pay for the YSP through higher interest rates and higher monthly payments. Where YSPs are understood, they can provide a useful option for consumers to pay the broker's direct fees and other closing costs as part of the mortgage by essentially building them into the loan rate and payments.

Many Mortgage Bankers Receive Compensation throughout the Life of a Loan and Are Financially Accountable for Loan Performance

Mortgage bankers earn revenue in several ways, including through fees for services related to loan origination and underwriting. Borrowers pay these fees at closing or may choose to finance some or all of these fees. The borrower may also pay the mortgage banker "points" to reduce further the interest rate on the mortgage loan.

17 The duration of a broker's liability for early payoffs depends on the specific terms of a broker's contract with a lender.

18 In the case of early payoffs, most wholesaler agreements require the broker to forfeit some or all of his fees. Wholesaler agreements normally provide that the broker is liable for repurchase in the case of fraud. However, repurchases rarely occur due to brokers' limited capital. As a fallback, wholesalers will seek an indemnification from the broker that he/she will reimburse for any losses incurred on the loan; this usually ends up taking the form of some or all of the brokers' fees.

A mortgage banker who holds the loan in its portfolio receives interest payments from the monthly payments over the life of the loan. A mortgage banker holding a loan in portfolio must manage and hedge against both the interest rate and credit risk associated with the loan; correspondingly, the mortgage banker's financial gain or loss is linked to the success of that risk management.

Mortgage bankers also realize gains (or losses) on the sale of mortgages when loans are pooled and sold to investors in the secondary mortgage market. A secondary market sale and the corresponding financial outcome, however, are not always a certainty at the time a loan is closed. Constant fluctuations in the market, shifting interest rates and unpredictable investor appetites for mortgages mean that there is no assurance that mortgage bankers can sell loans to investors at a profit.

Additionally, selling a loan to a secondary market investor does not fully eliminate the financial risks to the mortgage banker. When selling a loan to a secondary market investor, the mortgage banker ordinarily guarantees to the investor that the loan and borrower credit characteristics are as stated to the investor and that the loan complies with relevant legal and regulatory requirements, including applicable anti-fraud and anti-predatory lending laws and guidelines. Typically, mortgage bankers are bound contractually to buy back non-performing loans[19] found to be inconsistent with these representations and warranties. This is an on-going financial risk that the mortgage banker bears.

Mortgage bankers who service loans (known as "servicers") also earn servicing fees. However, a servicer only earns these fees as long as the borrower is making timely payments. A loan's servicing rights can be sold separately from the loan itself. A mortgage banker who sells a loan's servicing rights has ongoing financial exposure through representations and warrants made to the buyer of the servicing.

Profit Drivers for Brokers Increase the Likelihood of Steering

Studies indicate that the fees charged to borrowers for origination activities, such as application processing and underwriting rarely result in profits for mortgage bankers.[20] Instead, these fees offset the mortgage banker's costs of processing and underwriting a loan application. Other loan-related fees, such as fees for credit reports and appraisals, are required to cover only the actual out-of-pocket costs for items provided by third party vendors, such as credit reporting agencies and appraisal companies and the costs of reviewing them. They therefore do not provide profit for mortgage bankers. The vast majority of mortgage banking income comes from interest, loan servicing, and, where loans are profitably sold in the secondary market, asset sales.[21]

19 A "non-performing" loan is a loan that is delinquent or in default.

20 See Mortgage Bankers Association, *2007 MBA Cost Study,* at 10–12.

21 Ibid.

In contrast, origination and origination-related fees and YSPs are the main profit centers for mortgage brokers. Mortgage brokers do not generally have continuing business relationships with their borrower clients after loan closing (unless it is to refinance their loan or obtain another mortgage at a later date). Unlike brokers of other financial products, such as independent insurance agents, mortgage brokers do not receive additional compensation based on loan performance or have other meaningful incentives to assure such performance.

The importance of YSPs as a source of broker revenue, coupled with the fact that YSPs are not well understood, increases the risk that some mortgage brokers will steer borrowers to costlier mortgages because they provide the mortgage broker with more lucrative YSPs.

The difference in a mortgage banker's degree of control over a loan officer employee versus a mortgage broker also makes it easier for mortgage brokers to steer borrowers into unnecessarily costly loans. Mortgage bankers have a variety of means for monitoring their loan officer employees and disciplining loan officers engaged in inappropriate steering. While mortgage bankers can — and do — refuse to do business with mortgage brokers engaged in inappropriate steering and other unprofessional practices, mortgage brokers' independence and the fact that mortgage bankers are not present as mortgage brokers work with borrowers and shop loans makes monitoring difficult.

Mortgage Bankers' Incentives Are Aligned More Closely With Consumers' Interests

- **Mortgage Bankers, Like Borrowers, Benefit Financially from Positive Loan Performance and Lose from Negative Performance**

Mortgage bankers know at loan origination that their own financial success can depend on the long-term success of the loans they originate. As discussed, mortgage banking involves a variety of financial risks. Economic loss in mortgage lending can be a function of many factors, but usually involves the risk of default (e.g., non-payment of the loan by the borrower). If a loan defaults, a mortgage banker's financial exposure can be considerable whether a mortgage banker holds a loan in portfolio or has sold the loan to a secondary market investor.

In addition to losing the cash flows that come from a performing loan (i.e., servicing fee income and interest payments), when a borrower defaults, the mortgage banker can end up owning the home and incurring the costs associated with maintaining and ultimately selling the house.[22]

22 A 2003 Federal Reserve study estimated that losses on foreclosures range from 30 percent to 60 percent of the outstanding loan balances "because of legal fees, foregone interest, and property expenses." Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit,* (Board of Governors of the Federal Reserve System) (May 13, 2003) at 1.

Additionally, mortgage bankers that also offer other financial services have a significant financial stake in maintaining strong, ongoing relationships with their consumers. Business success for these mortgage bankers relies on their customers' long-term financial success.

Mortgage Brokers' Financial Incentives Are Not Linked to Loan Performance

On top of the compensation they receive for sourcing a loan and providing application-related services, mortgage brokers do not receive compensation based on loan performance. Furthermore, brokers do not generally have loan repurchase obligations.[23] As a result, a broker has a strong incentive to close loans and maximize their direct and indirect upfront fees.

While the market for brokerage services and the availability of competition can serve as brakes on broker fees, as indicated, many borrowers do not shop among competing brokers, either because the first broker they encounter is perceived to be an independent advisor shopping for them and/or there is limited competition among originators in the borrower's community.

Since YSPs are not well understood and loan performance does not affect compensation, a broker has a strong incentive to seek the most lucrative indirect fees. There is an information imbalance between broker and borrower that works in the broker's favor. Mortgage brokers are aware of the par rates and yield spreads of various loan products and of various mortgage bankers, and this information informs the broker's decision about what loans to offer any given borrower.[24] At the same time, if a borrower delegates comparison shopping to a broker and the broker's indirect compensation is not understood, the borrower is not taking action to educate himself further about other loan options and is unlikely to question a loan product and/or fees unless or until the borrower runs into trouble with the loan.[25]

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23 Some mortgage broker agreements provide for the broker to buy-back loans, but mortgage broker accountability under these agreements is limited by (1) the cost and effort required to enforce the obligation; and (2) the limited capital of brokers, which typically would not be sufficient to repurchase loans, even where a legal or contractual obligation exists.

24 See Kenneth R. Harney, *Study of Loan Fees Shows All Borrowers Not Equal,* The Washington Post (July 19, 2003), p. F01 (discussing a study by Susan E. Woodward, Ph.D.).

25 See 73 FR at 1699 (January 9, 2008).

Current Federal Disclosure Requirements Do Not Reduce the Risks of Steering by Brokers

Current Broker Disclosures Provide Consumers with Inadequate Information about Broker Compensation and Responsibilities

Since 1992, RESPA[26] regulations have required mortgage brokers to disclose on the good faith estimate (GFE), which is provided at the time of loan application, and on the HUD-1 Settlement Statement, which is provided at closing, the amount of direct fees from the borrower and the amount of any indirect fees received from the mortgage banker.[27]

Direct fees to mortgage brokers are listed and included in the borrower's total settlement costs. YSPs to brokers are disclosed as a separate number, outside the column of closing costs, designated as "YSP POC" or "Yield Spread Premium Paid Outside of Closing."[28]

Though the amount of the YSP is disclosed to the borrower and it is identified as a Yield Spread Premium, borrowers are not informed of the YSP's calculation and the fact that the borrower generally pays the YSP through a higher interest rate.[29] Additionally, current disclosures do not tell the borrower if the broker is or is not functioning as an agent of the borrower.[30]

Whether or not a broker is involved in a loan transaction, mortgage bankers' costs and fees related to origination — such as origination and underwriting fees, as well as discount points — are disclosed as settlement costs on the GFE and on the HUD-1 Settlement Statement.[31] The RESPA regulations do not require mortgage bankers to disclose payments from the secondary market or loan officer compensation. HUD has not treated these costs as equivalent to mortgage broker compensation. Unlike YSPs to mortgage brokers, secondary market payments, if they occur, are not paid at settlement and are outside RESPA's coverage.[32] These payments would also require imputation where loans are not sold.

26 12 USC § 2601 et seq.

27 For current mortgage broker fee disclosure rules, see 24 CFR § 3500.7(a) and (c), and Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 FR 10080, 10085 (March 31, 1999).

28 24 CFR Appendix A, Appendix B.

29 See *Predatory Mortgage Lending Practices: Abusive Uses of Yields Spread Premiums: Hearing Before the Senate Committee on Banking, Housing and Urban Affairs,* 107th Cong. (January 8, 2002) (statement of Prof. Howell E. Jackson, Harvard Law School).

30 This is the case with regard to federal and state mortgage lending laws. The precise nature of a broker's fiduciary duty is a question that several state courts have addressed, including in California, Missouri, and Texas, finding that brokers' had an agency and/ or fiduciary relationship with their borrower-customers. Additionally, a few state legislatures have begun examining the issue. See Joya K. Raha and Andrea Lee Negroni, *Mortgage Brokers-What Fiduciary Duties Exist?* Mortgage Banking (October 2007).

31 12 USC § 2604(c), 24 CFR 3500.7(a).

32 24 CFR 3500.5(b)(7). See also 57 FR 49600 (November 2, 1992), 67 FR 49134, 49140 (July 29, 2002), 66 FR 53052, 53053 (October 18, 2001).

Moreover, mortgage bankers sometimes lose money on these sales. HUD has not regarded employees as separate from their employers for other purposes under RESPA.[33] Importantly, mortgage bank loan officers do not function as independent intermediaries, nor do consumers perceive loan officers in the role of an "intermediary" responsible for shopping for the most favorable loan product available.

Regulators Recognize Broker Disclosures Are Weak and Need Improvement

For almost a decade, HUD has advocated an improved consumer disclosure that would clearly advise the consumer of the compensation the broker receives in the transaction. Most recently, HUD issued proposed changes to the RESPA regulations intended to enable consumers to compare more effectively origination costs and to inform consumers of the connection between the YSP to be paid to the broker and the interest rate.[34]

Separately, the Federal Reserve expressed "concerns that creditor payments to mortgage brokers are not transparent to consumers and are potentially unfair to them,"[35] recently proposed changes to its Truth in Lending rules (Regulation Z) pertaining to broker fees. The goal of the proposal is to "limit the potential for unfairness, deception and abuse in creditor payments to brokers in exchange for higher interest rates while preserving this option for consumers to finance their obligations to brokers."[36]

The proposed regulations prohibit a creditor (including mortgage bankers) from directly or indirectly paying a mortgage broker in connection with a mortgage transaction unless the mortgage broker enters into a written agreement with the consumer, before a fee is paid, spelling out the broker's total compensation for the transaction, including payments from the creditor and consumer, and the payment does not exceed such amount. The agreement would be required to state: (1) the total compensation that the broker will receive and retain from all sources; (2) that the consumer will pay the entire amount of the compensation even if all or part of it is paid by the creditor; (3) that the creditor will increase the borrower's interest rate if the creditor pays part of the compensation; and (4) that creditor payments can influence the broker to offer certain loan products or terms, which may not be in the consumer's interest or that they may be less favorable than can be otherwise be obtained.[37]

The prohibition would not apply if a broker is (1) subject to a state statute or regulation under which a broker may not offer loan products or terms less favorable than the consumer could otherwise obtain

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33 In 1992, when HUD amended its RESPA rules to establish the employer-employee exemption under the affiliated business provisions of RESPA, it indicated that it regarded employees as indistinguishable from their own employers for purposes of RESPA's anti-referral fee provisions. See 57 FR 49600 (November 2, 1992).

34 Department of Housing and Urban Development, *RESPA: Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs,* 73 FR 14030 (March 14, 2008).

35 73 FR at 1698 (January 9, 2008).

36 Ibid., at 1699.

37 73 FR at 1734 (January 9, 2008).

through the same broker assuming the same loan's terms and conditions or (2) where a creditor can demonstrate that the compensation it pays to the broker is not based on the interest rate.[38]

Barriers to Market Entry Also Differ and Are Greater for Mortgage Bankers

Entering Mortgage Banking Requires Significant Financial Resources

The barriers to entry and the costs of being in the mortgage banking and brokerage businesses differ significantly. This reflects the fact that a mortgage banker's business of funding loans and managing the corresponding credit and interest rate risk is more operationally complex and involves more ongoing financial exposure and management than a mortgage broker's business of arranging loan originations and related activities.

To participate credibly in the mortgage industry, a mortgage banker must have sources of capital for funding loans, or secure a credit line for loan originations, known as a warehouse line of credit. Moreover, to maintain and renew its license or charter, a mortgage banker must have a specified level of net worth and/or regulatory capital. The continuing (and continuously escalating) operating costs, including costs associated with regulatory compliance, also help to ensure that undercapitalized and uncommitted mortgage bankers have little incentive to enter the industry, and even less ability to continue with success.

Mortgage bankers also must operate in accordance with multiple levels of government and market oversight as well, such as the guidelines and requirements of the secondary market agencies (Fannie Mae, Freddie Mac, and Ginnie Mae), loan insurers and guarantors (the FHA and VA), and other investors (such as banks and investment funds).

Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA) approve and oversee any mortgage banker who wishes to work with or sell loans to them. This includes minimum net worth requirements ($250,000 for Fannie Mae/Freddie Mac seller-servicer status; $250,000 for FHA approved mortgagees) and pre-approval reviews for financial and operational soundness.[39] Additionally, private investors and mortgage insurance companies routinely conduct audits of the mortgage bankers with whom they work.

38 Ibid.

39 Institutions (including mortgage brokerages) can also seek approval as Fannie Mae or Freddie Mac sellers only. In the case of Fannie Mae, applicants for seller-only status, however, must have a minimum net worth of $1,000,000 and undergo extensive operational and financial reviews covering all aspects of their businesses. Freddie Mac's public materials do not specify a minimum net worth level for "seller only" status.

Prospective Mortgage Brokers Face Few Barriers to Entry

Entering the mortgage brokerage business requires fewer resources and less operational capacity. Mortgage brokers face little federal regulation and, as discussed in this paper, are subject to widely varying degrees of state regulation in an environment where state regulators have limited enforcement staff and resources. Mortgage brokers generally are not required to have funding sources or net worth except in nominal amounts, and even the nominal requirements of state laws are inconsistent. FHA requires brokers who wish to offer FHA-insured products to have a minimum net worth of $63,000 and undergo yearly audits.

Mortgage brokers are typically authorized or chartered only by state governments, and they are far less likely than mortgage bankers to be approved (and subject to ongoing audit by) the secondary market agencies or federal government agencies with lending related regulatory functions.

Current Federal and State Regulatory Requirements Differ and Are More Rigorous for Mortgage Bankers

Mortgage bankers are subject to many complex state and federal laws that impose substantial penalties for non-compliance. Whether they are depository or non-depository institutions, federally or state chartered, mortgage bankers are routinely supervised by federal and state regulators and must comply with a vast array of state and federal laws applicable to their lending activities. Federally chartered mortgage bankers are subject to regulatory review and examination by the federal financial regulatory agencies, and other mortgage bankers are subject to regulation and examination by state regulatory agencies. All mortgage bankers are subject to federal loan origination laws, such as RESPA, the Truth in Lending Act (TILA)[40] and HMDA.[41]

Notwithstanding that the mortgage brokerage industry has grown rapidly since mortgage brokers first appeared in the late 1980s, there are far fewer substantive laws regulating mortgage brokers at the state and federal levels. Additionally, the consequences of noncompliance by mortgage brokers are less severe. The number and variety of regulators focused on mortgage broker regulatory compliance is also fewer and these regulators are concentrated at the state level, where constrained state budgets and thin staffing often translate into minimal oversight.

40 The Truth in Lending Act (TILA) is the popular name for Title I of the Consumer Credit Protection Act, 15 USC § 1601 et. seq.

41 12 USC § 2801 et. seq.

State Laws

Both mortgage bankers and mortgage brokers are subject to state licensing and registration under a diverse set of state laws. In addition, state mortgage regulatory agencies (typically, banking and financial institutions departments) have adopted a patchwork of administrative rules that apply to various aspects of the mortgage business. These laws and regulations vary from state to state and, in many cases differ in their treatment of mortgage bankers and mortgage brokers. Even in states whose licensing requirements do not differ substantially between mortgage bankers and brokers, the sheer volume of licensed brokers suggests that brokers are not likely to be subject to the same degree of scrutiny and supervision as mortgage bankers.[42]

National policymakers have identified the inconsistency of broker regulation as an area in need of reform. In fact, the March 2008 report of the President's Working Group on Financial Markets (PWG) includes, among several recommendations affecting the mortgage and credit markets, a call for state financial regulators to implement strong nationwide licensing standards for mortgage brokers.[43]

While mortgage banking regulations also vary state to state, mortgage bankers overall are generally subject to state licensing laws that are more rigorous and extensive than those affecting mortgage brokers.[44] Specifically, state licensing laws tend to impose more burdens (financial, experience, reporting and otherwise) on mortgage bankers than on brokers. Additionally mortgage bankers are sometimes subject to multiple licensing laws depending on their loan product offerings. For example, several states have additional licensing laws for mortgage bankers depending on the loan finance charge, principal amount, or other criteria.[45]

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42 For example, in Nevada, mortgage bankers and mortgage brokers must have two years of verifiable experience in mortgage lending, and neither bankers nor brokers are subject to minimum net worth or surety bonding. However, as of August 2007, the Commissioner of Mortgage Lending in the Nevada Department of Business and Industry had oversight of 294 mortgage bankers and 1,029 mortgage brokers. With the same staff to investigate and enforce the statutes involving both bankers and brokers, there is a greater statistical likelihood that a mortgage banker will be examined and regulated than will a Nevada broker.

43 The President's Working Group on Financial Markets, *Policy Statement on Financial Markets Developments,* (March 2008) p. 12 http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf

44 There are exceptions to this general rule, as described below. For example, the states of Alabama, Montana, Ohio and Texas regulate mortgage brokers under comprehensive licensing statutes, while most mortgage companies (mortgage bankers) are currently exempt from licensing in these four states, or are subject to a lesser degree of state regulation. In Alabama, the Mortgage Brokers Licensing Act, Ala. Code § 5-25-1 et seq., requires mortgage brokers to be licensed, maintain net worth of $25,000, and complete approved education, but mortgage bankers approved under the National Housing Act (FHA lenders) are exempt from licensing in Alabama. Ohio's mortgage broker registration law, Oh. Rev. Code § 1322.01 et seq., requires registration of mortgage brokers but exempts "mortgage bankers." Mortgage bankers include persons and entities that make, service, buy or sell mortgage loans, underwrite loans and are approved by HUD or the VA or one of the secondary market agencies. Texas has supervisory laws for both mortgage bankers (who must register under Tex. Fin. Code Ann. § 157.001 et seq.) and mortgage brokers (who must be licensed under Tex. Fin. Code § 156.001 et seq). The registration process is simplified; the registration of Texas mortgage bankers is primarily designed to facilitate the handling of complaints from the public. The licensing procedure for mortgage brokers, on the other hand, requires each licensed broker to maintain an office in Texas, have a minimum level of experience and/or education, and pass an examination.

45 For example, the Florida Mortgage Brokerage and Lending Act, Fla. Stat. Ann. ch. 494 et seq., requires both mortgage bankers and mortgage brokers to be licensed by the Office of Financial Regulation. This licensing law applies to residential mortgage loans and to loans on commercial property with five or more dwelling units where the borrower is a natural person or the lender is a noninstitutional investor. The Florida Consumer Finance Act, Fla. Stat. Ann. ch. 516, on the other hand, applies only to lenders (not to brokers) of loans of $25,000 or less where the annual interest rate exceeds 18 percent.

Virtually every state requires the registration and licensing of mortgage broker companies, and almost two-thirds require individual broker licensure or registration. However, the requirements are uneven, and in one case — California — any individual licensed as a real estate agent is automatically licensed as a mortgage broker. Some states call for individual brokers to meet various continuing education, examination, and criminal background check requirements, as well as net worth, surety bond, and auditing requirements, while others do not. Mortgage brokers generally are not subject to multiple licensing laws in a single state based on the size or terms of loans they arrange. Also, recently enacted high-cost loan laws targeted at "predatory lending" generally are directed mainly to mortgage bankers, not to brokers.[46]

State laws regarding a broker's obligation to a borrower vary significantly. Some state laws hold that a broker must act as an agent of the borrower. In other states, courts have ruled that agency relationships exist based on the broker's conduct. Other states have concluded there is no agency relationship implied.[47]

Mortgage bankers are subject to a continuous examination schedule by their chartering agencies, their funding sources, loan guaranty and insurance agencies, and investors. Mortgage brokers are typically authorized or chartered only by state financial institution regulators. They generally are not required to have funding sources or net worth except in nominal amounts, and they are unlikely to be subject to ongoing examination or audit.[48]

New York is an illustrative example of the differences in the state qualification and regulation of mortgage bankers and mortgage brokers.[49] Both mortgage bankers and mortgage brokers are subject to licensing by the New York Banking Department, but the approval criteria are quite different, and the extent of supervision of licensees varies significantly.[50]

In New York, a mortgage banker must have a minimum net worth of $250,000 and access to a $1 million line of credit, plus a surety bond that varies with the volume of loans closed in the calendar

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46 For example, the Florida Fair Lending Act, Fla. Stat. Ann. § 494.0078, applies principally to mortgage bankers of high-cost mortgage loans and their assignees.

47 For an overview of the state-by-state imposition of fiduciary duties on mortgage brokers, see "Mortgage Brokers — What fiduciary duties exist?" by Andrea Lee Negroni, Esq. in the October 2007 issue of Mortgage Banking Magazine.

48 As indicated above, the general rule is not universal. For example, in Arizona, the experience required to obtain a mortgage broker license is three years (for each individual licensed broker) but for a mortgage banker, only the "responsible" individual must have three years of lending experience. Moreover, mortgage brokers licensed under Arizona law must take and pass an examination to test their competency, but mortgage bankers are not subject to pre-licensing exams.

49 N.Y. Banking Law § 589 et seq.

50 New York Banking Department data indicates that for calendar year 2006, there were 321 New York-licensed mortgage bankers, of which 124 were examined, an examination rate of 38.6 percent. Only 527 of the 2,431 New York-registered mortgage brokers were examined in 2006, an examination rate of 21.6 percent. Thus, in 2006, mortgage bankers were 70 percent more likely to be examined than mortgage brokers. (The statistics for the first nine months of 2007 reflect an examination rate of 15.1 percent for mortgage bankers and 13.3 percent for mortgage brokers, indicating that the examination frequency gap between the two types of licensees was substantially reduced in 2007.) Moreover, the average duration of an examination of a licensed mortgage banker is 10 days, whereas for a mortgage broker, the average duration of an examination is three days, meaning a mortgage banker's examination was more than three times as long as a broker's.

year preceding the license year. The minimum bond is $50,000, while the maximum is $500,000. An applicant for a mortgage banking license must have five years of verifiable experience in the business of making residential mortgage loans or similar lending and credit evaluation experience.[51]

In contrast, a residential mortgage broker in New York is not required to maintain any minimum amount of net worth, not required to maintain a credit line, and its surety bond requirement ranges from $10,000 to $100,000 depending on the number of loan applications taken in the year prior to the license year.[52]

New York's registration requirements for mortgage brokers are much looser, the main requirement being that the Superintendent of Banking find the applicant's financial responsibility and experience "acceptable."[53] This generally means two years of experience, though some applicants — such as real estate brokers and attorneys — are not required to demonstrate any experience at all.[54] Moreover, a mortgage broker may apply for registration on the sole basis of having completed relevant coursework (with no test or other objective evaluation of whether he or she has learned from the coursework). In contrast, an applicant for a mortgage banker license does not have the option to substitute coursework for the required five years of experience.

Federal Laws

Mortgage bankers of all types are subject to an array of federal laws governing loan originations, including TILA, RESPA, the Fair Housing Act, the Equal Credit Opportunity Act,[55] and HMDA.

While mortgage brokers are subject to fair lending laws, they are not subject to HMDA's reporting and disclosure requirements. While mortgage brokers are subject to RESPA and TILA to some extent, consumer disclosure obligations under these laws are mainly the responsibility of mortgage bankers.

TILA

The Truth-in-Lending Act (TILA)[56] is designed to promote the informed use of credit by consumers through meaningful disclosure of its costs. Creditors (i.e., mortgage bankers) making residential mortgage loans for personal, family, or household purposes must provide TILA disclosures except where transactions satisfy specific exceptions. TILA disclosures are detailed and mandatory and

51 3 N.Y. Comp. R & Regs. § 410.1.

52 3 N.Y. Comp. R & Regs. § 410.15(a).

53 3 N.Y. Comp. R & Regs. § 410.3.

54 Individual real estate brokers and attorneys are not required to demonstrate any particular experience to engage in the mortgage brokerage business, despite the fact that the qualifications for these occupations and professions do not ordinarily demand specific familiarity with mortgages or consumer credit.

55 15 USC § 1691 et seq.

56 15 USC § 1601 et seq.

failure to make them timely and accurately subjects the creditor to significant penalties and remedies, including the borrower's right to rescind the loan.

The principal TILA disclosures for mortgage transactions include: the amount financed; the prepaid finance charge;[57] the finance charge; the finance charge expressed as an annual percentage rate (APR); the number, amounts, and due dates of payments; the total of payments; any late payment, prepayment or nonpayment provisions; whether a security interest is taken in the transaction; and the creditor's assumption policy. While a broker may furnish the initial TILA disclosure forms to a mortgage applicant, TILA's disclosure requirements fall squarely on creditors or mortgage bankers in covered transactions.

The potential liabilities and penalties associated with TILA violations provide significant incentives for mortgage bankers to comply.[58] Furthermore, market mechanisms (e.g., the salability of covered loans in the secondary market) add another layer of incentives for creditor compliance. An error in calculating any of the key terms in a TILA disclosure has significant consequences for the creditor.[59] A large body of case law attests to the frequency with which borrowers sue mortgage bankers for TILA non-compliance, both perceived and real. Consumers injured by creditor violations may rescind their loans and sue to recover their damages plus penalties, costs and attorneys' fees. Moreover, assignees of creditors may be liable for violations by original creditors.

Unlike mortgage bankers, mortgage brokers have no liability under TILA, although they may deliver TILA disclosures to consumers.[60] A mortgage broker who verbally underestimates loan costs, finance charges, payments or other key elements of a loan in connection with soliciting an application undermines the purposes of TILA, but bears no liability.

RESPA

The Real Estate Settlement Procedures Act (RESPA)[61] mandates disclosure of certain settlement costs to consumers, including direct broker fees and YSPs, and prevents certain fees among settlement service providers which may increase settlement costs.[62] RESPA requires a mortgage banker to provide a good faith estimate (GFE) of settlement charges at the time of mortgage application

57 "Finance charge" is a difficult definition to work with under the law because of the lengthy list of items included and excluded from its calculation.

58 15 U.S.C. § 1640(a).

59 15 U.S.C. § 1601 et. seq. See also Brophy v. Chase Manhattan Mortgage Co., 947 F. Supp. 879 (E.D. Pa. 1996).

60 15 USC §§ 1602(f), 1631(b).

61 12 USC §§ 2601-2617.

62 "It is clear that at the time RESPA was passed, its basic thrust was to enable consumers to understand better the home purchase and settlement process, and, where possible, to bring about a reduction in settlement costs." Paul Barron and Michael A. Berenson, "Federal Regulation of Real Estate and Mortgage Lending," Fourth Edition, § 2:1 (Thomson/West 2003) (hereafter, Barron, "Federal Regulation of Real Estate and Mortgage Lending").

and a statement of costs at settlement. RESPA prohibits kickbacks, referral fees, and unearned fees among settlement service providers for federally related mortgage loans.[63]

Mortgage brokers may provide GFEs as well. As long as the mortgage broker has provided the GFE, the funding mortgage banker is not required to provide an additional GFE, but the funding mortgage banker is responsible for ascertaining that the GFE has been delivered.[64] However, to ensure compliance, lenders customarily provide their own GFEs to borrowers. A mortgage banker that requires the use of affiliated providers for settlement services is obligated to disclose any relationship between itself and the provider(s).[65]

There are no statutory penalties under RESPA for failure to provide RESPA-required disclosures,[66] but various courts have held that the lack of a statutory penalty does not obviate a borrower's right of action for violation of the disclosure rules,[67] so mortgage bankers can be subject to lawsuits for noncompliance with RESPA. More frequently, federal and state regulators enforce mortgage banker compliance with RESPA disclosure requirements. Mortgage bankers must keep HUD-1 settlement statements and all other documentation in connection with loans, including the application. This recordkeeping obligation does not fall on brokers.

The Fair Housing Act and the Equal Credit Opportunity Act (ECOA)

The Fair Housing Act prohibits discrimination both by direct providers of housing (such as landlords and real estate companies) and mortgage bankers and others who provide services in connection with a "residential real estate-related transaction." Both mortgage brokers and mortgage bankers are subject to the Fair Housing Act. Under the Fair Housing Act, it is unlawful for "any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin."

ECOA prohibits a "creditor" from discriminating against a loan applicant "with respect to any aspect of a credit transaction" and an "arranger" of credit (such as a mortgage broker) from discriminating on the basis of race, color, religion, national origin, sex or marital status, age (provided the applicant has the capacity to contract), "because all or part of the applicant's income derives from any public assistance program," or "because the applicant has in good faith exercised any right under [ECOA]." While both mortgage bankers and mortgage brokers are subject to these laws, consumers

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63 The term "federally related mortgage loan" is broadly defined under RESPA. 24 USC § 2602 (1).

64 24 CFR § 3500.7(b).

65 24 CFR § 3500.7(e).

66 RESPA also requires that prospective borrowers be given a Special Information Booklet which describes settlement costs. The receipt of an application for a federally related mortgage loan triggers the obligation to provide the Booklet. Mortgage bankers or mortgage brokers may provide the Special Information Booklet. 24 CFR § 3500.6.

67 Barron, "Federal Regulation of Real Estate and Mortgage Lending," § 2:41.

and regulators are more likely to make claims against mortgage bankers for any discrimination by independent mortgage brokers because mortgage bankers are perceived to have the resources to pay fines and judgments.

Home Mortgage Disclosure Act (HMDA)

Although mortgage bankers and mortgage brokers are subject to the fair lending laws, only mortgage bankers are required to report and disclose data on mortgage lending activities under HMDA and, thus, are subjected to the scrutiny that HMDA brings. HMDA regulations are the responsibility of the Federal Reserve. The Federal Reserve has stated that the three main purposes of HMDA are:

- To provide the public and government officials with information that will help show whether financial institutions are serving the housing needs of the neighborhoods and communities in which they are located;
- To help public officials target public investments to promote private investments in neighborhoods where investment is needed; and
- To provide data that assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.

HMDA, among other things, requires covered mortgage bankers to collect, report, and publicly disclose detailed data relating to mortgage applications, denials, and loan pricing. These data include loan type and amount; property location and type; the disposition of the application, such as whether it was denied or resulted in an origination; and the applicant's ethnicity, race, sex, and income.

For 2004, the Federal Reserve began requiring mortgage bankers to report pricing data for first-lien loans with an Annual Percentage Rate (APR) equal to or greater than the rate payable on a Treasury security of comparable maturity plus three percent and for subordinate-liens with an APR equal to or greater than the rate on a comparable Treasury security plus 5 percent. In establishing these requirements, the Federal Reserve sought data on lending patterns in the subprime mortgage market.

As a consequence of these HMDA amendments and the availability of pricing data, hundreds of governmental reviews have been initiated concerning loan pricing by mortgage bankers. These reviews include several by the Department of Justice, the Federal Trade Commission (FTC), the Office of the Comptroller of Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) the Federal Reserve, the Office of Thrift Supervision (OTS), and various state attorneys general. These agencies have continued to use HMDA data in support of other fair lending initiatives, including the review of traditional denial disparity issues, redlining, predatory lending, and steering.

Recommendations for Regulatory Improvements

MBA believes that by appropriately recognizing the differences that exist between mortgage bankers and mortgage brokers, legislators and regulators can take important steps toward addressing consumer protection shortcomings in the mortgage process. MBA recommends the following:

Borrowers Should Have Access to Improved and Timely Disclosures Regarding the Services Furnished by Brokers and Compensation for Those Services

Some have proposed broad prohibitions on compensation linked to loan terms without differentiating between mortgage bankers and mortgage brokers. MBA believes that consumers and the market would be better served with clear information on the amount of total broker compensation, its sources and the broker's functions, early in the process. Such information would encourage consumers to comparison shop among brokers just as they currently do among mortgage bankers, help the consumer understand how compensation derived from rate can be used to pay origination charges and other settlement costs, and increase the likelihood that the consumer ends up with the most favorable loan terms. Additionally, clear information on whether the broker is or is not serving as the borrower's agent would similarly inform the consumer's decision about shopping among multiple brokers.

The recent Federal Reserve proposal to require mortgage brokers to enter into a written agreement with the consumer before compensation is paid to a broker is notable. It would require disclosure of the broker's direct and indirect compensation and help borrowers avoid steering. Additionally, HUD's most recent RESPA proposal seeks to improve YSP disclosures to make clear to the consumer the link between YSP and a higher interest rate. While MBA has concerns with the HUD and Federal Reserve proposals, MBA applauds both HUD's and the Federal Reserve's work in producing them. Additionally, MBA encourages both agencies to work together as they finalize their proposals.

Some have pointed to studies by the Federal Trade Commission (FTC) to refute the position that more information about broker compensation would better equip consumers to comparison shop for mortgages and mortgage providers.[68] The FTC tested various forms of YSP disclosures with consumers and found that the disclosures did not help consumers identify the least costly loans. The FTC staff report also concluded that the YSP disclosures caused a bias against broker sourced loans. While the FTC's findings highlight the challenges in improving consumer mortgage disclosures, they do not address the problem of consumers' often incorrectly placed reliance on brokers as trusted advisors. Nor do the FTC staff conclusions obviate the need to counter steering through improved consumer information about brokers' compensation and legal responsibilities.

Brokers Who Claim to be or Act as Borrowers' Agents Should Be Treated As Agents Under the Law of Principal and Agent

If a broker asserts or acts in a manner that indicates that he or she is shopping for the borrower, the broker should be subject to the duties of agency.[69] This would clarify that a broker is acting on the borrower's behalf and has an obligation to act in the borrower's best interests.

MBA believes that this is best accomplished through a declaration (or disclaimer) of agency relationship by the broker. This clearly would inform a borrower as to whether he should rely on a broker to shop for him. Mere imposition of an undefined standard of fiduciary duty on all mortgage brokers, irrespective of the borrower's wishes, would likely increase liability and costs to both mortgage bankers and borrowers.

All Loan Originators Should Be Registered and Subject to Appropriate, Rigorous Licensing Standards

MBA supports the President's Working Group on Financial Markets' recommendation that mortgage brokers should be held to stronger licensing and enforcement standards. In fact, MBA supports requiring licensing for all individual loan originators — brokers and bankers — except those employed by an institution with a federal charters (current law exempts employees at federally chartered institutions from state licensing laws). Additionally, there should be a nationwide registry

68 James M. Lacko and Janis K. Pappalardo, "The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment," Federal Trade Commission Bureau of Economics Staff Report (February 2004).

69 Agency is a fiduciary relationship created by express or implied contract or by law, in which one party (the agent) may act on behalf of another party (the principal) and bind that other party by words or actions, C.J.S. Agency §§ 2, 4-6, 23, 25–27, 33, 38-40, 58.

of mortgage broker and mortgage banker employees who originate loans. All originators, including those employed by federally chartered institutions, should participate in this registry. A nationwide registry would provide a powerful tool for regulators, industry participants, and consumers in tracking unscrupulous actors.

MBA also supports rigorous and appropriate licensing standards for loan originators. Ensuring that loan originators fall under rigorous licensing requirements will ensure that mortgage brokers, as well as mortgage bankers have the competence and professionalism required to serve consumers. Additionally, MBA supports greater appropriations at the state and federal level for enforcement of such requirements.

Brokers Should Have Sufficient Financial Resources to Provide Relief to Borrowers and Mortgage Bankers Where Necessary

Brokers should be required to maintain a minimum level of financial net worth. Currently, FHA requires brokers offering FHA-insured mortgages to have a net worth of at least $63,000, plus $25,000 for each branch office.

MBA supports establishing a nationwide financial net worth requirement for all mortgage brokers consistent with these requirements. A requirement for minimum financial worth would provide greater protection to consumers and mortgage bankers and help brokers meet their repurchase obligations, making brokers more financially accountable.

Brokers, Where Possible, Should Be Sufficiently Bonded

Additional protection for the public can be obtained if surety bonds are required in connection with licensing of mortgage brokers. MBA supports minimum bonding, where available, of $75,000 or an amount equal to 10 percent of the broker's annual loan volume, whichever is higher.

A number of states already require brokers to maintain surety bonds. Fidelity bonding for the employees of mortgage brokers would be an additional protection for consumers who put their trust in a mortgage broker to obtain mortgage financing. Bonds commonly are available from commercial insurers, and obtaining them would not generally create a hardship on brokers.

Aggrieved consumers and mortgage bankers could file claims for economic losses against the bonding companies. Moreover, since bonding in many cases requires a financial audit, such an audit can provide additional protection to the public and is consistent with existing FHA regulations.

Mortgage Brokers, as Independent Entities, Should Not Be Made Agents of Mortgage Bankers as a Matter of Law

The foregoing recommendations will solve key regulatory concerns in a more targeted manner. Recently, however, one federal legislative proposal suggested that mortgage bankers should be liable for the acts, omissions, and representations made by mortgage brokers whenever they sell or deliver a subprime mortgage to a mortgage banker or for any loan where a mortgage broker receives a YSP from a mortgage banker.

MBA strongly believes this proposal would have deleterious, albeit unintended, effects. Mortgage brokers are independent entities and act independently from mortgage bankers during the loan sourcing and application process. Mortgage bankers lack the ability to control and oversee broker conduct. Making mortgage bankers liable for mortgage brokers, considering brokers' independence, would result in fewer purchases of mortgage broker loans by mortgage bankers. This would decrease competition and lessen choices to borrowers, ultimately increasing borrowers' costs.

Conclusion

The U.S. mortgage market offers a wide array of mortgage credit options and has been a critical factor in increasing national homeownership rates, which are near record levels. Nonetheless, a rising foreclosure rate and recent excesses in the subprime market have brought calls for greater regulation of all aspects of the mortgage process, including the duties and responsibilities of mortgage brokers. The current challenges that the housing market and some homeowners face point to weaknesses in the quality of consumer information and required disclosures.

Both mortgage bankers and mortgage brokers perform beneficial functions in the mortgage market and have been able to offer borrowers an array of credit choices. As this paper illustrates, although complementary, mortgage bankers and mortgage brokers have fundamentally distinct functions and responsibilities. MBA, therefore, urges legislators and regulators to resist pressure to embrace an unwarranted one-size-fits-all regulatory approach. Instead, MBA believes the differences between the brokerage and lending industries should be recognized, considered, and carefully addressed to assure that regulatory inadequacies are properly addressed, consumers are protected, and that the market functions fully and fairly for the benefit of all.

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