



June 11, 2008

The Honorable Brian D. Montgomery  
Assistant Secretary for Housing-Federal Housing Commissioner  
Federal Housing Administration  
U.S. Department of Housing and Urban Development  
451 Seventh Street, SW  
Washington, DC 20410  
Electronic Submission: [www.regulations.gov](http://www.regulations.gov)

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

Dear Commissioner Montgomery:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits this comment on the proposed rulemaking on the *Real Estate Settlement Procedures Act (RESPA): Proposed Rule to Simplify and Improve the Process of Obtaining mortgages and Reduce Consumer Settlement Costs*. The Office of Advocacy commends the Department of Housing and Urban Development for its efforts to comply with the Regulatory Flexibility Act (RFA) as well as its efforts to work with Advocacy on small entity outreach in order to address the concerns of small entities in the new proposal. While we are grateful that HUD is considering how RESPA reform will impact small business, Advocacy still has concerns with the potential economic impact of the proposal. We are committed to helping you address these concerns before finalizing the rule.

### Advocacy Background

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or of the Administration. Section 612 of the RFA requires Advocacy to monitor agency compliance with the Act, as amended by the Small Business Regulatory Enforcement Fairness Act.<sup>1</sup>

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<sup>1</sup> Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

On August 13, 2002, President George W. Bush enhanced Advocacy's RFA mandate when he signed Executive Order 13272, which directs Federal agencies to implement policies protecting small entities when writing new rules and regulations. Executive Order 13272 also requires agencies to give every appropriate consideration to any comments provided by Advocacy. Under the Executive Order, the agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.

## **The Proposed Rule**

On March 14, 2008, the Department of Housing and Urban Development (HUD) published a proposed rule on the Real Estate Settlement Procedures Act (RESPA) in the *Federal Register*. The purpose of the proposed rule is to simplify and improve the disclosure requirements for mortgage settlement costs under the Real Estate Settlement Procedures Act of 1974 (RESPA) and to protect consumers from unnecessarily high settlement costs. The objective of the revisions is to protect consumers from unnecessarily high settlement costs by taking steps to: 1) improve the Good Faith Estimate (GFE) form to make it easier to shop for settlement service providers; 2) ensure that page one of the GFE provides a clear summary of the loan terms and total settlement charges; 3) provide accurate estimates of costs of settlement services; 4) improve disclosure of yield spread premiums; 5) facilitate comparison of the GFE and the HUD-1/HUD-1A Settlement Statements; 6) ensure that at settlement, borrowers are aware of final loan terms and settlement costs, by reading and providing a copy of a "closing script" to borrowers; 7) clarify HUD-1 instructions; 8) clarify HUD's current regulations concerning discounts; and 9) expressly state when RESPA permits certain pricing mechanisms that benefit consumers, including average cost pricing and discounts, including volume-based discounts.<sup>2</sup>

Advocacy is concerned that HUD may have underestimated the costs of the proposal and created a potential uneven playing field for some small entities. Moreover, there may be less costly alternatives that achieve HUD's stated goals.

## **Requirements of the RFA**

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Pursuant to the RFA, the federal agency is required to prepare an initial regulatory flexibility analysis (IRFA) to assess the economic impact of a proposed action on small entities. The IRFA must include: (1) a description of the impact of the proposed rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant

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<sup>2</sup> 73 Fed. Reg. 14030.

economic impact of the proposed rule on small entities.<sup>3</sup> In preparing the IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.<sup>4</sup> The RFA requires the agency to publish the IRFA or a summary of the IRFA in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule.<sup>5</sup>

Pursuant to section 605(a), an agency may prepare a certification in lieu of an IRFA if the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. A certification must be supported by a factual basis.

### **HUD's Compliance with the RFA**

Preliminarily, Advocacy would like to thank HUD for the amount of work that it put into analyzing the impact that the proposed rule may have on small entities and the effort that it made to minimize the economic impact on small entities. However, small entities have informed Advocacy that HUD may have underestimated the economic impact and that there may be less costly alternatives.

#### *HUD's Assessment of the Economic Impact of the Proposal*

The proposed rule will impact small brokers, loan originators, lenders, settlement service providers, and realtors. HUD estimates that \$4.13 billion, or 49.5 percent, of the \$8.35 billion in consumer savings will come from small businesses, with small originators contributing \$3.01 billion and small third-party firms contributing \$1.13 billion. In addition, small businesses will bear \$390 million of the estimated \$570 million in one-time compliance costs: \$280 million from the proposed GFE and \$110 million from the HUD-1. According to HUD, the proposed rule will result in \$548 million in annual recurring compliance costs for small business (out of a total \$1.23 billion).<sup>6</sup>

Advocacy has met with a wide range of small entity representatives from different sectors of the industry; several have stated that the proposal is more costly than HUD's estimates and is potentially anticompetitive.

#### *Good Faith Estimate (GFE)*

HUD proposes a revised GFE to provide borrowers with information about closing costs prior to the loan application. The new GFE is a four-page standardized form, the first of which is a summary page that captures the major elements of origination and closing costs. Three additional pages provide a more detailed breakdown of closing costs and alternatives offering different interest rates coupled with corresponding up-front costs. The purpose of the redesigned

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<sup>3</sup> 5 USC § 603.

<sup>4</sup> 5 USC § 607.

<sup>5</sup> 5 USC § 603.

<sup>6</sup> 73 Fed. Reg. at 14102.

GFE is to give consumers the information that they need to shop for loans and compare the different offers they receive.

According to the National Association of Realtors (NAR), HUD has significantly underestimated the costs of the new GFE because HUD assumed that the average borrower would obtain only 1.7 GFEs. NAR asserts that if one assumes that borrowers will have just 2 GFEs, the compliance costs of the proposal on small entities will increase significantly.<sup>7</sup> Moreover, the Independent Community Bankers Association (ICBA) asserts that the GFE requirements may be particularly burdensome to small entities that may not have some of the automated systems used by large volume originators that provide cost efficiencies.

In addition, the proposed form is four pages long and does not mirror the HUD-1. As such, at the time of closing, it may be confusing for the borrower and require additional time that HUD has not considered in its estimate of costs. The American Land Title Association (ALTA), ICBA, NAR, and the National Association of Mortgage Bankers (NAMB) suggest that HUD develop a GFE form that mirrors the HUD-1 to simplify the process and reduce potential costs.

### *Tolerances*

When a GFE is issued, the originator (defined as the lender or the mortgage broker) will now be required to guarantee the origination fee and certain third party closing costs (e.g., title insurance, appraisal, etc.) for a minimum of 10 business days. The guarantee is subject to tolerance levels. The originator must also specify an interest rate and a lock-in period for the rate. If the borrower accepts the terms identified on the GFE, those terms will be generally guaranteed until the loan is closed. Although HUD has allowed for some discrepancies in the event of “unforeseen circumstances,” changes resulting from movements in interest rates or other economic developments are not allowed.

According to ICBA and MBA, this requirement is problematic because some of the costs can change on a daily basis, making the lender or loan originator responsible for the actions of a third party that are beyond its control. The borrower may also request change to the type of loan in the GFE. Moreover, in the case of new home construction, borrowers often make changes to the home that change the terms of the loan and require revised disclosures.

Although HUD allows the originator to make changes in the event of unforeseen circumstances, the language is vague and may be problematic. The 10 percent increase may also be too restrictive because the costs are beyond the control of the lender or loan originator.

### *Closing Script*

The proposed rule also requires that a closing script be read to borrowers to provide information about the terms of the loan. Small entities have told Advocacy that this requirement is problematic. For example, the National Association of Realtors (NAR) contends that while HUD calculates the cost of the requirement on the settlement agent, HUD does not recognize the

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<sup>7</sup> *Estimated Costs of HUD's Proposed RESPA Regulations*, prepared for the National Association of Realtors by Ann Schnare, June 3, 2008, Page 9.

costs to other participants such as realtors.<sup>8</sup> NAR also asserts that by increasing the amount of time at closing, the closing script will create a time delay and possibly require additional space to service the same amount of loans.<sup>9</sup>

Likewise, the ALTA states that the proposal does not take into account additional questions that the borrower may have or the fact that it is the lender who is most able to answer such questions, not the settlement service provider. The proposal does not allow for the fact that the majority of closings occur at the end of the month because of tax reasons. According to ALTA, this will result in a delay in closing that could result in lost revenue. Because of the problems that the closing script may present for small entities, Advocacy recommends that HUD eliminate the requirement of a closing script.

### *Volume Discounts*

ALTA, ICBA, NAMB, and NAR contend that volume discounts will favor large settlement service providers and loan originators/lenders at the expense of small businesses and place them at a disadvantage.

Advocacy recognizes that volume discounts are occurring in the market. However, Advocacy is concerned that including volume discounts in the rule may act as an endorsement and result in an unfair advantage to those who offer discounts, and make it more difficult for small businesses to compete on service. Accordingly, it may cause small businesses to leave the market and result in higher prices for consumers in the long term. Advocacy encourages HUD to reconsider its decision to cover volume discounts in this rule.

### *YSP Disclosure*

When the interest rate of the loan exceeds the par interest rate of the lender, the lender pays the broker at closing an amount in excess of the principal amount of the loan. This excess is commonly referred to in the mortgage industry as a yield spread premium (YSP).<sup>10</sup> In the proposal, HUD reclassifies the YSP as a credit to the borrower. According to NAMB, the practical effect of this change is to put mortgage brokers at a competitive disadvantage by imposing asymmetrical disclosure obligations among originators receiving comparable compensation. Recharacterizing YSP as a credit to the borrower also may create, rather than eliminate, confusion among consumers. NAMB further asserts that this will maintain, and accentuate, the difference between a broker transaction and a lender transaction.

Advocacy understands that the brokers and bankers do not agree in terms of whether brokers and bankers should have to disclose what is being earned on the loan. However, the industry does seem to agree that HUD's proposal regarding the YSP disclosure will create more confusion. Accordingly, Advocacy encourages HUD to reconsider its current proposal with regard to the

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<sup>8</sup> Testimony before the U.S. House of Representatives Committee on Small Business on "RESPA and Its Impact on Small Business" by Adam D. Cockey, Jr. of the National Association of Realtors, May 22, 2008, page 6.

<sup>9</sup> *Estimated Costs of HUD's Proposed RESPA Regulations*, prepared for the National Association of Realtors by Ann Schnare, June 3, 2008, Page 14.

<sup>10</sup> 73 Fed. Reg. at 14041.

YSP until it can develop a method that accomplishes its goals without being prejudicial to any particular sector of the market or creating additional confusion.

## **Conclusion**

The RFA requires agencies to consider the economic impact on small entities prior to proposing a rule, to provide the information on those impacts to the public for comment, and to consider less burdensome alternatives. Advocacy encourages HUD to give full consideration to the economic information and alternatives suggested by small entities prior to going forward with the final rule. In addition, if HUD decides to go forward with the RESPA reform, Advocacy strongly encourages HUD to provide a delay in the implementation date to allow small businesses ample opportunity to absorb the costs and comply with the new requirements. We respectfully advise HUD to document the additional costs to small entities and consider harmonizing the GFE with the HUD-1 as well as clarifying the provision on tolerances. And, the Office of Advocacy supports HUD moving forward without the closing script requirement, the volume discount language, and the YSP classification.

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943.

Sincerely,

/s/

Thomas M. Sullivan  
Chief Counsel for Advocacy

/s/

Jennifer A. Smith  
Assistant Chief Counsel for  
Economic Regulation and Banking

cc: The Honorable Susan E. Dudley, Administrator  
Office of Information and Regulatory Affairs, OMB