BROWN, FOWLER & ALSUP
A Professional Corporation
Attorneys at Law

J. Alton Alsup
Board Certified in Residential Real Estate Law
Texas Board of Legal Specialization

10333 Richmond Avenue, Suite 860
Houston, Texas 77042
www.LoanLawyers.com

Telephone 713/468-0400
Facsimile 713/468-5335
AlAlsup@BFAlegal.com

June 12, 2008

Regulations Division
Office of the General Counsel
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
451 Seventh Street, SW Room 10276
Washington, D. C. 20410-001

Re: Comment on Docket No. FR–5180–P–01 titled 'Real Estate Settlement Procedures Act (RESPA): Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs' (the "HUD Proposed Rule")

To the Department of Housing and Urban Development:

Our Houston-based law firm represents financial institutions, mortgage bankers, and mortgage brokers in the process of mortgage loan documentation and closings for thousands of Texas home loan transactions each month. We practice exclusively in the field of residential mortgage banking and real estate law, and our legal services include preparing home mortgage loan documents and counseling our clients in related federal and state regulatory compliance, real estate, title, and closing matters. I am Board Certified in Residential Real Estate Law by the Texas Board of Legal Specialization and have written and lectured extensively on the subject of Texas and federal regulation of housing finance.

We have earlier commented in opposition to the Department's proposed revision to the definition of "required use" (Reg. X, §3500.2) by separate letter dated June 6, 2008, which was submitted electronically and assigned Comment Tracking Number 8061d15d.

The HUD Proposed rule, when coupled with the Proposed Rule of the Federal Reserve Board amending Regulation Z (73 FR 1671) and touching on many of these same issues (the "FRB Proposed Rule"), would establish new national standards that fundamentally change how home mortgage loans are originated, processed, underwritten, closed, and serviced (and how fees to mortgage brokers and other settlement service providers are paid and disclosed) throughout the nation. We have resisted the temptation to "shotgun" criticisms that occur to us upon our study of the proposed rules and form and content of the Good Faith Estimate (GFE) and the HUD-1/1A Settlement Statement (HUD-1), including the so-called "Closing Script" addendum to the HUD-1, which are central to the Proposed Rule changes. Our red-line mark-ups of these proposed forms at this point resemble an Italian road map, and we believe our recommended changes in the form of suggested interlineated and marginal notes would be of little practical value to the Department in absence of an opportunity to meet with the Department's staff members and attorneys to discuss them in some depth. We believe that the Department's basic concept of establishing reliable estimates of settlement costs at an early stage of the loan shopping process that may be readily compared by the consumer against actual costs at loan closing is a good one. However, the many deficiencies of these proposed forms of disclosure documents illustrate why

such far reaching rules should not be written in a vacuum by the Department. The "notice and comment" procedures of administrative rulemaking, while important, are not adequate for the task of developing workable rules and precise forms of consumer contract and disclosure documents for practical use in such a complex industry. The prior counsel of knowledgeable and experienced legal practitioners in the related fields of residential real estate, residential mortgage, and title insurance law would be invaluable to the Department in that undertaking, and, given the importance of the proposed rule to the industry, many practitioners would happily devote their time and energies *pro bono* as a resource to the Department for that purpose. Our brief comments on the Proposed Rule are organized under the broad headings of our specific recommendations to the Department, which follow:

Recommendations Regarding the Form and Content of the Proposed Good Faith Estimate

1. *Change Title*. Change the title of the form to read "Good Faith Estimate (GFE) of Loan Terms and Settlement Charges."

2. *Reduce Length.* Reduce the form of GFE to two (2) pages, consisting of the information contained on pages 1 and 2 of the Department's proposed form. Authorize the form to be printed on a single sheet of 8 ½ x 11" or 8 ½ x 14" paper, front and back.

3. *Offload Instructional Information to Settlement Information Booklet.* Incorporate the information contained on pages 3 and 4 of the Department's proposed form of the GFE into a revised publication of the Settlement Information Booklet (SIB). Cross reference the availability of the SIB at the bottom of Page 2 of the GFE. Require that loan originators provide a SIB booklet to all loan applicants at the same time as delivery of the GFE. Require that borrowers certify in writing at loan closing that each has been provided a copy of the SIB and has had an opportunity to read its contents and to ask questions of the loan originators to clarify applicability of its contents to the loan terms and provisions offered.

4. *Abandon Notion of Enforcing Mandatory Tolerances and Availability Periods*. The GFE, as envisioned in the HUD Proposed Rule, is essentially a quote of loan terms and estimated costs that precedes a consumer's determination to make a loan application with the issuer of the GFE, who nevertheless is expected under the rule to hold the estimated loan terms and settlement costs open for acceptance by the consumer for a stipulated period of time while the consumer shops the competition. While many routine settlement costs are stable and reliably predictable, interest rates and related costs fluctuate with market conditions and in volatile markets may change twice or more each day. Consequently, no mortgage broker is in a position to commit for any period of time to an interest rate and related finance costs until taking a loan application and registering the loan with a wholesale mortgage lender, which provides the pricing commitment. Even assuming for discussion purposes that the Department currently is authorized under RESPA to impose upon loan originators guarantees of the availability of estimated costs within tolerances, the monitoring and enforcement of such requirements for hundreds of thousands of home mortgage loans annually is too monumental and impractical for the Department to even consider. However, a loan originator's commitment to tolerances and availability periods could be encouraged and made voluntary and, if required to indicate on the GFE whether or not the estimated loan terms and settlement charges will be held available for acceptance by the

consumer for any period of time, market forces may ultimately shape a practice in which commitments are routinely made for a competitive edge. In any event, a history of frequently quoting loans terms that are not currently available or settlement charges that are found to be significantly understated may be found by the Department as evidence of a "pattern or practice" of a Section 5 violation, and, with the new authority it will seek from Congress to impose civil penalties, the Department will have the enforcement means to deal with rogue loan originators. Given the threat of civil money penalties, the risk of reputation loss by loan originators cited by the Department as violators, and competitive market forces operating in compliance with these guidelines, a high degree of GFE accuracy in the industry should be achieved without making the proposed tolerances and availability periods mandatory. It is our experience, in any event, that most national wholesale lenders selling or securitizing their loan product in the secondary market today insist on the accuracy of the Good Faith Estimates for their deliveries, going so far under their own practice standards as to refund fees or excess amounts collected at closing that were not properly disclosed on the GFE, although not required to do so under current law.

5. *Cross Reference HUD-1 Line Items.* Instead of revising the HUD-1 Settlement Statement (line items 801-803, inclusive) to cross reference the GFE as proposed, cross reference on the GFE where (i.e., the specific line item) each particular charge will be disclosed on the HUD-1 at closing. Include a legend or statement cross referencing that a summary of loan terms and actual settlement charges will be provided as an addendum to the HUD-1 at closing with which the borrower may make side-by-side comparisons of estimated and actual charges.

6. *Clarify that GFE is Not a Mortgage Application.* Revise Instructions and Important Dates legends on page 1 to clarify that the GFE is being provided before a loan application has been taken or received to allow the consumer to shop for a loan that suits the consumer's needs; that no credit decision has yet been made; that if the consumer desires to apply for a loan with the issuing originator, the consumer must complete a formal mortgage application and be approved for the loan based upon final underwriting and property appraisal. Alternatively, a bold and conspicuous legend to that effect could be provided at the bottom of page 2.

7. *Don't Introduce New Terminology.* Don't invent new terminology for old concepts well known and vetted in the industry. The proposed term "Our Service Charge" should instead read "Loan Origination Charges." Service charges in the parlance of the industry are the nominal charges by banks and loan servicers for performing particular requested services, such as wiring funds upon request or preparing a loan payoff statement. Origination charges are generally understood in the industry to mean the taking of a loan application, and the processing, underwriting, and closing of a mortgage loan. Use of the term "Loan Origination Charges" also better comports with the term used in Block A of "Adjusted Origination Charges." Also, the vague use of "we" in this context is ambiguous. Is the consumer to understand that this figure is the issuing loan originator's origination fee or, as proposed, the collective origination charges of mortgage brokers, third-party originators, if any, and the funding lender? Assuming that a maximum amount of mortgage broker compensation, expressed as a dollar figure, must be set forth by written agreement between the mortgage broker and the consumer under the FRB Proposed Rule, the GFE and the corresponding disclosures on the HUD-1 must properly reflect that maximum figure both to evidence the lender's authority to pay such amount and to confirm to the consumer that contractual compensation terms have been complied with. Moreover, the use

of the term "(points)" in item 2 of Block A seems erroneous. The term "points" generally refers to "discount points," which are in the nature of prepaid interest paid at closing that is correlated with the contract note rate and serves to reduce that rate accordingly. This item 2, however, reflects the rate differential (i.e., a premium over so-called par rate), which is used to credit and offset mortgage broker compensation, and, to the extent it exceeds mortgage broker compensation due, other settlement charges for which the borrower is obligated. This also raises the issue of how the Department proposes to properly disclose bona fide discount points on the HUD-1. Because discount points may be deducted by consumers for federal income tax purposes, the HUD-1 should clearly indicate qualifying discount points.

8. *Acknowledgment.* Add a form of acknowledgment at the bottom of page 2 for each of the applicants to date and sign to evidence that the GFE was properly and timely issued.

Recommendations Regarding the Proposed Forms of HUD-1 Settlement Statement and "Closing Script"

1. *Leave Form of HUD-1Intact.* Don't change the form and content of the HUD-1 Settlement Statement at all, not one dotted "i" or crossed "t". It is the industry standard that all document software systems accommodate and all settlement agents nationwide are familiar with and trained in its proper preparation. Importantly, it's not necessary to revise the HUD-1 to achieve the purposes outlined by the Department. The easy comparison of estimated charges on the GFE with actual charges on the HUD-1 can be better achieved by an addendum to the HUD-1, as described in paragraph 2 below.

2. *Abandon Notion of a "Closing Script" in Favor of More Meaningful HUD-1 Addendum Delivered in Advance of Closing.* Settlement agents under the HUD Proposed Rule would be required to prepare and read aloud to the consumer at closing a new form of addendum to the HUD-1, referred to as the "Closing Script," comparing actual costs charged at closing with estimated costs on the GFE and to explain to the consumer in particular whether actual costs exceed those estimated within the allowed tolerances for accuracy, including mortgage broker compensation, and whether detailed loan terms and related information disclosed on the GFE vary from actual loan terms as set forth in the promissory note secured by the mortgage. Although the notion of a Closing Script that would be read aloud by the settlement agent for all borrowers (not just for the illiterate) may seem plausible, it would be, besides mind numbing and condescending, a most impractical and overly burdensome rule with few consumer benefits. Closing is hardly the time to be first educating the borrowers on the salient terms and features of their loans, and settlement agents are hardly the appropriate parties to be stuck with undertaking that education. Without rehashing the numerous protests of the industry lodged on this issue, the Department should now be aware of the burdensome time and costs associated with both the preparation of such a complex disclosure document as proposed and the significant time that would be added to each closing necessary for the settlement agent to actually read aloud the disclosure and oversee its acknowledgment (reducing the number of table closings that could be conducted in a typical business day and correspondingly increasing escrow fees charged for each loan by settlement agents to compensate for the additional

services performed). Moreover, there are no means or authority for settlement agents to resolve consumer complaints that predictably could arise from such a reading (lenders don't attend table closings in most jurisdictions) and the process has the potential for clogging the loan settlement process if closings require an additional 30-45 minutes each or must be adjourned to resolve issues with the lender, or if loans "bust out" entirely. And, the industry is concerned about the qualifications of escrow officers and other settlement agents (who traditionally are trained only to conduct the administration of the closing) for the task of explaining the terms of the loan to the borrowers, adequately responding to questions raised by the borrowers, and the attendant risks of civil liability of settlement agents in the process for claims of the unauthorized practice of law or for providing erroneous or bad advice upon which the borrowers rely. The proposed rule also doesn't seem to allow for compliance with this requirement for "mail-out" settlements, "signing service" settlements, or escrow closings when all parties are not at the table simultaneously.

The Department instead should jettison the whole notion of the "Closing Script" rule as proposed and accomplish its stated purposes by adopting a rule for adding an Addendum to the HUD-1, which would replace the proposed "Closing Script" addendum, generally of the following description:

- *Title:* The Addendum could be titled "Addendum to HUD-1 Settlement Statement — Summary of Loan Terms and Settlement Charges."

- *Format and Content:* The Addendum could be formatted similar to, in the same order as, and using the identical terminology as the GFE. Side by side columns could be headed respectively "GFE Estimates," "HUD-1 Actual," and "Variance ±". A smaller fourth column could contain a code for footnoted explanations of any variance. For example, if a 1% origination fee were estimated on the GFE as $1,000 assuming a $100,000 loan, and the borrower subsequently requested and was granted a principal loan increase to $110,000 based on appraisal, the HUD-1 Actual column would then disclose a charge of $1,100, The "Variance ±" column would disclose + $100, and the Explanation column might have, for example, "B", which when the corresponding footnote is referred to indicates that the increase is based upon an increased loan amount requested by the borrower. Columns could also be subtotaled by category and totaled showing total variances, with overstated charges offsetting understated charges, and a final total variance from GFE estimates (which could be the benchmark for "pattern and practice" Section 5 violations investigated by the Department). The content should mirror that of the GFE, and all extraneous and duplicative disclosures of loan terms should be eliminated. For example, the Department seems oblivious to the fact that detailed disclosures of all ARMs and other variable rate loan programs, such as so-called option ARMS, must be given to loan applicants at the time of application under Regulation Z, §226.19(b). Attempting to again disclose terms of such loans in some abbreviated format as proposed seems confusing and at odds with the purposes of the Truth in Lending Act regulated by the FRB. The Department instead should have a bold and conspicuous legend to the effect that the borrower has earlier been provided disclosures about the terms and features of such loans and the borrower should refer to those disclosures for a better understanding of loan terms. The form of Addendum also

should contain (i) incorporation language expressly making it a part of the HUD-1, and (ii) a bold and conspicuous caveat to the effect that the information disclosed is a summary of contract terms only and does not supersede, amend or modify loan terms as set out in the note, security instrument, and other contract documents.

- *Early Delivery and Acknowledgment:* The Addendum, as part of the HUD-1, would be completed and delivered to borrowers in advance of loan closings under the authority that the Department has announced it will seek from Congress. The Department's announced intent to seek statutory authority to require that a copy of the HUD-1 be delivered to borrowers "at least three-business-days" in advance of loan closings seems unnecessarily burdensome. In our experience in dealing with a similar requirement for pre-closing disclosures in connection with Texas home equity loans, we would recommend that the Department instead seek authority for requiring advance delivery of the final HUD-1, complete with the addendum "Summary of Loan Terms and Settlement Charges," at least on one calendar day preceding the date of closing. At closing, each of the borrowers would be required to sign a form of acknowledgment that the HUD-1 had been timely delivered in advance of closing, that borrowers had been given adequate time to read and understand the HUD-1, including the Addendum, and to seek clarification of any of its content with the loan originator in advance of loan closing.

Recommendations Regarding Payment and Disclosure of Mortgage Broker Compensation

1. *Correct Flawed Disclosure Scheme Proposed for YSPs.* In quest of a "level playing field" for mortgage brokers, who like other settlement service providers must disclose their compensation for loan origination services performed, the Department unfortunately obfuscates how mortgage broker compensation is determined and disclosed. Disclosure of mortgage broker compensation on the proposed modified form of HUD-1 would radically differ from current regulations, requiring most particularly that all loan origination charges of the lender and broker be disclosed together as a lump sum on the GFE and Line Item 801 of the HUD-1 (denominated as "Our Service Charge") and any compensation paid by the lender to the mortgage broker (denominated as "Your Charge or Credit for the Specific Interest Rate Chosen," in lieu of the more common industry term "yield spread premium") be credited to the borrower in reduction of that Service Charge on Line Item 802 to produce a net charge or credit to the borrower (denominated as "Your Adjusted Origination Charges") on Line Item 803. Although the Department professes to seek transparency in home loan transactions to further the purposes of RESPA, under this proposed disclosure scheme the name of the mortgage broker in fact never appears on the HUD-1 nor is any direct or indirect payment specifically to the mortgage broker ever disclosed. (Note that only the name of the lender is disclosed in Section F of the HUD-1 and that even in a table-funded transaction in which the mortgage broker is the named payee in the promissory note, Reg. X, §3500.2 defines "Lender" to mean the "person to whom the obligation is initially assigned at or after settlement.") Accordingly, the name of a mortgage broker would never appear on the HUD-1 and the broker's compensation would be mired in the line 801 "Our Service Charge" sum, with no break out of how that amount is to be distributed among the loan originators. Obviously, the lender would still be paying the amount of broker compensation set forth in line 802 to the mortgage broker outside of closing, although no such P.O.C. payment must be notated on the HUD-1, as required under current disclosure rules.

Moreover, the very concept of how mortgage broker compensation is determined is seriously flawed, as defined by the Department in terms of a so-called yield spread premium constituting "the difference between the price the wholesale lender pays the broker for the loan and the initial loan amount." In fact, a mortgage broker is never the holder of the loan and does not sell the loan to a wholesale lender. A mortgage broker instead, as the Department has acknowledged in its own rulemaking and should well know, is a settlement service provider who performs loan origination services and is entitled to agreed-upon compensation for actual services performed. A yield spread premium is, or should be, a means for the borrower to finance payment of mortgage broker compensation through payment of a premium note rate, based on a calculated rate differential adequate to allow the lender to recoup over time the amount of mortgage broker compensation paid by the lender outside of closing on behalf of the borrower. There would, therefore, seem to be no reason for deliberately blurring the fair disclosure of the actual dollar amount of the mortgage broker's charges for its services.

In fact, under the FRB Proposed Rule, Creditors would be prohibited from making any payment to a mortgage broker at all unless the mortgage broker has first entered into a written agreement with the consumer that includes a clear and conspicuous statement of the maximum dollar amount of compensation the mortgage broker will receive and retain from all sources, including from the consumer and any other source, such as the lender. Such an agreement also would be required to contain clear and conspicuous statements that (i) the consumer will effectively pay the entire amount of all such compensation, even if all or part of the compensation is paid directly by the creditor, because the creditor will recover any payments it may make to the broker through a higher interest rate charged the consumer; and (ii) that such payments from a creditor can influence the broker to offer loan products or terms that are not in the consumer's best interest or are not the most favorable terms obtainable. A creditor's payment to a mortgage broker under that proposed rule could not exceed the total compensation amount stipulated in such a written agreement (reduced by any amount paid directly to the broker by the consumer or from any other source).

Accordingly, assuming the FRB Proposed Rule is adopted substantially in its proposed form, the flawed disclosure scheme for mortgage broker compensation proposed by the Department must be corrected to be harmonized with the FRB Proposed Rule requiring early disclosure and contractual agreement of the maximum dollar amount of mortgage broker compensation. Once mortgage brokers must disclose and reach written agreement with loan applicants on the maximum dollar amount of their compensation for services, the whole convoluted disclosure scheme for mortgage broker compensation under the HUD Proposed Rule would seem outmoded.

2. *Require a Straight-Forward Disclosure of Mortgage Broker Compensation.* The willing use of the term "yield spread premium," appropriated as it was years ago from the secondary mortgage market in which loans are bought and sold, should be discontinued in future rulemaking in favor of a straight-forward denomination of broker fees as "Mortgage Broker Compensation." Particularly if the FRB Proposed Rule is adopted in final form, there would be no reason or disadvantage to mortgage brokers to do so. Assuming, as we have recommended in this comment letter, the form and content of the HUD-1 is unchanged, we would further recommend the proper disclosure of Mortgage Broker Compensation (and the credit to the borrower for the premium rate differential under the final rule adopted by the Department) should be disclosed in a straight forward manner substantially as follows in this example:

- First, charge the agreed upon amount of mortgage broker to the Borrower in the 800 Series of the HUD-1:

  804. Mortgage Broker Compensation to XYZ Mortgage Advisors, Inc. . . …….. . $2,500.00

- Next, offset the cash amount owing by the Borrower at closing by a credit to the Borrower in the amount of the premium rate differential (formerly, the "Yield Spread Premium) chosen by the Borrower:

  204. Lender Credit to Borrower to finance Mortgage Broker Compensation.. …..$2,500.00

  In this example, the line 204 credit will entirely offset the line 804 charge, and the Borrower will owe no cash at closing to pay Mortgage Broker Compensation. XYZ Advisors, Inc., like other settlement service providers, would submit its invoice for the contractual $2,500 compensation agreed upon to the settlement agent and would be paid at closing from loan proceeds wired by the lender to the closing table (or variations of this process in states with closing practices other than table closings), rather than being paid outside and after closing POC by the lender. If the yield differential produced a credit of only $2,000, in further example, that amount would be offset against the $2,500 charge, and the $500.00 difference would fall to line 303 and be used to compute amounts owed or owing to the Borrower.

Final Recommendation: Withdraw Current Consideration of the Proposed Rule while Seeking from Congress the Necessary Statutory Amendments to the Real Estate Settlement Procedures Act of 1974 (RESPA) to Provide the Department the Unquestioned Authority under RESPA §§5(c) and 19 for the Far Reaching Rulemaking Proposed.

The interpretive rulemaking authority of the Department is arguably exceeded in some respects and may be subject to being set aside by the courts in a proper case. Of particular concern in that regard is the questionable authority of HUD to impose a mandatory form of Good Faith Estimate (GFE) that not only requires estimates of settlement charges as contemplated by Congress in enacting RESPA §5(c), but also requires that the GFE serve as a form of open offer of the interest rate and other loan terms and a guarantee of itemized settlement charges, within tolerances for accuracy, for a period of time during which the offer may be accepted by the consumer and thereby contractually obligate the loan originator. RESPA, §5(c), however, requires only that each lender provide loan applicants 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 [HUD]" at the time the lender provides the applicant the Settlement Information Booklet prescribed by that section. While HUD has been delegated rulemaking authority by statute to interpret and implement RESPA to achieve its purposes, it does not have the authority to itself legislate or create regulations "out of whole cloth." Such a mandatory form of GFE that must be issued even before mortgage loan application and that imposes liability on all mortgage loan originators to provide specific loan terms and guaranteed settlement charges arguably is not a rational interpretation of the statute requiring mere disclosure of estimated charges contemplated by Congress, and the Department should appeal to Congress to enact necessary statutory authority to support this linchpin of its proposed rule.

Other proposed provisions also may be subject to challenge for the Department's failure to comply with requirements of the federal Administrative Procedures Act. That Act regulates the rulemaking process and requires that an agency demonstrate reasoned decision making. The most critical factual material that is

used to support an agency's position must be made public in the proceeding and exposed to the possibility of refutation by interested persons during a comment period. This is of particular concern in the matter of HUD's proposed revision of the defined term "required use" that would prohibit seller discounts conditioned on the use of the seller's affiliated mortgage or title company. In the HUD Proposed Rule, for example, the agency makes unsubstantiated assertions that the discount offers of homebuilders are "disingenuous" because the cost to the builders of incentives and discounts have been built into the sales price of the homes and accordingly are not true discounts (but instead are penalties in the form of higher sales prices). To support such an assertion, HUD presents no factual data or analytical studies at all, but instead sets out only a few unsubstantiated, unattributed, and unreviewable one-sentence anecdotal accounts of consumer complaints to the effect that to get the benefit of the discounted settlement services offered by the homebuilder the consumer paid a higher sales price or a higher interest rate or origination fee than the "market rate." The failure to conduct any analysis of factual data and present the data and analysis as the underlying rationale for the proposed change in the rule that may be scrutinized and refuted by interested persons in accordance with the requirements of the Administrative Procedures Act may subject the HUD Proposed Rule to challenge on this issue.

We appreciate the opportunity to comment on the Department's Proposed Rule and continue to believe that the interpretive guidance provided by the Department through its interpretive rulemaking authority and the "reliance on rule" protections the rules provide our clients making a good faith effort to conform their practices to the rules is of great service to the home mortgage lending industry.

Respectfully,

J. Alton Alsup
For the Firm