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Proposed RESPA Changes: An Ongoing Debate

by Dave Wolkowitz

The Real Estate Settlement Procedures Act — HUD's effort to protect consumers during the home buying and borrowing process — might undergo some major changes. Savvy real estate agents can get a leg up on their competition and better serve their clients by understanding the heated debate about the impact of the proposed changes.

Yield Spread Premiums: Shedding Light on Mortgage Brokers' Profits

One key point of contention is the issue of forcing mortgage brokers to disclose yield spread premiums. A broker can earn a yield spread premium (YSP) by marking up the lender's par rate — the interest rate the borrower qualifies for and what the lender would offer if the broker were not involved. Currently, when brokers sign borrowers to loans at a rate greater than par, brokers do not have to disclose that fact to borrowers - so borrowers might mistakenly think brokers profit solely the brokerage fee and not realize they actually qualify for a lower interest rate (the par rate) for their loan.

Paul Hancock, partner at the law firm of Hogan & Hartson and 27-year Department of Justice veteran, thinks the transparency generated by YSP disclosure would help borrowers make smart decisions.

"The deficiency of the current system is that yield spread premiums are disguised. They are listed as paid outside of closing" which makes it hard for a borrower to determine the true costs of their transaction and creates surprises at closing.

But he also understands why mortgage brokers object to revealing their yield spread premiums. For starters, no businesses like to disclose their profits to customers. Additionally, brokers feel they are being singled out since primary lenders don't have to disclose profit they earn by selling a loan on the secondary market. However, RESPA has no authority over the secondary market; HUD cannot force primary lenders to disclose profits derived from the secondary market.

"Brokers are entitled to fair compensation, but consumers should be made aware of what they are paying the broker. That would allow the consumer to shop for the best deal," Hancock said.

Here, Take it All: The Bundling of Settlement Services

Another point of contention involves changes regarding the legality of bundling settlement services. When RESPA was created in 1974, its purpose was to prevent collusion and kickbacks among settlement service providers and to promote transparency in the settlement process. To that end, RESPA's Section 8 outlaws the practice of different service providers coming together to present bundled deals to a borrower while offering referral fees to each other. Currently, the only settlement providers that can offer bundled services without violating Section 8 are very large providers that offer multiple services in house.

The proposed changes would create a safe harbor from possible Section 8 bundling violations which would allow settlement providers to bundle services and trade referral fees without fear of violating RESPA. To achieve this safe harbor, or Section 8 exemption, a lender must stipulate several items in a written statement for the buyer at the beginning of the home buying process: a price for the home, a guaranteed mortgage rate, and settlement costs.

Bundling: Perhaps a Good Idea, But Wrong Execution

While the convenience of one-stop shopping for settlement services and the simplicity of one price for the bundled services might seem appealing, some experts think the proposed changes to RESPA might not be good for borrowers.

According to Norwood Gay, chief legal counsel and senior VP of Attorneys' Title Insurance Fund, the Section 8 bundling exemption has a dangerously insidious nature. Though Gay agrees with HUD in concept that the one-stop shopping afforded by packaging could be good for borrowers, he thinks HUD went too far in creating exemptions that will allow lenders to pass on hidden costs to borrowers and will decrease competition in the settlement services industry — ultimately leading to higher prices for borrowers for many types of settlement services. Though HUD claims its Section 8 exemption would help keep hidden costs down, Gay said relevant committees in the U.S. Senate and House believe HUD hasn't proved that to be true since its own economic analysis contains no testimony to that effect.

Senator Rich Shelby, chairman of the Senate Banking Committee, recently released the following in a statement about HUD current proposal: "In its current form, I think it is anti-competitive; significantly damaging to small businesses; and lacks effective provisions to provide clarification for consumers...I have not been able to get a satisfactory answer from anyone that explains why hiding information from consumer protects them...in my experience, the best decisions are made when consumers are armed with all the information they need to make an informed choice. Transparency is a central component."

Gay said he thinks "Lenders will assemble settlement services providers across country, and as HUD itself said, will negotiate low prices for each other." Essentially, settlement service providers could form alliances and offer special deals only to members of their alliance. "The lenders, because of the proposed Section 8 exemption, will not be required to pass on savings to borrowers, but will mark up charges and pocket the difference without having to disclose it," Gay said. He added that aside from missing out on costs savings, borrowers will likely have to pay higher fees as a result of service providers giving referral fees to their partners and passing on the costs to borrowers.

According to Gay, the impact of certain service providers working together will be to force many smaller local providers out of the market — providers with whom many real estate agents may prefer to work. Since lenders hold the purse strings, they can choose who gets in on bundling deals and who doesn't. Those companies that don't bundle may face hard times.

HUD spokesperson Brian Sullivan doesn't think that's a fair criticism.

"I know there are those who say only big lenders have access to capital, but small settlement services providers could saddle up with others. Even if they became part of a larger entity, that could provide them with opportunities" Sullivan said. "We are not going to dictate who does bundling, we provide the options. It's a market-driven reform."

HUD acknowledges change may be difficult for some providers. "We understand RESPA changes will require changes in business practices. We think anyone in the industry who makes adjustments to new

realty will thrive. Conversely, if they are change averse they will be challenged,” Sullivan said.

Gay suggests that if real estate agents don't like the results of the bundling exemption, they can steer their clients to providers who choose to disclose all fees and don't offer referral fees to other settlement providers; it's something real estate clients will appreciate.

A Loan Shopping Trick:

Consumers are used to shopping around for the best deal on everything from clothes to cars. Gay thinks looking for a mortgage shouldn't be any different. He said one proposed RESPA change could be a good trick borrowers can use to increase their bargaining power.

According to Gay, the change means that “When a prospect walks into loan office and says ‘This is my name, I'm looking at a house and will offer \$150 thousand, I want borrow 80 percent, and I want a loan application’ the lender has three days to give the person either an enhanced good faith estimate or a guaranteed mortgage package agreement in which lender guarantees rate and settlement costs, or in the case of a good faith estimate, a range of costs.”

This “3-day rule” would be an advantage to buyers because it would give the borrower an option to shop for the best loan terms when shopping is meaningful — during the beginning stages of the home buying process.

The Purpose of It All:

Hogan & Hartson's Hancock views RESPA as protection against predatory lending practices. According to Hancock, regulations are necessary because some settlement companies take advantage of consumers and confuse them with complicated procedures.

"When you look at settlement process now, there are a lot of items on the settlement they don't understand. Point charges, origination fees, processing fees and the like," Hancock said. "Closing costs are added that people don't understand."

HUD's Sullivan said the primary goal of the proposed RESPA changes is to encourage home ownership and to empower the consumer. "The proposed changes will help create consumers that are able to shop," he said. "A consumer will get up-front cost information so they can shop and compare," Sullivan said.

Hancock generally approves of the spirit of proposed RESPA changes. "HUD has been working very diligently that meets goals of RESPA," he said. "They have to balance the legitimate business interests of the lending community with the consumer protection issues that are important to this country."

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