



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

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Regulations Division
Office of the General Counsel
U.S. Department of Housing and Urban Development
451 Seventh Street, SW
Room 10276
Washington, DC 20410-0001

Re: 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, 73 Fed. Reg. 14030 (Mar. 14, 2008)

To Whom it May Concern:

I am writing to provide the comments of Federal Reserve Board (Board) staff on the Department of Housing and Urban Development's (HUD) proposed amendments to Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA). HUD's proposed amendments seek to simplify and improve the effectiveness of RESPA's disclosure of mortgage settlement costs so that consumers can make informed shopping decisions and avoid unnecessarily high settlement costs. We support HUD's goals and commend HUD for its continued efforts in this area. We also support HUD's efforts to consumer test the proposed RESPA disclosures. We look forward to working with HUD's staff to ensure that any changes to the RESPA rules are coordinated with the Board's rules under the Truth in Lending Act (TILA).

Background

RESPA seeks to protect consumers from unnecessarily high real estate settlement costs by (1) providing them with information about the costs required to close a mortgage loan, and (2) prohibiting certain business practices. A good faith estimate (GFE) is provided shortly after loan application, containing an itemized estimate of the costs the consumer will pay at closing (such as fees for a survey, appraisal, credit report, title examination and insurance, discount points and mortgage broker fees). The settlement statement (the HUD-1) provided in connection with the closing shows the actual costs paid and amounts to be held in reserve accounts. RESPA is implemented by HUD's Regulation X.

TILA's purpose is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the

uninformed use of credit.”¹ TILA promotes the informed use of credit through standardized disclosures that reflect the cost over the life of the loan and highlight certain credit terms. To aid consumers in understanding the total cost, TILA requires the disclosure of two key terms—the finance charge and the annual percentage rate (APR). The finance charge reflects the cost as a dollar amount and includes interest as well as other costs such as origination fees, discount points, mortgage broker fees, and private mortgage insurance. The APR for closed-end mortgage loans is the total finance charge for the loan expressed as an annualized rate. Creditors must also provide a payment schedule showing the amount and timing of the consumer’s payments, including any balloon payment, and specify whether any prepayment penalty may be imposed. TILA is implemented by the Board’s Regulation Z.

Although RESPA’s purpose is to inform consumers about settlement costs, and TILA’s is to inform consumers about loan terms, these purposes overlap. Settlement costs may include loan origination fees, and consumers may finance their settlement costs. In 1996, Congress directed HUD and the Board to consider ways to harmonize the two rules and, if possible, combine the TILA and RESPA disclosures on a single form. In 1998, the agencies concluded that using a single disclosure form would benefit consumers and issued a joint report to Congress that included a prototype form developed for this purpose with the assistance of consumer focus groups.² The joint report also included recommendations for legislative reform.

Discussion

1. The agencies should develop, consumer test, and adopt a single form that complies with both RESPA and TILA.

Board staff believes that the agencies should continue to pursue ways to harmonize TILA and RESPA consistent with the Congressional mandate. A single, integrated form, which creditors may use to satisfy the requirements of both laws, would mitigate the problem of “information overload,” and ensure that consumers review and understand the most important terms of the transaction. HUD’s proposal, however, departs from the approach of a single, integrated disclosure form with little rationale, stating that “the proposed GFE is designed as a distinct, required form to promote shopping by consumers. HUD believes it is best complemented by providing a separate TILA disclosure along with the GFE.”³ HUD’s approach would add more disclosures to the RESPA form, some of which would duplicate the disclosures required by TILA. As discussed below, our consumer testing for other disclosures has shown that “more” is not necessarily better or more meaningful and can, in fact, defeat the purpose of the disclosure. As discussed below, we are concerned that the contents of the two forms are duplicative and in some instances inconsistent. We urge HUD to coordinate its proposal with the Board to ensure that consumers receive information on loan terms and settlement costs on a single form at the same time.

¹ 15 U.S.C. § 1601(a).

² *See generally* Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act (July 1998).

³ 73 FR 14030, 14037 (March 14, 2008).

The Board's review of mortgage loan disclosures is already underway. The Board's goal is to make loan disclosures more effective and we will be reviewing the content and format of the disclosures, as well as their timing. The Board has begun conducting preliminary consumer testing for the mortgage disclosures currently required by TILA, as well as additional or different disclosures the Board may propose for comment. Our recent experience in testing credit card disclosures demonstrates the significant benefits of rigorous consumer testing that includes one-on-one cognitive testing of how consumers actually use the disclosures. Consumer testing provides valuable input about what information consumers understand and use, whether different terminology can enhance the disclosures' effectiveness, and how format changes can make the disclosures easier to navigate. Testing would also be instructive on the best way to combine the TILA and RESPA disclosures on a single form.

The Board recently proposed amendments to its TILA rules that would facilitate the creation of a single, combined TILA RESPA form consistent with the Congressional mandate. On December 18, 2007, the Board approved proposed amendments to Regulation Z, which would require creditors to provide TILA disclosures earlier to ensure that consumers receive them when they are most useful. Currently, creditors must provide TILA's cost disclosures within three days of receiving a written application for a home-purchase loan; for non-purchase mortgage loans, however, existing rules allow creditors to provide TILA disclosures anytime before the transaction is consummated. Under the Board's proposal, for all mortgage loans creditors would be required to provide the early TILA disclosure within three days after receiving a written application and before a fee is imposed (except a fee for obtaining a credit report). Accordingly, under the proposal creditors would provide TILA disclosures at the same time that they provide the GFE under RESPA. We suggest that any changes to the TILA and RESPA rules be coordinated to ensure creditors provide disclosures under both statutes at the same time.

HUD's proposal would permit lenders to charge consumers the cost of providing the GFE, which may include, but is not limited to, the cost of an initial credit report. The Board's rules would only permit a credit report fee before the early TILA disclosure is given to the consumer. The "cost of providing the GFE" is not defined in HUD's proposed rule. The rule should be revised to ensure that the fee is not substantial enough to discourage consumers from shopping and comparing different loan offers.

2. HUD's revised GFE, which would include details about loan terms, would be duplicative of and, in some cases, inconsistent with the TILA disclosures.

HUD's proposal would result in consumers receiving a disclosure distinct from TILA that duplicates details about loan terms. In some cases, the information on the revised GFE would overlap with the TILA disclosures, raising concerns about information overload. Our testing of credit cards and loan terms shows that providing too much information can lead consumers to disregard key information and focus instead on less significant features or terms. More importantly, the revised GFE provides information that seems inconsistent with the TILA disclosures, raising concerns about consumer confusion.

For example, the revised GFE would disclose the loan amount, while the TILA form would disclose the often-different “amount financed.” The revised GFE would disclose a monthly payment that includes principal, interest, and mortgage insurance, but not property taxes and homeowner’s insurance. Our preliminary testing of mortgage disclosures indicates that consumers find the monthly payment of “PITI” (principal, interest, taxes and insurance), to be the most useful measure of monthly cost. TILA permits creditors to include taxes and insurance in the monthly payment disclosure. In the case of adjustable rate mortgages (ARMs), the revised GFE would disclose the initial monthly payment and the maximum payment, without reference to when the maximum payment will go into effect, which may occur many years after. In contrast, TILA discloses the entire payment stream, using the rate or index then in effect.

In addition, the revised GFE would disclose the “initial interest rate” for an adjustable rate mortgage (ARM) while the TILA form would disclose the annual percentage rate (APR), which is based on interest at the fully-indexed rate and other finance charges. The initial interest rate often can be a temporary introductory rate and not the fully indexed rate then in effect. Focusing on the temporary rate may not be beneficial to consumers’ understanding of the transaction, especially if the consumer does not know when or how much the rate can increase. The revised GFE also would show the maximum interest rate or “cap,” but without knowing how quickly the interest rate can reach the cap, consumers could mistakenly believe that two loans with the same rate cap are identical. The Board’s testing will look at how to present information about ARMs so that consumers can use it to shop and compare loans.

HUD proposes to address any confusion between the TILA disclosure and the RESPA GFE forms in a third disclosure, the Special Information Booklet given to consumers.⁴ Given the Board’s experience in consumer testing credit card and other disclosures, we believe it is unlikely that most consumers will take the time to navigate between the GFE and TILA disclosure on the one hand and the Special Information Booklet on the other in an effort to understand inconsistent loan terms. We believe that the inconsistencies and other differences between the proposed GFE and the TILA disclosure are likely to confuse consumers and, undermine consumers’ ability to make informed shopping decisions and avoid unnecessarily high settlement costs.

3. Additional testing of the content and format of the proposed RESPA disclosures will enhance their effectiveness.

Board staff commends HUD for engaging in consumer testing. However, while the Board did not participate in HUD’s testing of its revised GFE form, it does not appear that HUD’s testing focused on how consumers understood the specific terms being disclosed on the revised GFE or whether they understood the multiplicity of terms represented in the different loan choices in the side-by-side comparison. A Federal Trade Commission study of mortgage disclosures was conducted after HUD’s testing⁵ and produced many new lessons and insights, which do not seem to have been incorporated in the revised GFE. Accordingly, the staff believes

⁴ 73 FR 14030, 14037 (Mar. 14, 2008).

⁵ See generally “Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms, a Bureau of Economics Staff Report (June 2007).

that, notwithstanding HUD's consumer testing efforts, additional work is needed to test and develop a better disclosure.

Regarding disclosure of mortgage broker compensation, Board staff is concerned about consumers' understanding of the terminology used on the GFE. The revised GFE refers to yield spread premiums as the consumer's "credit" for the interest rate chosen, rather than broker compensation. The Board has proposed a different approach and is engaging in consumer testing. Clearly, consumers would benefit from consistent methodology and terminology in the disclosure of mortgage broker compensation. The Board's preliminary testing suggests consumers are confused about the broker's role in the transaction, e.g., whose interests the broker serves, who compensates the broker, and how the broker's compensation may affect a loan's interest rate or other terms. Board staff is concerned that the language on the revised GFE will contribute to consumer confusion rather than provide further clarity for consumers.

HUD is also proposing to require a "script" for closing agents to follow as they conduct the settlement. Board staff commends HUD for considering this novel approach, but we believe that consumer testing is needed to ensure that borrowers benefit from having the transaction explained in the precise manner dictated by HUD's script. We note that there may be practical difficulties with the script, including how closing agents would comply if the circumstances of a particular loan were not consistent with the HUD script.

Any effort to hasten adoption of new mortgage loan disclosures without adequate testing and development could, in the long run, hurt consumers more than help them, especially if consumers receive inconsistent disclosures under different legal regimes. The best interests of consumers can be served by an integrated approach to disclosing loan terms. We stand ready to work with HUD on this important effort.

Sincerely,

A handwritten signature in cursive script, appearing to read "Sandra F. Braunstein". The signature is written in black ink and is positioned below the word "Sincerely,".

cc: Gary M. Cunningham
Paul S. Ceja