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**"Mortgage Disclosures: How Do We Cut Red Tape for Consumers and Small Businesses?"**

**Hearing before the House Financial Services Committee**
**Subcommittee on Housing and Community Opportunity**
**Wednesday, June, 20, 2012**

Chairwoman Biggert, Ranking Member Gutierrez and Members of the Subcommittee, thank you for the opportunity to submit a written statement to you today on behalf of **IMMAAG**[1] and the thousands of state licensed mortgage loan originators not directly represented at today's important hearing. Today's hearing is particularly relevant given the rapid pace of Congressional and Regulatory reaction to the financial crisis and the short amount of time the Congress has to act to avoid the seriously negative consumer consequences that will result if certain provisions of the Dodd Frank Act are not amended before the Bureau of Consumer Financial Protection is required to implement them in January 2013. And, the subject of this hearing, *"Mortgage Disclosures: How Do We Cut Red Tape for Consumers and Small Businesses"* may serve as the poster child of the core of the missteps and miscalculations taken to date to cure or prevent the targeted problems.

This subcommittee has for the first time since 1968 the chance to orchestrate something ground breaking and very positive. There may be a great debate about the rationale for creating the Bureau of Consumer Financial Protection. This hearing is not focused on that so I will withhold my opinion about its creation, but I will say that the CFPB does represent one potentially very positive result. Since it is now the center of all financial regulations germane to protecting consumers in the mortgage process, it could be given the statutory authority to "do it right" and to design something meaningful. However, early indications do not bode well if that kind of innovative and creative outcome is desired and unless the Dodd Frank Act is immediately amended such an outcome will become impossible. If we miss the opportunity to seek the "do-over" that this new agency gives us the chance for than we will have missed a singular opportunity to truly help consumers and to achieve the answer to subject of this hearing, <u>"How Do We Cut Red Tape for Consumers and Small Businesses?"</u>

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[1] IMMAAG is a Colorado for profit information company founded in 2008 to provide the tens of thousands of small and independent mortgage brokers and originators a clearing house and information source regarding legislative and regulatory activity affecting their business and customers and with 2,900% growth in registered users since January 2010 has evolved into a center for advocating their common causes.

I am proud to be a state licensed mortgage loan originator in Colorado and the past president of our state's affiliate of the National Association of Mortgage Brokers. Further, in explaining my interest in the hearing's subject and qualifications to comment today, I offer that I began my financial services career here in the D.C. metropolitan area as an assistant manager and ultimately manager of one of five branches of a locally owned and operated small loan company in 1967. As some of you may recall before 1969 consumer credit was basically limited to automobiles, mortgages, gasoline and department store credit cards. In D.C. one of the earlier "MasterCard/Visa-like" initiatives was Central Charge which allowed local consumers to buy on terms from local retailers such as Hechts, Woodward and Lothrop and Lansburgh's. But, if a consumer needed an unsecured loan and did not have adequate savings in their bank account they used the services of companies such as Household Finance, Aetna, Beneficial and the five branch local company for which I managed, Major Finance.

I begin this statement with this background because in 1968 as a manager in Major Finance, I am one of the people who actually used a Monroe 10-key calculator and the iterative processes described in Regulation Z that were necessary to determine the Annual Percentage Rate (APR) for what our industry termed "Discount Loans". I may be the only contributor to today's hearing who can boast that experience. I also know that this approach to lending more than any other element created the idea of using an APR to try to normalize and create a numeric expression for the relative cost of borrowing. The issue was simple. The small loan industry offered six percent (6%) discount loans. So, assume you borrowed $1,000 for three years. You would sign a note for a 6% discount loan, repay $27.78 per month for 36 months and receive $820.00 at closing. The $180 was retained by the lender (0.06 X $1,000 X 3 = $180) as prepaid interest. If you prepaid your loan the industry earned interest using the sum of the months digits methods (better known as the Rule of 78's) which accelerated the earnings, particularly on shorter term loans. Converting the advertised six percent discount loan to what would have been earned making payments on a simple interest loan at 6% resulted in an APR of about 13.38%. Clearly not 6%.

Forty-four years ago the Truth in Lending Act was passed to, ". . . *.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. . . .*".[2] Since that time the Act has been amended, updated, "simplified" and modified numerous times. But as the subcommittee solicits input forty four years later, the issue of effective disclosures remains unresolved and the changes since 2008 have only added to the complexity and confusion. The primary reason is that

[2] 15 U.S.C. §1601 (a)

there has been an apparent inability or unwillingness to recognize that one disclosure statute is not capable of addressing the disclosure needs, if a statutory approach is necessary at all, of the diverse financial products covered under the umbrella of the Consumer Credit Protection Act.

As a result the Congress in its reactive role has responded to the diverging needs and demands of industry, consumer groups and other interest groups by patching together a hodge-podge of legislation that has no chance to serve the simple purpose stated in 1968 – "to assure meaningful disclosure. . . ".

Adding to the complexity of the challenge to protect consumers in the mortgage industry is that the services necessary to buy, sell or refinance a home go beyond the financial transaction and bring to bear the provisions of yet another antiquated statute, the Real Estate Settlement Procedures Act. RESPA was passed in 1974 to *"insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country."*[3]

Taken together as they have been for more than three and a half decades these two pieces of legislation and their implementing regulations, Reg Z and Reg X have done more to prevent achieving the stated purposes than they have done to protect anyone. It is not the intent that is misplaced. Consumers should have the opportunity to evaluate alternatives and make timely, informed decisions about all purchases, financial or otherwise. However, when the design, development and implementation of disclosures is relegated to academics and administrative professionals with no experience in the actual processes and with little or no understanding of what consumers really need or use to make their day to day decisions, the likelihood of an effective outcome is reduced to pure chance. There in lies the path our mortgage disclosure laws have taken for almost three generations.

It is extremely difficult to reduce to a few pages or to a few minutes of testimony the details which have led the mortgage industry to the events which caused the passage of the numerous

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[3] 12 U.S.C. §1601 (a)

well intended but less than thoughtful legislative actions since 2008. The attempt to cure problems and to prevent recurrence has led to some of the most onerous and harmful regulations in the four decade history of regulating consumer protection.

But to summarize how we got where we are and why a few missteps have become the most significant barriers to making true progress we need only look to 1968 when the idea of APR was imposed on mortgages, follow that to 1974 when RESPA began to do more to bar market efficiency than to protect consumers and then advance to 1992 when the issue of Yield Spread Premiums was mishandled and a compromise which should never have been orchestrated turned the legislative and regulatory focus away from achieving clarity and meaningful disclosure to an irrelevant mandate to make an artificial number important to consumers when it never was and never will be. The accumulation of these events has distracted the debate and become such a barrier to really figuring out what information consumers need to make decisions that we no longer look for the answers, we simply look for ways to add more irrelevant but "transparent" information.

## **The Good Faith Estimate (GFE) – A Debacle**

Prior to January 2010, mortgage loan originators prepared a generally legal length document for every borrower. This good faith estimate provided details of the loan amount, every dollar that the borrower would be required to pay for the loan and even told them how much money they needed at closing. While Regulation X did not require the presentation of the interest rate, business practice almost universally included that number as well.

In January 2010 the HUD introduced the "new" three page GFE. To HUD's credit it went to great lengths to explain the form to industry and even allowed some "burn in time" to adopt the new form. However, since the changes did not address the information borrowers really wanted the form has failed to meet any of its objectives.

Instead of achieving the intended result the new three page form reduced to a single non-transparent number the very detail sought after by every consumer about the upfront costs. The new form did not even include the bottom line information most consumers want, "How much cash do I need at closing". Implementing this form not only added pages, it required every originator to supplement the summary information with details by using a "fee worksheet" (the old GFE) and by adding an Intent to Proceed form required because consumers were not allowed to either initial or sign the new three page version. Combine with this the onerous timing requirements, restrictive tolerances and consumers often find their loan processes extended and delayed because of the inability of industry to standardize the new inefficient process. And, the most troubling part is that none of this was needed. It neither cures nor prevents anything except efficiency, clarity, simplicity and full useful, meaningful disclosure.

**<u>The Clearer, Easier Alternative</u>**

In order to explain how a simple pre-closing disclosure could have been designed years ago it is necessary to discuss the total misconception of the importance or Yield Spread Premium (YSP) on the consumer's ability to make informed decisions. **IMMAAG** has prepared and over the past two years circulated to the HUD, the FRB, the CFPB and to members of Congress a position statement that explains the misconceptions of YSP and how that has directly and negatively affected not just disclosures but the overall debate about consumer protection in the mortgage process. That position statement is attached. In summary, the attachment explains that YSP has been misunderstood since the term was used over two decades ago. In a frustrating example of how the Federal Reserve Board and others misunderstand the term, I invite the committee to read the April 2, 2010 HUD FAQ's regarding the Good Faith Estimate rule – from page 13, question 37 – ***"Q: If a loan contains mortgage insurance that is paid by the lender (LPMI) and will not be charged separately to the borrower, should the loan originator disclose it in the "Summary of your loan" section of the GFE or as a charge in any Block on the GFE?***

***A: No, because the LPMI has already been captured in the interest rate and is not charged separately to the borrower, it is not disclosed on the GFE. "***

The essence of the YSP debate is answered in this one question and neither HUD, nor the FRB nor the Congress have been able to grasp it. As a result, legislation and regulation has been passed which can neither cure nor prevent harm because the cause of the harm has not been properly identified.

As **IMMAAG**'s three year old position statement clearly demonstrates if a consumer knows the interest rate, the loan amount, and the term to maturity the consumer knows the interest cost of the loan. It does not matter what the lender does with that revenue, nothing changes the consumer cost. And, the market allows the consumer to "shop" interest rates without limit. Today, even those consumers that some consumer groups claimed could not comparatively shop have unfettered access to information about current rates.

So, if the problem is not interest rate, what makes shopping confusing? The comparison problem arises when one lender offers a rate of 5% with a total of $5,000 in costs while another lender may offer the same loan amount and term to maturity at 4.75% and costs of $5,500. So, which one is better for the consumer? Assuming, as it appears Congress does, that lowest cost defines better, which I argue is only part of the consumer decision matrix, the one page supplement to the pre-2010 GFE offered in the position statement makes determining that answer as simple as looking at a breakeven point based on cash flow.

Once the front end costs are known and monthly payments are quantified and a cash flow breakeven is made available, the TIL disclosures really add virtually no value to enabling improved shopping. The form does provide the total costs in such an encoded and confusing form that even title professionals and CPA's can't effectively define the basic items of Finance Charge and Amount Financed and since almost no borrower ever carries the loan to maturity the summation of the numbers leading to a useless APR carry no useful meaning either.

**<u>The TIL Conundrum and the Simple Solution</u>**

A major obstacle to achieving the objective of "meaningful disclosure" is that industry has been burdened since 1968 with a statutory requirement driven to solve for non-simple interest loan disclosure issues. Using an APR in mortgage loans actually produces a worse outcome, it makes consumers think they see a number that means something when it bears no relationship to their loan's reality whatsoever. The fact is that the consumer cares about the cost. He or she could care less whether the cost is in a prepaid finance charge or not. Yet when we calculate APR we take a discreet list of the costs and either include them or exclude them and we do so inconsistently and we create a "normalized" number that is not normal. It would be much more useful to the consumer and more accurate to simply provide the cash used over time using various alternative loans. All that would be required is to produce a schedule which shows the monthly cash expended by the consumer at a given interest rate, adds the front end costs and generates the cash outflow over time to determine the breakeven point for any number of varying rate/cost options. **IMMAAG** offered this solution to the HUD, to FRB, to Professor Warren and the CFPB and to the CFPB's current mortgage market management team, but it has received no apparent attention.

**Conclusion**

There are numerous fundamental issues preventing Congress and the regulators from achieving the stated objectives of both RESPA and TILA. It starts with the irrelevance of chasing YSP as an issue and continues through the idea that APR is of value as a mortgage shopping tool when much simpler forms of information will provide the consumer what they need. But, possibly one of the biggest barriers to actually producing effective processes to help consumers make better decisions is that for reasons that escape explanation the FRB and members of Congress have determined that an industry made up of tens of thousands of small, independent business professionals who live in the community they serve and who depend on repeat and referral business to sustain their livelihoods are somehow the "bad guys". As a result, instead of designing effective solutions agencies such as the Federal Reserve Board fabricate "facts" to justify attacking an easy, somewhat defenseless target.

This subcommittee has a chance to do something right. The only way to achieve the hearing's goal of answering the question How do we cut red tape for consumers and small business is to amend the Dodd Frank Act. **IMMAAG** has attached a draft of such amendments to this statement. By recognizing that the actions taken in the cited sections of the Act do not cure nor prevent the causes for which they are intended and by requiring an independent evaluation of that hypothesis this subcommittee can begin the action needed by Congress to provide the Bureau with the time it needs to actually work with industry and consumers to design solutions which have a chance to work because they are based on fact and not long standing myth.

The amendments allow for the possibility that if the Dodd Frank initiatives are determined to not provide the curative or preventative steps, we can take that learning and properly integrate and reform RESPA and the mortgage aspects of TILA to produce a workable, consumer-centric solution.

Two things are clear: the present approach is harmful not useful (Refer to **IMMAAG**'s attached March 12, 2012 letter and evidence provided to Mr. Peter Carroll, Acting Director Mortgage Markets at the CFPB) and the "toxic" products which have been blamed for much of the problem and the "bad actors", thanks to provisions of legislation like the SAFE Act are removed from the industry. So, if there was ever a time in history for our representatives to own up to the possibility that maybe they got some things wrong and there may be a better, different way; this is that time and this is your chance.

On behalf of the 193,000,000 American adults who aspire to own, buy, sell, rent, invest in or refinance real estate and on behalf of the 116,000 state licensed mortgage loan originators I ask you to take the leadership role entrusted to you and don't simply follow the easy path – launch a new, likely to succeed approach and finally achieve what you have asked the witnesses today to address – How to cut the red tape for consumers and small business.

Finally, Americans from every state are supporting the Dodd Frank amendments attached to this statement. Attached is a copy of a petition to Amend the Dodd Frank Act which has been signed by 6,463 Americans from every state. A list of those signatures from the twelve states represented on the subcommittee (2,947 signatures – 45% of the signers) is included.

I thank you for allowing me to comment. **IMMAAG** welcomes the chance to assist the subcommittee, its staff and the CFPB in moving forward with this initiative.

W. F. Kidwell

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Attachments:

- Petition to Amend the Dodd Frank Act
- Signature List for residents of the states represented on the subcommittee
- Copy of the Draft of the Background and Amendments to the Dodd Frank Act
- **IMMAAG** Position Statement - Consumers, Compensation & Confusion - *A clarification and solution supporting TILA's & Regulation Z objectives*
- Letter and Evidence Package to Mr. Peter Carroll, March 12, 2012
- Letter and Package to FRB Chairman Ben Bernanke and Director Sandra Braunstein, April 29, 2011