

# Are You Prepared for RESPA Reform?

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HUD's proposed rules to simplify and improve the disclosure requirements for mortgage settlement costs under RESPA may provide some interesting challenges for most lenders and mortgage brokers. The main objective of these modifications is "to protect consumers from unnecessary high settlement costs." It is uncertain if the proposed changes will make the closing process clearer, more useful and less costly for consumers. Let's review a few of the proposed changes to the new Good Faith Estimate (GFE) and some of the challenges these changes may present.

## **New Good Faith Estimate Trigger**

### Proposed Change:

The new rule proposes that a Good Faith Estimate (GFE) be given **before** the potential borrower fills out a "mortgage application". This "introductory" GFE will be given so the prospective borrower can "shop around" before making a credit decision. The lender may only require the borrower to provide the following information to receive a GFE.

- Borrower's name
- Social security number
- Property address
- Monthly income
- House price or best estimate of the property's value
- Desired loan amount

### Challenges:

The purpose of this early GFE is to allow the consumer to "shop for credit." However, once a credit report is pulled for the potential borrower, they are not shopping for credit anymore, they are applying for credit. Ordering multiple credit reports during this "shopping" process, may also lower the consumer's credit score and may prevent them from receiving the very best credit terms they deserve.

The information permitted in the GFE application does not include borrower asset information. Without this information, lenders and brokers are unable to offer a loan and are unable to determine if the borrower has money for a down payment and closing costs. When lenders and brokers are unable to determine if the borrower is able to make a down payment of 20% of the purchase price, it is impossible to accurately determine how much mortgage insurance will cost. All of this contributes to the inaccuracy of the Good Faith Estimate which borrowers will be using to "shop for credit."

## **New GFE required Form**

### Proposed Change:

The new GFE form will have four pages whereas the current form is only 2 pages long. The first page of the new GFE is designed to summarize the most important information and will contain the following information.

- Initial loan amount
- Loan term
- Initial interest rate
- Initial monthly payment owed for principal, interest, and mortgage insurance
- Rate lock period

The form also discloses if the interest rate, loan amount or monthly payment are allowed to increase and if they are allowed to increase, the maximum amounts that they may increase to. The new form also clearly discloses if there is a prepayment penalty, a balloon payment provision, and whether the loan includes a monthly escrow payment for property taxes and possibly other obligations. If a prepayment penalty or balloon payment provision is included on the loan, additional details are given about those loan features.

Finally, the first page includes a summary of the borrower's settlement charges. These charges are categorized into "Adjusted Origination Charges" which include the lender's service charge and the charge for a specific interest rate (discount points if applicable,) and "Charges For All Other Settlement Services." All the terms on the GFE are binding for 10 days.

### Challenges:

It is difficult for the lender and broker to give a binding GFE to the consumer based only on the minimum information provided for the GFE without asset information. The only entity that would be better able to give a correct GFE would be the consumer's depository institution because they know at least some of the borrower's asset information, giving them a competitive advantage over brokers and mortgage companies. However, depository institutions tend to charge higher interest rates for mortgage loans because of the increased costs of doing business. In the end, what should cost less to the consumer may end up being more expensive.

There is still the problem of making the consumer read all, or at least some, of the information on the GFE, even if it's only the first page. Most consumers believe they cannot understand the content of mortgage disclosures. As a result, they don't even try to read and understand them.

## **Treatment of Yield Spread Premium**

### Proposed Change:

Yield Spread Premium is not mentioned on the new GFE form. Charges from loans originated by mortgage brokers will be disclosed as a credit for the specific interest rate chosen, which reduces total origination charges.

### Challenges:

The new disclosure form includes the YSP as a payment to the borrower and from the borrower. The inclusion of the YSP as a fee paid by the borrower may affect TILA disclosures and/or state law thresholds for high cost loans. And last but not least, will the consumer understand that he or she received a credit from the lender that they will never actually see?

## **Closing Script**

### Proposed Change:

The loan originator will transmit all information necessary to complete the prescribed addendum to the HUD-1/1A settlement form to the settlement agent, this is referred to as the "closing script." The addendum will be prepared by the settlement agent and will accurately reflect the loan documents and related settlement information provided by the lender. The settlement agent will be required to read the addendum aloud to the borrower at settlement. The addendum will compare the loan terms and settlement charges estimated on the GFE with those on the HUD-1 and will describe in detail the loan terms for the specific mortgage loan as stated in the mortgage note, and related settlement information. The length of the addendum will vary depending on the specific details of the borrower's loan.

### Challenges:

It is very late in the mortgage process to make the borrower realize that the loan product chosen, or any of the terms of the loan might not meet the consumer's financial needs. The time for the borrower to learn about the different loan products available, terms, amount of required fees, prepayments, balloon provision, late fees and so many other factors that could bring financial hardship to the borrower is before they have paid a substantial amount of earnest money.

Although reading the proposed "closing script" is a nice gesture, borrowers who are unfamiliar with the mortgage process will probably not receive an epiphany once the "closing script" is read. It will provide a nice opportunity for the well informed borrower to verify important loan terms, but will provide little to borrowers who don't understand the mortgage process.

## **Summary**

The current “housing slump” was not caused by one particular event or one unscrupulous group that took advantage of unsuspecting borrowers. There were many factors involved and many different players in the mortgage market have to own up to their share of the responsibility.

Perhaps the most important player is the borrower. A new GFE form may be an important step but will not in and of itself produce better informed borrowers equipped to make sound financial decisions. Lenders will play an important role in making sure that borrowers are better informed and educated in the mortgage process.

Just as borrowers will need to become better educated, lenders will also need to keep pace with the changes in our challenging mortgage market. DocuTech encourages all its lenders to stay informed to better position themselves to compete in this tight market. Be sure to stay informed regarding the proposed HUD RESPA reform proposal so you will be prepared to make any necessary adjustments to your loan process. Comments on this proposal are due May 13<sup>th</sup>, 2008.

## **About DocuTech**

Since 1991, DocuTech Corp. (DocuTech) has provided outstanding compliance services and documentation technology for the mortgage industry. DocuTech's software interfaces with leading loan origination systems (LOS) and enables mortgage professionals to generate documents locally. DocuTech manages and secures all information needed for a loan, guaranteeing accuracy, security and compliance. For more information visit the company's Web site at [www.docutechcorp.com](http://www.docutechcorp.com).

