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A Brief Note on the Guaranteed Mortgage Package*

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The Consumer Financial Protection Bureau has been charged by Congress with preparing integrated forms and for mortgage loan transactions, and is now engaged in that process. This effort has been an ongoing one for at least 20 years, one which has been impeded over time by a split in the authority over disclosure for mortgage transactions. CFPB has now been given the sole responsibility to do the job.

The most ambitious previous effort to achieve that goal was that undertaken by HUD about 10 years ago. The Department of Housing and Urban Development submitted a proposed rule on RESPA simplification to OMB for clearance on December 16, 2003. After considerable written comments and extensive lobbying, and in conjunction with the process by which the Acting Secretary of HUD could become Secretary (a key Member of Congress was urging the rule not be passed without further public hearings), the proposed rule was withdrawn in March of 2004 with promises for additional hearings and publication of a new rule.

Additional "roundtable" hearings were held, but no new rule was proposed during the terms either of the Secretary that sent the original proposal to HUD or the Acting Secretary (who later became Secretary) who withdrew that rule and promised promulgation of a new rule. HUD much later proposed and adopted new rules governing the GFE, but those rules did not reflect the policy positions of the Guaranteed Mortgage Package rule.

The Proposed Guaranteed Mortgage Package Rule

The rule would have presented home buyers with an option for obtaining a guaranteed price on settlement services costs along with a hold fast on the interest rate on the mortgage for a short period of time. The borrower was not obliged to use this option. That "guaranteed package" was to be made

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available before the borrower committed to any specific lender so that the borrower was free to shop around for a better package from another lender. In shopping, the borrower would only have two numbers to compare — the cost of the settlement package and the cost of the loan. HUD argued that this would provide the power to consumers to make informed decisions.

Secretary Martinez said these reforms could save Americans up to $8 billion per year or an estimated $700 of savings for every consumer buying or refinancing a home. In addition, the clarity of the offer would simplify the chore of homeownership financing and avoid nasty closing day surprises.

Reaction to the Rule

Hundreds of substantive responses were submitted, and a major lobbying effort against the bill began. Not surprisingly, many of the settlement service providers had an immediate negative reaction to the package since it would provide some leverage in favor of the lender to negotiate a lower settlement service price. Mortgage brokers objected as did Realtors, and over time a chorus representing settlement service providers such as closing attorneys, appraisers, title companies, etc., joined in. Surprisingly, many consumer groups failed to support the proposal although the benefit to consumers was obvious to all.

HUD announced that it was making some changes in the proposed rule, but did not share those with the public. In the interim, various groups met to discuss possible changes, such as permitting a variety of participants to prepare packages of settlement services or even sub-packages, and the progress of those talks were shared with HUD, formally and informally. For some groups, concern was replaced with fear and then paranoia as each interested group imagined that the worst possible result for them would be embedded in the revised rule.

When HUD submitted the amended rule to OMB without sharing its contents, formally or informally, no one knew what changes had been made or whether or not their particular issues had been resolved favorably.

Faced with that opaqueness, a horde of lobbyists descended upon Congress and a letter, ultimately signed by over 200 Members of Congress, urged withdrawal of the rule, public hearings on the rule, and republication for further comments.

The Rule was Withdrawn

Acting Secretary Jackson withdrew the rule on March 14, 2004, promising public hearings and publication of a revised rule. Hearings were held, but no rule was ever published.

Present State of a GMP Proposal

No current proposal for a GMP currently exists. The Consumer Financial Protection Bureau currently is engaged in drafting new mortgage disclosure forms for new home buyers and those who are refinancing, but the concept of a guaranteed package of settlement costs is not being considered.

Comments

No groups seriously contested the assertion by HUD that the savings from this program for consumers would be very, very large. In normal times such a result would have commentators clambering to support the proposal that created such a result. But the withdrawal occurred in 2004 when the housing market was steaming along, apparently destined to improve year by year into the distant future. As the letter from the Members of Congress said, "It is critical that we delay implementation of a rule that may negatively impact the healthiest sector of the economy — housing. The U.S. homeownership rate was 68.4% in the third quarter of 2003 — its highest level ever... The American mortgage finance system is justifiably the envy of the world."

Now, of course, we know that the housing sector in 2004 was truly sick, and destined to become even sicker. Rather than the envy of the world, had the world known what is now obvious about that period, our mortgage finance system would have been seen as the bane of the world.

Would a Guaranteed Mortgage Package rule have made a difference? One can argue about that. From a consumer perspective, at least in the short run, prices arguably would have been more transparent and lower.

Certainly consumers would have been provided an option to have in front of them a true shopping document that they could have used to attempt to get better prices for the loans they wanted. For most consumers, it probably is irrelevant what the cost of any particular settlement services might be, and instead it is the total of those costs that is relevant. Therefore, the details

of one price or another can be ignored in making a decision on financing.

And for consumers that feel they could get better prices by shopping for individual services themselves, they would have been free to do that by abandoning the "package" guarantee. It was not mandatory.

Servicers would have been free to strike the best deal with providers of settlement servicers, which would pressure service providers to provide the best possible price, and not an inflated one. Any excessive servicer costs would have been squeezed out of the system. The packager (whether a lender or Realtor or a title company) would have to compete with other packagers, so would not be free to pocket the savings that such leverage provided. Of course, squeezing excess profits from one perspective was argued from another to be a system that would put small businesses out of business.

All in all, the consumer was a clear beneficiary of the Guaranteed Mortgage Package. That made the lack of strong support from consumer groups (Consumer Federation of America being the exception) puzzling, particularly when they said they were concerned it would facilitate predatory lending. If anything, it would have been the best protection against predatory lending that had yet been suggested. Their objection remains a puzzle to this day.

Some Members of Congress seemed much more concerned about the effect on settlement services providers. The letter seeking withdrawal, for example, said that "many small businesses would not be able to compete in that environment." It would seem that this is a statement that if a borrower was to use those businesses, the borrower would have to be prepared to pay a higher price than they would pay using a different service provider. That excess cost for settlement servicers is exactly what would have been removed from the system, to the benefit of consumers, but to the detriment of the higher priced providers, whether they were small or large businesses.

It is possible, therefore, that some providers rely too heavily on a price structure for their services that is not the best for the consumer, and might indeed have not been able to continue to exist had the GMP rule been adopted. It is hard to see how that is bad for consumers or the economy generally, however, since the rule would have promoted economic efficiency in the industry.

Some argued that the rule would shrink the number of providers and

lenders, and that in some way the smaller group of those entities would lead to fewer choices and higher prices for consumers. That, of course, is a standard argument against improving products and services for consumers, and one which leaves those defending the rule to say "No, it won't." Both sides then can say they made their point on this issue and go on with their lives. It does seem, however, that to conclude that the rule would ultimately lead to bad results for consumers one would have to conclude (a) the shrinkage in participants in the market would have to be extremely dramatic; (b) those left would have to collude in violation of anti-trust laws; and (c) entry into the business would be impossible for new players.

Even if prices would have been lower for consumers, and the settlement services market would have remained healthy with many options and efficient pricing, it is not clear that the program would have blunted the effect of poor underwriting; fraud on the part of brokers, lenders and consumers; and the heady feeling that there was an endless supply of gullible investors, huge secondary market bonuses to be won, endlessly escalating house prices, and regulators that failed to grasp what some astute observers of the market had seen — this was a bubble ready to pop. On the margin, however, some of the borrowers might not have been so deeply in debt.

The Office of Information and Regulatory Affairs at OMB believed the rule would have been useful. In its letter responding to the withdrawal of the rule in 2004, it said that the rule "would increase competition and improve consumer choice."

The Guaranteed Mortgage Package concept was an innovative one, one that probably would have reduced prices and increased transparency for consumers. What its other impacts would have been is unclear. Had it been offered now, rather than in the midst of the frenzy that was the 2003 housing market, some of the lobbying groups might not have been as successful since they do not now have the leverage they did in 2003 and 2004. Had HUD seen fit to share what changes it had made in the rule when it submitted it to OMB in December of 2003, most likely many of the fears those groups had would have been assuaged and the rule would have been adopted.

But then was then, now is now. The roads diverged, we took the well-traveled one, and we will see if that makes a difference.

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