Testimony before the
U.S. House of Representatives
Committee on Small Business

Regarding

HUD's Proposed RESPA Reform and the Economic Effects on Small Business

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Good afternoon Chairman Manzullo, Ranking Member Velazquez, and Distinguished Members of the Committee. I am Terry Clemans, Executive Director of the National Credit Reporting Association (NCRA) in Bloomingdale, Illinois and I would like to thank you for inviting me to testify today in the hearing regarding the Department of Housing and Urban Development's (HUD) recently proposed rule on the Real Estate Settlement Procedures Act (RESPA) Reform and its Economic Effects on Small Business.

NCRA is a non-profit trade association that represents the Consumer Reporting Industry and specifically "Mortgage Credit Reporting Agencies". There are approximately 300 businesses in the United States that specialize in Mortgage Credit Reports.[1] NCRA's more than 125 members, alone, provide in excess of 15,000,000 credit reports per year and specializing in the "Three Bureau Merged" and "Residential Mortgage Credit Reports" (RMCR)[2] as required by HUD, Fannie Mae and Freddie Mac for mortgage loan underwriting. Our typical member is a classic small business with approximately eight employees and annual revenues of about $1,000,000. Our members are highly specialized agents in the credit reporting industry that provide industry-specific mortgage credit services. Their responsibility is to assure the accuracy of credit files used for the most critical purchase of an average American consumer's financial life…the purchase of a home.

While we commend Secretary Martinez and HUD for addressing problematic issues regarding the current mortgage settlement solutions process, we have grave concerns regarding HUD's adherence to the Regulatory Flexibility Act (5 USC §601 et seq, the "RFA") and the proposed RESPA Reform. Our concern focuses specifically on the proposed Guaranteed Mortgage Package (GMP) as it relates specifically to the credit reporting industry and the enormous potential risk this plan represents to consumers.

Issues with HUD's Consideration of the Regulatory Flexibility Act

As the Committee knows, HUD must comply with a number of procedural steps in order to finalize a new rule or amend a current rule affecting the American people. It is the position of NCRA that HUD has adopted a proposal that will not properly safeguard consumer interests and has failed to abide by procedural requirements to produce a fair and appropriate regulation.

[1] Compiled from lists of credit reporting partners published on the web sites of Fannie Mae, Freddie Mac, Ellie Mae's ePASS and Calyx's Point Preferred Partners.

[2] A "Three Bureau Merged" report is a single report consolidating the raw data contained in all three of the national repositories…Equifax, Trans Union, and Experian. A Residential Mortgage Credit Report is an enhanced Three Bureau Merged report in which, for one standard price, all of the data has been validated, verified, updated, changed, or corrected by a Mortgage Credit Reporting Agency.

The Regulatory Flexibility Act was enacted by Congress to require federal agencies to consider the effects of their regulatory actions on small businesses and other small entities and to minimize any undue disproportionate burden. Subsequent to the publication of the Proposed Rule, on August 13, 2002, the President signed Executive Order 13272, strengthening the Small Business Administration's Office of Advocacy's ability to bolster agency compliance with the RFA. Executive Order 13272, "Proper Consideration of Small Entities in Agency Rulemaking," underscores agencies' obligations to consider the impact on small entities when writing new rules and regulations. Additionally, the Order requires that Advocacy teach agencies how to solicit and consider the views of small entities throughout the rulemaking process.

The SBA's Office of Chief Counsel for Advocacy reported in its Annual Report on Implementation of the Regulatory Flexibility Act for Fiscal Year 2002 (February, 2002):

> "The RFA requires each federal agency to review its proposed and final rules in order to determine if the rules will have a "significant economic impact on a substantial number of small entities." If a proposed rule is expected to have such an effect, an initial regulatory flexibility analysis (IRFA) must be prepared and published in the *Federal Register* for public comment. If the analysis is lengthy, the agency may publish a summary and make the analysis available upon request. This initial analysis must describe the impact of the proposed rule on small entities. The initial analysis must also contain a comparative analysis of alternatives to the proposed rule that would minimize the impact on small entities and document their comparative effectiveness in achieving the regulatory purpose."

Pursuant to the RFA, HUD purportedly performed an Initial Economic Analysis and attached a portion of it to the Proposed Rule[3]. On August 13, 2002 HUD published a notice[4] stating that it had not only made a copy of the Economic Analysis available for public inspection, but had also posted a copy of it on its website. While we have been told that the Economic Analysis was available for some time, a comprehensive search of the site reveals that it is no longer available. Indeed, there is no mention whatsoever of the Economic Analysis anywhere on the website.

Due to the difficult accessibility of this research we suggest that this Committee seriously consider amending the RFA to require all agencies to publish the entire Initial Economic Analysis on their websites, in an easily accessible manner, along with any proposed rules. This would allow full accessibility on the part of small businesses and consumers so that more complete comments may be made to agencies when proposals for rules are published. Without the readily available information utilized by agencies in the adoption of proposals, the public is unable to provide the input contemplated by the statutes and regulations governing the creation and amendment of regulatory plans by federal agencies.

A major part of the Proposed Rule would set up a new process for originating mortgages called the Guaranteed Mortgage Package Agreement. This process would allow a lender to offer a guaranteed mortgage package (mortgage, third party settlement services and closing costs) for a set price. Independent credit reporting agencies issuing reports for mortgage purposes, almost all small businesses as mentioned earlier, do not have the bargaining power to enter into volume-based discounts with third party settlement service providers, as do the few large entities in the industry. Under the Proposed Rule, NCRA estimates well over 90% of the mortgage credit reporting agencies, currently providing the vital

[3] 67 Federal Register pages 49170—49174 (July 29, 2002)

[4] 67 Federal Register page 53958 (August 13, 2002)

services needed to reach the record mortgage volumes of the past year, would not be able to compete with these larger entities and will be forced out of business.

In reviewing the Initial Economic Analysis as attached to the Proposed Rule, it is clear that HUD totally ignored the small business components of this industry. Mortgage credit reports are only mentioned as being part of settlement services, and nowhere is there an analysis of the importance of credit history information to both consumers and lenders in the process of the granting of mortgages. HUD's own estimates project a $3.5 to $5.9 billion loss in revenues if this proposal is implemented to small businesses. Since we have not been able to verify these numbers in the Economic Analysis, we are unable to ascertain if these numbers include the potential elimination of a few hundred small businesses in the mortgage credit reporting industry. Therefore, it appears that the estimates may be very low.

In a letter dated October 28, 2002, the SBA's Office of Advocacy reviewed HUD's compliance with the RFA in regard to the Proposed Rule and wrote to HUD that:

> "HUD's analysis included the overall cost of compliance for the proposal in its analysis. A revised IRFA would allow for HUD to compute the compliance cost per small entity. This would enable HUD to identify and analyze significant regulatory alternatives to minimize the potential burdens on small businesses subject to the rule. In addition, this information would assist small entities in understanding the nature of the impact of the rule on their businesses."

NCRA believes that HUD must undertake a broader and more realistic review of the economic impact that the rule will have on the mortgage credit reporting industry, and many other small businesses in the settlement services industry, as mandated by the Regulatory Flexibility Act.

NCRA further believes that this Committee should thoroughly review the RFA and its requirements in conjunction with the many opportunities afforded by internet technology to allow small businesses and consumers to have adequate knowledge regarding the factors behind rule proposals so that they in turn will have the ability to influence the regulations under which they must do business.

It seems ironic that HUD would overlook such a significant assessment regarding so many small businesses with such a negative financial impact when they claim to be pro-small business. Their policy in the operation of their own Procurement Opportunity Program and in their Small Business Policy Statement dictates:

> "It is the policy of the Department of Housing and Urban Development to ensure non-discrimination in Federal procurement opportunities for small businesses and especially those small businesses owned by the disadvantaged (SDB), women (SWOB), service disabled veterans (SDVB), and those located in Historically Underutilized Business Zones (HUBZone), or part of the 8(a) Business Development Program (8(a)). It is HUD policy to take affirmative steps to ensure inclusion of these businesses in HUD contracting. The Department recognizes that these businesses are of vital importance to job growth and economic strength of the country and that they have faced historic exclusion and under utilization in Federal procurement. A successful and strong business community is an integral component of the Department's overall mission of job creation, community empowerment and economic revitalization".[5]

[5] HUD Website - **http://www.hud.gov/offices/osdbu/policy/statemnt.cfm**

The ideals behind the proposed RESPA reform do not agree with the ideals of HUD's commitment to small business as described in the HUD policy on small business and their claim in understanding the importance of small business to the overall economic growth of our nation. The small businesses of the mortgage credit reporting industry are highly populated with firms that are owned by women, with more than 20 percent of NCRA's membership in this category. It is especially ironic that this comes at a time when our nation's economic state is so fragile and the success of the housing industry has been a mainstay in avoiding further economic problems.

Issues with HUD's Guaranteed Mortgage Package

The concept for system improvement and the intentions behind the GMP are sound and propose potential improvements to a current settlement solutions environment that is riddled with problems. The closing costs presented on the Good Faith Estimate (GFE) and the actual closing costs on the Settlement Statement (HUD-1) are, frequently, very different. Additional charges, not included on the GFE, that many times show up on the HUD-1 due to "additional services" required to close the loan, can be extremely costly and difficult to comprehend for the average consumer. In the midst of legitimate additional services required, the current situation provides opportunity for some unscrupulous lenders to include spurious charges for services that are difficult to identify and serve only to improve the lenders' profit margins.

NCRA understands the benefit to consumers of obtaining a guaranteed closing cost that would allow them a true "apples to apples" comparison of both interest rates and closing costs between lenders when shopping for the best deal on their home financing. Having one price quoted for all settlement services needed for the mortgage transaction could be a great benefit to the consumer; however, it also opens new areas for consumer overcharges and provides considerable financial risk to the consumer with credit reporting as part of the package.

The credit report is truly unique to the overall mortgage services package as it is one of the most important documents in the mortgage process to both the consumer and the lender. The credit report starts the entire loan process and its contents will influence the transaction beyond the closing and well into the secondary securities market. It alone can kill the loan and will dictate if all the other mortgage services, or the real "settlement" services are even needed. It also is the most important factor in determining how much the consumer will pay for interest and origination fees for the loan, by far the greatest cost to the consumer, many times exceeding the principal cost of the home.

NCRA's position is that the credit report should definitely not be included in the GMP for the following reasons:

1. If not properly performed, this service could cause serious financial harm to both the consumer and the lender.
2. It is one of the least expensive line items in the services related to the mortgage process.
3. It is the very first item obtained by a lender and is used to determine if the consumer qualifies for a loan, at what interest rate they will pay, and if any of the other services for settlement may even be needed.
4. The credit report is a pre-qualification and approval service, not a settlement service.

These Traits Make the Credit Report Different from All Other Services

As previously noted, the credit report is different from all other settlement services for a number of reasons. The most basic and distinctive difference is that it is required to ***pre-qualify and approve*** a mortgage loan and is the very first step in the process. It is also unique in that its value is realized regardless of the outcome of the actual loan. The lender receives the value of the credit report even when determining if the consumer does not qualify for a loan. All other services are required to actually ***close*** the mortgage loan and are only ordered after the credit report has been evaluated. It is this very basic difference that has created a two-step process that is the standard in the mortgage industry. This standard was developed based on reasons addressed later in this document and, in our opinion, should not be changed in a new environment. Loan approval and loan closing should be maintained as separate processes, each with their own responsibilities, checks and balances for the protection of the consumer and the lender alike.

In HUD's proposal of the GMP, the credit report and selected other services are eligible to be excluded from the GMP, however, an exclusion option of the credit report does not protect the consumer and should not be a choice for the lender. Allowing the lender or a settlement service "bundler" or "packager" to decide whether or not the credit report is part of the GMP provides far too much influence regarding the consumer's credit evaluation and the type of credit services needed to properly evaluate the consumer. A serious conflict of interest exists if the lender has the ability to steer the type of credit services offered to the consumer due to the influence of the credit report on the consumer's interest rate and fees. This conflict is especially prevalent when a lender owns a Credit Reporting Agency.[6] For this reason the credit report should be required by HUD as a separate transaction, outside of all other settlement services, in either the revised GFE or the GMP proposals.

How GMP Savings Can be Quickly Lost

The savings that this proposed program is intended to bring consumers is minute compared to the cost of interest over-charges that could be in store for a consumer if the credit report is not completely accurate. It could, in many cases quickly cost consumers more in over-charges of interest rates than the total cost of all the settlement services needed to close the loan combined[7]. Accuracy in credit reporting has been greatly debated recently due to the December 2002 release of "Credit Score Accuracy and Implications for Consumers," published by NCRA and the Consumer Federation of America (CFA). A projected 38 percent of the applicants reviewed in one phase of the study were at risk of being incorrectly categorized into a higher cost loan due to characteristics found in their credit reports.[8] Other independent studies have been conducted with different findings regarding credit file accuracy. Results vary significantly with

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[6] Several lenders have purchased or created Credit Reporting companies that engage in the credit evaluation of loans of which they have an interest. The most notable is LandSafe Real Estate Closing Services. LandSafe, Inc. was created in 1994 as a subsidiary of Countrywide Credit Industries, Inc., one of the nation's largest mortgage banking operations. As such, LandSafe is part of the publicly owned Countrywide® organization, whose stock is traded on the New York Stock Exchange (NYSE) under the ticker symbol CCR.

[7] Interest on a loan with an "A-" designation, the designation for sub prime loans just below prime cutoff, can be up to 2.25 percent higher than prime loans. On a 30 year, $100,000 mortgage, a borrower who is incorrectly placed into a 10 percent "A-" loan would pay a difference of $161.15 per month or $58,017.56 in interest payments over the life of the loan. This represents $215,925.77 in interest, compared to $157,908.41 if that borrower obtained a 7.75 percent prime loan. Thus, the consumer experiences a potential overcharge greater than half the cost of the principal amount of the actual loan, and has an unnecessary monthly expense equal to or less than the one time cost of the higher level credit report services that could have prevented the situation.

[8] In Phase One of the CFA/NCRA study, a sample of 1704 credit reports were randomly selected, producing 1545 files that could be reviewed for the three target criteria to signify problems in the potential effectiveness of automated three repository merged credit reports (159 reports (one out of ten files) had less than or more than one credit score per repository due to "mixed" credit files or a lack of a credit score from the repository). 38 percent of all files met one of the categories below and 20 percent fell into the categories of greatest sub prime risk by meeting criteria two and/or three below.
The high score and the low score on the file varied by 50 points or more,
The high score and the low score on the file varied by 30 points or more, and the file's middle score was between 575 and 630, or
The file had a high score above 620 and a low score below 620
Considering the files with multiple scores from a single repository or missing credit scores, the percentage of consumers with a questionable effectiveness of three repository merged reports increases by 10 percent.

some research showing error rates as low as two percent;[9] however, research done by the Federal Reserve[10] found some considerable credit data issues that could significantly impact a consumer's credit score.[11] Some of these findings in the Federal Reserve presentation seem to correlate closely to findings in the CFA/NCRA study and have serious implications for some consumers[12].

Despite these system shortcomings, NCRA believes the three credit repositories do an admirable job of accurately maintaining the files of almost 200 million consumers considering the circumstances in which they must operate. The credit repositories handle billions of pieces of data each month provided to them by a vast assortment of credit granting entities. Each credit grantor has their own set of errors or incomplete data that is being passed along to the credit repository as factual information. There are further challenges when unscrupulous consumers try to beat the credit system by changing their name, assuming someone else's identity, or disputing accurate derogatory information for financial gain. These situations create an environment in which the credit repository files will never be without errors. As our report shows, for the vast majority of Americans the system contains complete and accurate files, especially considering all the factors influencing the process.

While the system works well at a macro level, if you are one of the individuals in the high-risk group, the fact that most credit reports are complete and accurate and most loans are approved at the right rate is not important to you. With 38 percent of the population found to be in the high-risk category, this "micro" segment of the population is far too large for HUD to disregard without much greater investigation. NCRA strongly requests this committee to instruct HUD to conduct its own analysis and provide data to prove that consumers will not be harmed prior to implementing a program like the GMP, whereby credit

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[9] A 1992 study conducted by Arthur Anderson, commissioned by the Associated Credit Bureaus (now known as Consumer Data Industry Association) studied the behavior of 15,703 consumers who were denied credit based on a credit grantor's scoring system. From this sample, 1,223 consumers (7.8%) requested their credit report from the issuing credit repository, and 304 consumers (1.9% of the total sample) disputed the information on the report. Of these, 36 disputes (11.8% of those who disputed, or 2% of the total sample) resulted in reversals of the original credit denial.

[10] From a presentation titled "Credit Performance: Does situational data like the Economy Matter"? Robert S. Avery and Paul S. Calem, Federal Reserve Board, Presented at the Credit Risk Modeling and Decisioning Conference, May 29, 2002 sponsored by the Federal Reserve Bank of Philadelphia and the Wharton School. Views expressed are those of the authors and do not necessarily represent those of the Board of Governors of the Federal Reserve System or its staff.

[11] The Federal Reserve presentation outlined that of the 250,000 files it used in their research from "detailed account-level" data selected from a national credit repository in June of 1999 that:
-35% of the tradelines are not currently reported and not reported as closed
-13% of these are missing current balance
-30% of these are missing current payment status (though 5/6 of these have 0 balance)
-2.5% of these show current payment status of a minor delinquency with a positive balance. These represent 57% of all accounts which are "currently" minor delinquent
-Many of these are closed-end accounts past due
-Appears accounts often are not closed when they are transferred, paid or sent off to collection
Particularly acute problems with mortgages. 80% of individuals with 2 or more open mortgages showed that one mortgage was opened within 2 months of the last reporting of the other mortgage for approximately the same amount. Often one is listed as past due. Hard to distinguish between sale of servicing and a new loan.
Big problem with major derogatories. Hard to follow accounts when sent to collection departments or agency. Cannot tell if one or two accounts. Sporadic reporting of chargeoffs and payoffs.
Collection agency accounts also a big problem.
-30% of individuals show some collection account.
-88% are small (under $500).
-Source of creditor not coded. We parsed name of creditor to estimate type. Estimate 52% are medical; 24% are utilities; only 5% are for normal "tradeline type" loans (some of these are double counted).
-Payoff information sparse and often not linked to the original account. Inconsistency in reporting multiple small charges or single consolidated amount.
Credit limit missing in 34% of open revolving accounts currently reported.
Account ownership status missing for many non-primary account holders. Cannot tell if authorized user, cosigner, or co-applicant.

[12] Both the CFA/NCRA study and the Federal Reserve presentation noted problematic issues with collections, mortgage accounts and missing credit limits on revolving accounts. The most often cited reasons or factors provided with the credit score explaining why the consumer did receive a higher score relates directly to problematic findings in the reports.

reports will be produced by the cheapest provider. The adage "you get what you pay for" should not be forgotten when dealing with services that have such large impacts for some Americans.

Consumers have already seen a previously intended savings in the mortgage credit reporting industry fall short with the transition from the RMCR to the Three Bureau Merged report. When Fannie Mae, Freddie Mac and HUD endorsed this change, their intentions were to reduce the time and cost involved in a full investigation and to enable the implementation of "automated underwriting systems" that could approve a loan in minutes based upon risk-based scores generated by using the raw data contained in a consumer's credit report. While these systems have provided such benefits to the GSE's, lenders, and many consumers, the CFA/NCRA study points out that roughly 8,000,000 consumers are potentially at risk of being denied a loan or steered into sub-prime interest rates in a fully automated environment. At the very least, these consumers are paying far more in supplemental reports and "re-scoring" charges than the original RMCR would have cost.

Additional Services are Needed to Correct the Problem in the Mortgage Marketplace

Within today's fast-paced mortgage system that utilizes automated underwriting technology to make lending decisions in less than a minute, the credit report contains the greatest potential to prompt a legitimate need for additional services that can elevate the cost exponentially based on the specific contents of the consumer's credit history. No other settlement service has common and legitimate price swings of 100 to 1000 percent that are identified and ordered with the consumer instructions,[13] unlike many of the "add on" charges that have been know to find their way onto the HUD1 that the GMP is designed to stop. Additional credit reporting services are easily understood by consumers because they pertain to the completeness and accuracy of their financial obligations as detailed in the credit report. The average consumer usually knows if their credit card payments have been made on time or if an account was sent to a collection agency and if they have paid it.

NCRA believes that if a consumer is going to be charged anything above prime rate the lender should provide a copy of the credit report used to the consumer so they can review the credit data with the lender and understand the reasons for the increase in rate and/or the need for additions or corrections to the credit report. NCRA strongly believes that the consumer should be empowered with the information to make informed decisions about their options under the Fair Credit Reporting Act to dispute and correct these items themselves without an additional charge or, to work via the lender and hire professional assistance from the credit reporting agency to have the work done for them on an expedited basis. The consumer's first hand knowledge of their credit obligations provides a safeguard from abuse when they are provided the information to make informed decisions that is not found in most settlement services that are less well known by the average consumer.

In previous Congressional testimony on the proposed RESPA Reform[14] and in the official comments sent to HUD during the comment period that closed October 28, 2002 there are positions from the lending industry requesting to hide, from the consumer, information contained in the credit report or in some

[13] Prices for mortgage credit reports vary widely, even within the same type of service. A sample price range as researched by the NCRA found these results: Three (3) Repository Merged Report $10–$25; Residential Mortgage Credit Report $ 50-$100; Credit Re-scoring Services $50-$600. Individual service options also vary in price; such as lender verifications or updates $10-$50, due to the fees charged by many lenders for the data to be obtained, or supplements and non-traditional credit verifications, such as landlord verifications, $7-$25. Supplements and lender verifications are a vital step in making necessary additions, alterations or corrections to a credit report based on closing conditions from the lender. In some cases there may be multiple supplements required for each borrower on a loan.

[14] Testimony of the Community Bankers Association on the RESPA Reform before the US House of Representatives Committee on Financial Services, Subcommittee on Housing and Community Opportunity Feb. 25, 2003 Sec. IX E. "The requirement to provide copies of the certain documents (e.g. pest inspections; appraisal; credit report; and lenders title) to consumer on request is unnecessary."

cases even the type of report used for the loan.[15] We urge the committee to advise HUD to carefully look at this position and completely question the reasoning behind it. We are unable to detect any benefit to consumers and question the incentives for non-disclosure when there are issues of accuracy in this score-driven risk-based process.

Areas of Potential Consumer Abuse Involving Credit Reporting Services in the GMP

Lender Operational Cost Abuse

There are two areas of the GMP process that will allow lenders to potentially harm consumers by providing an opportunity for lenders to shift their internal operational costs that are not related to a consumer-specific loan, directly to that consumer in the mortgage origination process. This has been a problem historically with some services, despite RESPA regulations that prohibit this practice. With the "Safe Harbor" of RESPA Section 8 created by the GMP, the credit report could become a fertile ground for abuse. We have already seen this questionable practice in credit reporting and similar services needed for portfolio servicing, with the RESPA violations documented by HUD. The following two examples illustrate the abuse that HUD should be attempting to prevent:

1. Lenders have historically tried to lower or include the costs of pre-qualifying mortgage applicants into the costs of the settlement services billed directly to the consumer. Over the years, there have been many questions to HUD regarding the legality of this activity with respect to RESPA's interpretation of whether or not a pre-qualification credit report is something of value that should not be used as an enticement for other settlement services business[16]. This question would have a new twist in the proposed GMP, as it would now be cleared of any Section 8 scrutiny for all pre-qualification credit report costs to be billed to the consumers in the GMP.

2. In November 2001, HUD Secretary Martinez announced settlements of more than $2 million from illegal mortgage fees.[17] The two largest settlements in this November 2001 announcement were related to shifting of lender costs directly to consumers via this process. These RESPA settlements (between HUD and The First American Corp. and Transamerica Corp.) found that flood services had been provided from both companies to certain lenders at a greatly discounted cost or at no cost for portfolio review flood services**,** in exchange for referrals of future business of flood certifications required for new loan originations. These flood certifications at origination are paid for by the consumer. While the companies charged admitted no wrongdoing, HUD reached a settlement with these two companies at $1.2 million from First American and $613,000 from Transamerica.

The credit report is also used heavily in loan portfolio servicing, providing lenders new opportunities to shift significant operational expenses directly to the consumer under the proposed GMP with a waiver of the RESPA Section 8 regulations that currently forbid these practices. The credit report, due to its use in portfolio reviews (note the aforementioned flood services) and widespread use in all other areas of personal lending and loan servicing, is a greater potential target for abuse than any other mortgage related

[15] Commentary to HUD's proposed RESPA Reform Docket No. FR-4727-P-01 from Consumer Mortgage Coalition Oct. 28, 2002 Section 18 Disclosure of Anticipated ordering of credit report, Pest Inspection, Appraisal, or Lenders Title Insurance "HUD should not require packagers to reveal which credit verification procedures they use, because in many cases these are proprietary underwriting tools."

[16] It has been so commonplace in the industry that the leading independent credit-reporting agency in the county, First American Credco, has a policy statement online to discourage lenders from requesting them. http://www.credco.com/HTML%20files/RESPA.htm

[17] HUD News Release No. 01-118, November 2, 2001 – HUD Moves to Protect Families From Illegal Mortgage Fees – Pay $2 Million.

service. Lenders have a big appetite for credit reports. From pre-qualification and underwriting of all types of loans (both mortgage and personal) to the servicing reviews of all types of loan portfolios, the inclusion of the credit report in the GMP, with no fear of RESPA Section 8 violation, leaves consumers open to charges for all types of credit services that are not related to their actual loan transaction.

Incorrect Credit Service Reduces the Consumer's Ability to Obtain Properly Priced Loans

The credit report as part of the GMP could significantly reduce the consumer's ability to obtain properly priced mortgage financing, causing the consumer to have a huge increase in the overall cost of the loan. While there are several types of credit reports with drastic price differences (see footnote 13), the standard three bureau merged report is generally considered to be sufficient for much of the population. As mentioned earlier, however, previous studies question its effectiveness for more than one-third of all mortgage originations.

The CFA/NCRA study[18] compared and contrasted the credit scores between the three credit repositories for a sample of 502,000 three-bureau merge credit reports. Three phases of research, with various depths of investigation, were conducted on two subsets of this sample. This review compared the variance in scores from each of the three credit repositories when their files were accessed simultaneously for a mortgage loan, as a proxy for the consistency of the data on each of the consumer's reports. It reveals that the random mortgage applicant had an average (mean) range between the high and low credit score of 41 points. Chart 1 (see Charts) shows the point range of all files evaluated.

Applications near or at the fringe of prime to sub-prime interest rates (typically about 620) were further examined in detail. It should be noted that the files with lower scores showed a gradually increasing variance in the credit score range. The Regression line in Chart 2 (see Charts) shows this trend. As consumers fall into the below 620 score range, they would most likely be charged a higher "sub prime" interest rate or denied a loan. At this point, many files cross into an area of score discrepancy of nearly 50 points between the high and low credit scores from each of the three repositories. With the risk-based pricing models currently in use in the mortgage marketplace, the incorrect evaluation of the consumer's credit history can cause a significant increase in housing finance costs. From the in-depth investigations done in phase one of the study, it was observed that a single collection could have a 100-point effect on a consumer with an otherwise solid credit history. This research also conservatively estimated that more than two percent of all borrowers are likely being pushed into sub prime mortgages due to errors observed on the files reviewed.

More thorough credit research of the nature to meet the demands of the automated underwriting systems comes at a price (see footnote 13) that may not be encouraged in a GMP driven marketplace with credit as part of the package. HUD's emphasis is clearly focused on lowering the consumer's cost related to home finance services with no consideration given to true credit evaluation needs of the individual consumer. In the proposed rule, discussions state "competition is the substitute for regulation."[19] In an environment with credit as part of the GMP, will the lender want to order the additional services required and risk having to pay for them out of his/her own pocket? How often may they order these services, at their own expense when the results may produce a lower interest rate and a less profitable loan? Or will it be

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[18] While the Consumer Federation of America and the National Credit Reporting Association, Inc. jointly collaborated on the study, *Credit Score Accuracy and Implications for Consumers*, the views and opinions expressed in this paper are exclusively those of the National Credit Reporting Association, Inc.

[19] Federal Register, 24 CFR Part 3500, July 29, 2002, Department of Housing and Urban Development - Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers; Proposed Rule, Page 49173 Item 2-C.

required that these services are thrown in by the credit-reporting agency in an “all inclusive” price to the lowest bidder? Either way compromises service and quality.

While there is no guarantee a credit report that gets re-scored will produce higher scores, common changes of just one or two errors can produce results of 40 to 100 points in a consumer’s file. Some extreme cases have been documented in which consumer scores have increased by 200 points. One highly publicized example illustrated that “within five days, Phillips's FICO scores jumped 200 points -- taking her from a 580 to a 780, and from a high-risk mortgage applicant to an A-plus cream puff.”[20]

RMCR’s and Non-traditional credit access may also be more difficult to obtain under the GMP as these report options are very labor intensive and are higher priced as mentioned previously, (see footnote 13). When a consumer’s file is found to have questionable data or is in need of some type of additional service (verification of past landlords or other creditors not found on the file of any of the repositories) there should be no barriers to impede this additional service as it could be a major difference in the approval of loans on the fringe. Another irony is that the RMCR and Non-traditional credit services are used extensively in HUD’s FHA and VA programs.

It appears contradictory that with the stakes of accuracy as high as the above estimates, we would want a system that would endorse the use of the least expensive products for this critical service without any assurance that consumers are getting the proper service required for their specific needs. With the vast differences in the credit data within each repository (see Chart 2) and the potential downside to consumers for incomplete or inaccurate data being used on their loan, the question is raised: Is the credit report the area where HUD really wants to look for savings?

With the critical importance of accuracy and the potential consumer impact, we wish to restate the following question: Should the lender be encouraged to seek the cheapest possible solution for credit reporting services, when a bi-product of that encouragement may actually benefit the lender by overstating risks and obtaining higher interest rates than the consumer’s true credit history represents?

<u>Competition in the Credit Reporting Market</u>

Credit reports as part of the GMP would cripple the mortgage credit reporting industry as we currently know it by eliminating almost all competition that is not owned by one of the three major credit repositories, a title company, or a lender.

Over the past decade, the credit reporting industry has undertaken rapid changes to keep up with the requirements of the changing technology of the mortgage industry. With these changes, we have seen almost complete elimination of some segments of the industry. In the mortgage credit-reporting marketplace, it was estimated that there were more than 1500 credit reporting agencies serving the mortgage industry ten years ago. Today there are less than 300 credit reporting agencies listed as available to do business in the mortgage industry.[21]

Another area of contraction lies within the affiliates of the three major credit repositories. Less than twenty years ago, there were five credit repositories building a national database.[22] Ten years later there

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[20] The Washington Post, Ken Harney, The Nations Housing, 7/14/01 Bad FICO Mark? Rescore your credit page H01.

[21] Original numbers from NAICRA (now NCRA) 1992 membership marketing archives. Current numbers complied from lists of credit reporting partners published on the web sites of Fannie Mae, Freddie Mac, Ellie Mae’s ePASS and Calyx’s Point Preferred Partners.

[22] Trans Union, TRW (now Experian), Equifax, Chilton, and Pinger Systems.

were three and each had a vast network of affiliates providing consumers access to local service. All three of the repositories are in the process of buying back these affiliates, with one of them nearly finished, creating fewer sources from which to purchase credit files for resale. Many of these affiliates were also providers of mortgage credit reporting services and have been part of the industry loss explained above.

While the reduction in the past ten years is due to many reasons, if the GMP is approved with credit as an allowable package service, very few companies will be able to compete. The three major credit repositories own the files in their systems and will be able to provide their reports to lenders at a much lower cost than anyone else in the industry in exchange for the GMP business. Because of this file ownership and a monopolistic advantage the repositories maintain over the rest of the industry due to requirements by Fannie Mae, Freddie Mac, and HUD for Three Bureau Merged reports, they can do this at a significantly lower cost than any other credit reporting entity that has to purchase the credit files from each one of these essential facilities. While this would create a short-term reduction of overall profit for the repositories, once the majority of the competition had been eliminated, it is doubtful that prices would stay at a level competitive enough to warrant the further reduction in the industry. Just by the nature of the makeup of the entire industry, some anti-competitive questions could be raised.

The question of service vs. product has made it difficult to enforce antitrust activity in credit reporting, allowing pricing situations to go unchecked by the governmental agencies designated to enforce competitive practices. Considering these circumstances, and the importance of a healthy and competitive credit reporting industry, is it wise for HUD to pass regulation that could assist the exploitation of antitrust loopholes?

Despite argument to the contrary in the Proposed Rule[23] that characterizes the credit reporting industry as being "national in nature and characterized by economies of scale," credit reporting is also localized in nature (similar to appraisal) for very good reason. Many lenders know the value of the customer service that the smaller, more local credit reporting agencies can provide to this unique marketplace. Thanks to a handful of aggressive software companies that provide these specialized companies with the latest technology available, these smaller firms can offer a unique mix of technology, personalized service to consumers, and the flexibility required to close the tough loans with services sometimes not even offered by the largest companies.[24] Losing the ability to obtain this type of service could create a major problem for many consumers.

The companies likely to survive in an environment that has credit included in the GMP, aside from the major credit repository owned companies, include those firms that are owned by title companies (e.g., Credco, of the First America Corp.) or directly by lenders (e.g., LandSafe, of Countrywide Credit Industries) that could include credit reports as a loss leader for marketing of their own additional, more profitable settlement services or the actual loans themselves. This is a practice currently engaged in, despite seemingly clear RESPA issues, by some wholesale mortgage lenders as a potential inducement to

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[23] Federal Register, 24 CFR Part 3500, July 29, 2002, Department of Housing and Urban Development - Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers; Proposed Rule, Page 49173 & 49174 Item 2-G.

[24] Factual Data Corp, a large publicly traded credit reporting agency and one of five companies that is a direct provider to both Fannie Mae and Freddie Mac's automated underwriting systems, temporarily stopped offering RMCR's as part of their services. Upon returning them to their service portfolio, the prices were significantly increased as reported to NCRA by several of their customers.

It should also be noted that in conversations with HUD officials in April 2002, NCRA was told that certain larger credit reporting agencies report difficulty in the ability to obtain payment histories from landlords. Unautomated and non-traditional credit sources, the kind requiring high levels of manual research, are the areas in which the smaller, localized credit reporting firm's service levels excel. These types of services can also be crucial to documenting the true credit risk of those consumers on the border of prime/sub prime interest rates.

obtaining the funding rights to the loan from mortgage brokers.[25] The credit report is far too important and far too incomplete for a significant portion of the population to be reduced to a "loss leader" type product with an incentive to push it through the system at the lowest possible cost.

If these predictions of severe industry restriction hold true, what value could be provided to consumers by a further reduction of the credit reporting industry? When has less competition actually been good for the consumer? In times of peak refinance volumes such as those we have experienced in the past two years, would five to ten companies be capable of handling all of the volume or would we return to the days when consumer complaints about credit reporting agencies were labeled "Public enemy #1 at the FTC"?[26]

Conclusion

The National Credit Reporting Association, Inc. (NCRA) conditionally supports the pursuit of the GMP concept as a means to bring greater efficiencies to the consumer in the acquisition of settlement services. However, we only support it specifically for settlement services needed to close a loan, not to approve a loan. Therefore, NCRA supports the GMP as long as the credit report is required to be an additional service to the GMP, not included in it.

The credit report is required as the first step in the process of loan approval and has far too great an impact on the consumer, to be included in a package of services that are not even needed until after the credit report has been secured and processed. The enticement for the cheapest possible solution to credit reporting services may, at first glance, seem attractive; however, it is as full of pitfalls as the original problem HUD is trying to fix. The ability to pass along some of the lender's non-related operational costs provides the opportunity for more abuses to the system in new ways. Giving the lender the ability to decide whether or not to include credit as part of the GMP does not provide consumers with the protection they deserve to make sure they obtain the type of credit review needed for their specific credit circumstances.

Finally, further reduction in the number of credit reporting companies in business could prove very harmful, long term, for the entire competitive balance of the credit reporting industry. The three major repositories, being essential facilities to the rest of the industry's ability to exist, would have a monopolistic advantage over everyone else in the industry. Including the GMP "safe harbor" from RESPA Section 8, HUD would be empowering them with the ability to use questionable business practices to virtually eliminate all competition except that of companies that could provide credit reports as loss leaders for other services.

Considering that the credit report, depending on the type needed, is already one of the lowest cost services in the mortgage settlement services process, and that it is also the only service with a direct impact on the price of the most expensive part in the mortgage process -- the interest rate of the actual loan, should it be encouraged to be completed "on a shoestring"? It seems far too risky to allow the credit report to be the lenders' choice for inclusion in the GMP with an incentive for them to obtain it at the lowest possible price, regardless of the impact on the consumer. This is especially true when factoring in that 38 percent of the mortgage applications reviewed in the CFA/NCRA study were found to be at high risk for credit report problems due to extreme circumstances on their credit reports. The proposed "savings" associated

[25] Countrywide Credit Industries website, https://www.cwbc.com/Partner/StaticPopup.asp?DocumentName=Credit_Bureau_Update From their own credit reporting agency and through their Countrywide Wholesale Business Channel ® Countywide Credit Industries recently began offering free credit rescoring services to their mortgage broker customers. This seems to be a questionable practice under HUD RESPA Regulation X.

[26] 1993 US PIRG report *"Credit Bureaus: Public Enemy # 1 At the FTC"* found that credit reporting agencies were the number one consumer complaint to that agency each year between 1989 and 1992.

with the credit report as part of the GMP could cost a significant portion of our population, many of whom are in the position to least afford it, more in higher interest charges in a matter of only a few days or weeks, than could ever be saved by this proposal. HUD's quest to save a few dollars from one of the least expensive items in the entire mortgage process could for some, keep the American dream of home ownership only a dream. **

CHARTS

Chart 1

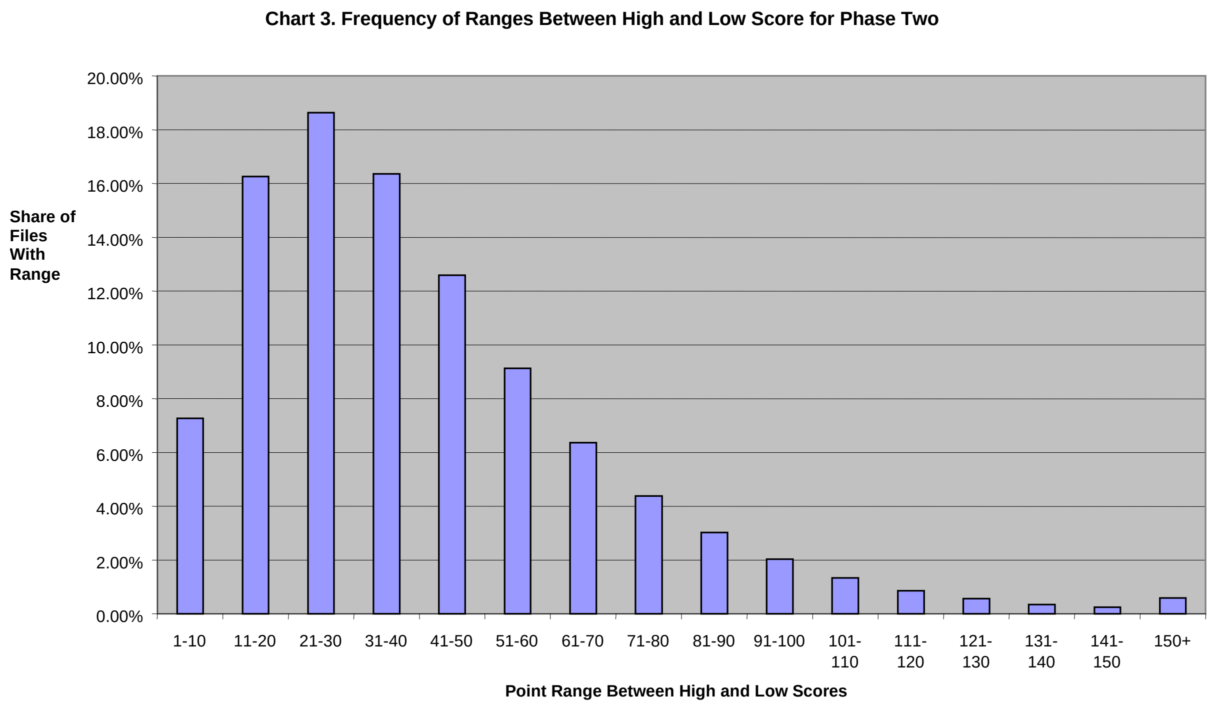

Chart 2