SAM GRAVES, MISSOURI
CHAIRMAN

NYDIA M. VELAZQUEZ, NEW YORK
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515-6315

To:	Members, House Committee on Small Business
From:	Committee Staff
Date:	July 30, 2012
Re:	Hearing: "Know Before You Regulate: The Impact of CFPB Regulations on Small Business"

On Wednesday, August 1, 2012, at 1:00 pm in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will meet for the purpose of examining the Consumer Financial Protection Bureau's (CFPB) proposed regulation to integrate various disclosures that are provided to consumers in a real estate transaction and the agency's efforts to reduce the impact of the proposed rule on small lenders, mortgage brokers, mortgage companies and settlement service providers.[1]

I. Introduction

Everyday consumers receive forms disclosing credit terms from lenders. Most people are familiar with the fine print disclosure forms sent along with their credit card statements.[2] A subset of the broader disclosure forms are those associated with a real estate transaction.

The Truth in Lending Act (TILA) was enacted by Congress in 1968 "***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, and to protect the consumer against inaccurate and unfair credit billing and credit card practices."[3] Congress originally delegated implementation of TILA to the Federal Reserve.[4] In 1974, Congress enacted the Real Estate Settlement Procedures Act (RESPA) to "***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

---

[1] The proposed rule is about as long as War and Peace but it is probably not as interesting to read, and it is about as indecipherable as if you were an English speaker trying to read the novel in Russian. Consequently, the memo's discussion of the regulation, its impacts, and costs is by no means exhaustive.

[2] If any readers of this memo have read the credit card disclosure form, please contact Committee staff. If any readers of this memo have read and actually understood the fine print, please contact the Board of Governors of the Federal Reserve System (Federal Reserve).

[3] 15 U.S.C. § 1601(a) (emphasis added).

[4] *Id.* at §§ 1601-67f (2010). The Federal Reserve promulgated rules under TILA known as Regulation Z.

certain abusive practices that have developed in some areas of the country."[5] The Department of Housing and Urban Development (HUD) was charged with oversight of RESPA.[6]

In the context of a real estate transaction, TILA and RESPA require two different disclosure forms be provided to consumers three days after applying for a mortgage and two different disclosure forms be provided at or shortly before closing the real estate transaction. While it has long been recognized that the two sets of forms overlapped and used inconsistent terminology, attempts to consolidate and simplify the forms had largely been unsuccessful.[7] The mortgage crisis, characterized by high-delinquency rates and foreclosures, focused Congress's attention on whether consumers were fully informed of and understood the terms of their mortgage loans. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[8] authority over TILA and RESPA was transferred to CFPB on July 21, 2011, and CFPB was required to propose both regulations and disclosure forms for public comment by July 21, 2012.[9]

II. TILA-RESPA Rulemaking

On July 9, 2012, CFPB posted the 1,100 page proposed rule to integrate the mortgage disclosures (the TILA-RESPA Rule or Proposed Rule) and model forms on their website.[10] The CFPB determined that integrating the disclosures was likely to have a significant economic impact on a substantial number of small businesses under the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (RFA).[11] As a result, the CFPB was required by § 609 of the RFA to convene and chair a Small Business Advocacy Review (SBAR) panel to receive input from affected small businesses.[12] After conducting the SBAR panel process, the agency realized that its original assessment was correct—the proposal would have a significant economic impact on a substantial number of

---

[5] 12 U.S.C. § 2601(a) (emphasis added).

[6] *Id.* at §§ 2601-17 (2010). HUD adopted rules to implement RESPA and denominated them Regulation X.

[7] In 1996, Congress directed HUD and the Federal Reserve to simplify and improve the TILA and RESPA mortgage disclosure and, if feasible, create a single disclosure statement. Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009 (1996). However, in 1997, HUD and the Federal Reserve concluded that "meaningful change could come only through legislation." BD. OF GOVERNORS OF THE FED. RESERVE SYS. AND UNITED STATES DEP'T OF HOUS. AND URBAN DEV., JOINT REPORT TO THE CONGRESS CONCERNING REFORM TO THE TRUTH IN LENDING ACT AND THE REAL ESTATE SETTLEMENT PROCEDURES ACT 1 (1998), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/tila.pdf (hereinafter "HUD-Federal Reserve Joint Report"). The agencies made a number of recommendations to Congress but no legislation was enacted. In 2008, HUD published a final rule that made changes to Regulation X including the use of a standard good faith estimate (GFE) form and a revised HUD-1 Settlement Statement that was required as of January 1, 2010. Real Estate Settlement Procedures Act (RESPA); Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs, 73 Fed. Reg. 68,204 (Nov. 17, 2008). In August 2009 and September 2010, the Federal Reserve proposed rules to modify the TILA required disclosure forms but decided to not to proceed with the rulemaking since the Dodd-Frank Act transferred TILA rulemaking authority to CFPB. http://www.federalreserve.gov/newsevents/press/bcreg/20110201a.htm.

[8] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[9] *Id.* at §§ 1032(f), 1098, 1100A, 124 Stat. at 2007, 2103-04, 2107-09 (respectively).

[10] Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Regulation X) and the Truth In Lending Act (Regulation Z), *available at* http://files.consumerfinance.gov/f/201207_cfpb_proposed-rule_integrated-mortgage-disclosures.pdf. The Proposed Rule has not been published yet in the Federal Register.

[11] *Id.* at 618.

[12] Section 609(b) requires designated federal agencies to convene SBAR panels. Section 1100G of Dodd-Frank amended § 609(b) to add CFPB to the list of agencies. This is the first rule issued by CFPB for which it conducted a SBAR panel.

small entities. Therefore, § 603 of the RFA required the agency to prepare an initial regulatory flexibility analysis (IRFA) to assess the impact of the rule on small businesses.[13] A key element of the IRFA is an agency's examination of alternatives to the proposed rule that will lessen burdens on small business. Since the CFPB has identified the TILA-RESPA Rule as one that will have a significant economic impact on a substantial number of small businesses, the Committee is interested in CFPB's assessment of the potential impacts and the alternatives the agency is considering to lower the compliance burden for small businesses.

A. Rulemaking Overview

The TILA-RESPA rulemaking is intended to help consumers better understand mortgage loan transactions and assist the industry in complying with the TILA and RESPA disclosure requirements.[14] Mortgage lenders (such as community banks and credit unions), mortgage brokers, mortgage companies and settlement service providers, the majority of which are small businesses, will be affected by this rulemaking. While much of the attention surrounding the rule has been focused on disclosure forms, the Committee is interested in the underlying regulations that will affect directly small businesses.

CFPB is proposing to amend Regulation X (RESPA) and Regulation Z (TILA) to establish new disclosure requirements, as well as the forms in Regulation Z for most closed-end consumer credit transactions[15] secured by real property.[16] The Proposed Rule will not apply to home-equity lines of credit, reverse mortgages, or mortgages secured by a mobile home or dwelling that is not attached to real property (land).[17] Although the Dodd-Frank Act did not include a deadline for the proposal of a final rule on the integrated disclosures, the statutory requirements of Title XIV of the Act, which made changes to the existing REPSA and TILA disclosure requirements for mortgage transactions, will go into effect on January 21, 2013, if there is no final rule implementing the Title XIV changes by that deadline.[18]

B. Summary of Proposed Rule

The Proposed Rule combines the TILA and RESPA mortgage disclosure forms and explains how the forms should be filled out and used. There are two new forms, the Loan Estimate and the

---

[13] Proposed Rule at 619.
[14] *Id.*
[15] Closed-end credit is defined as "consumer credit other than 'open-end credit'" in Regulation Z. 012 C.F.R. § 1026.2(10) (2012). Open-end credit is defined as "consumer credit extended by a creditor under a plan in which: (i) the creditor reasonably contemplates repeated transactions; (ii) the creditor may impose a finance charge from time to time on an outstanding unpaid balance; and (iii) the amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid. *Id.* at § 1026.2(20) (2012). In other words, in a closed-end transaction, credit is extended for a set period of time, and the schedule of payments, the amount financed, and the finance charges are agreed upon by the creditor and the consumer. So credit cards are typical of open-end credit and auto loans and mortgages are prototypical closed-end credit transactions.
[16] Proposed Rule at 1.
[17] *Id.* at 4. It also does not apply to loans made by a person who makes five or less mortgages in a year and is thus is not defined as a "creditor" under Regulation Z. *Id.* at 80.
[18] *Id.* at 65.

Closing Disclosure.[19] The Loan Estimate replaces the GFE currently required under Regulation X and early Truth-In-Lending (TIL) disclosure required now under Regulation Z.[20] The Closing Disclosure replaces the final versions of these early disclosures.

Within three days of submitting a mortgage loan application, the lender or broker must provide the Loan Estimate to the consumer. The TILA-RESPA Rule revises the definition of what is considered an "application." Detailed instructions are provided in the proposal and the official interpretations on how each line of the form should be completed. Sample forms for different loan products are included in the Proposed Rule. The Loan Estimate form also includes the new disclosures mandated by Congress in the Dodd-Frank Act.[21]

While the lender is still responsible for the accuracy of the form, the lender may rely on the mortgage broker[22] to provide the Loan Estimate form. Other than an exception that permits a lender to charge fees to obtain a consumer's credit report, a lender cannot charge a consumer any fees until the consumer has received the Loan Estimate and communicated his or her intent to proceed with the mortgage transaction.[23] While brokers and lenders may provide consumers with written estimates, those estimates must contain a disclaimer so that consumers understand that the written estimate is not the Loan Estimate.[24]

The Closing Disclosure form must be provided to consumers by lenders at least three days before the consumer closes on the loan. If any changes occur after the form is given and before the loan is closed, the lender must provide the consumer with a new Closing Disclosure form and three additional business days to review the form before closing. Exceptions from the three-day requirement are provided for common changes, such as those resulting from buyer/seller negotiations after the final walk through, and minor changes that result in less than $100 in increased costs.[25]

---

[19] *Id.* at 3-4.

[20] The GFE provides consumers with a good faith estimate of the amount or range of charges for certain settlement services (e.g., appraisal or title search fees) that they will likely incur at the settlement (closing) of a real estate transaction. 24 C.F.R. § 3500.7 (2011). The early TIL provides an initial estimate of the mortgage loan's terms including: 1) the annual percentage rate; 2) finance charges; 3) the amount financed; 4) the total number of payments; 5) whether the interest rate on the loan can change; and 6) whether the borrower has the option to refinance the loan. 12 C.F.R. § 226.18 (2011).

[21] Proposed Rule at 5. For example, the new disclosures include: warnings regarding negative amortization; disclosure of creditor's policy on acceptance of partial payments; disclosure of mortgage originator fees; and disclosure of total interest as a percentage of principal. *Id.* at 67-68.

[22] Mortgage brokers are retained by purchasers to facilitate a mortgage transaction by finding lenders and otherwise moving the process of a loan forward. Consumers need not utilize mortgage brokers but often do because the broker ultimately is not paid by the purchaser, but by the lender. RESPA Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed. Reg. 53,052, 53,053 (Oct. 18, 2001). The lender (creditor) is the entity which actually funds the mortgage loan with its own money. Lenders include: commercial banks and savings institutions; credit unions; and mortgage companies (non-bank lenders).

[23] Proposed Rule at 5. The CFPB is soliciting comment on whether other exceptions from the three-day requirement should be allowed.

[24] *Id.* at 5-6.

[25] *Id.*

The CFPB has not determined who is responsible for providing the new Closing Disclosure form. Currently, lenders provide the revised TIL disclosure and settlement agents[26] provide the settlement statement.[27] The agency is soliciting comment on two options: 1) the lender must deliver the Closing Disclosure to the consumer; or 2) the lender may rely on the settlement agent to provide the Closing Disclosure to the consumer but the lender is still responsible for the accuracy of the form.[28]

The Proposed Rule also limits the circumstances under which a consumer can be charged more for settlement services, including various services required to complete a loan (e.g., appraisals, inspections, etc.), than the amount stated on his or her Loan Estimate form.[29] Generally, charges in the Closing Disclosure cannot be higher than the Loan Estimate for: 1) the lender's or mortgage broker's own services; 2) services provided by an affiliate of the lender or mortgage; and 3) services for which the lender or broker does not allow the consumer to shop.[30] In addition, charges for other services generally cannot increase by more than 10 percent unless an exception applies. Exceptions include: 1) the consumer asking for the change; 2) the consumer choosing a service provider not identified by the lender; 3) the information being provided at application was or became inaccurate; or 4) the Loan Estimate expired.[31]

Other provisions of the Proposed Rule include a redefinition of the way the annual percentage rate (APR)[32] is calculated to encompass almost all of the up-front costs of the loan. The proposal also requires lenders to maintain records of the Loan Estimate and Closing Disclosure forms

---

[26] Settlement or closing agents facilitate the orderly and efficient closing of a real estate transaction. Settlement agents may be state licensed. They may be attorneys and generally have a connection with a title or escrow company. They handle and disburse monies to the appropriate parties in the transaction, document and record the closing of the entire mortgage and real estate transaction, and provide the currently required Uniform Settlement Statement (HUD-1) to the borrower, lender and seller (as applicable).

[27] The HUD-1 Settlement Statement is a complete, itemized statement of the settlement (closing) charges including: real estate broker commission/fees; loan fees (e.g., loan origination fee; appraisal fees; credit report fees; lender inspection fees; mortgage insurance application fee; mortgage broker fee); lender required pre-paid items (e.g., interest; mortgage insurance premium; hazard insurance premium; flood insurance); escrows, impounds, and reserves; title and closing charges (e.g., settlement/closing fee; title search/documentation fees; document preparation fees; attorney fees; title insurance); recording/government filing fees (e.g., recording fees and transfer taxes); and other miscellaneous charges (e.g., survey fee, inspection fees).

[28] Proposed Rule at 7.

[29] These limitations are also called tolerances. A tolerance is a restriction on the amount by which certain fees can increase from the Loan Estimate to the Closing Disclosure.

[30] Proposed Rule at 7.

[31] *Id.* at 7-8. Under the current regulations, a GFE may expire "[i]f a borrower does not express an intent to continue with an application within 10 business days after the GFE is provided, or such longer time specified by the loan originator." 12 § C.F.R. 1024.7(f)(4). The CFPB proposes to keep this portion of the regulations the same. Proposed Rule at 212.

[32] The APR is an interest rate calculation that is supposed to help consumer understand the total cost of the loan. It is "the finance charge expressed as an annualized rate that can be used to equate mathematically the stream of payments made over the life of the loan to its present value." HUD-Federal Reserve Joint Report, *supra* note 7, at 7. Currently, "[t]he finance charge reflects the dollar amount of the cost of credit and includes interest and other costs such as origination fees, discount points, and private mortgage insurance." *Id.* The APR is not necessarily the par value of the interest rate of the loan, i.e. the APR may be higher or lower than the interest rate charged by the bank. *Id.*

provided to consumer in a standard electronic format, which may be problematic for businesses that have to adopt this new format.[33]

Finally, the CFPB is seeking comment on when the final rule should go into effect. This rule is tied to other regulations mandated by Dodd-Frank including the qualified mortgage (QM) rule[34] and qualified residential mortgage (QRM) rule.[35] A joint industry letter to CFPB Director Richard Cordray encouraged the CFPB to coordinate the TILA-RESPA Rule with the related rulemakings because the QM and QRM rules will affect the disclosures.[36] The agency is considering whether to implement a longer period by which regulated entities must comply with the TILA-RESPA Rule to allow time for the necessary operational changes, revisions to computer software and systems, and the training of employees.[37]

III. Compliance with the RFA

A. *Outreach Efforts Under § 609*

The CFPB named this rulemaking the "Know Before You Owe" project and began designing the new combined mortgage disclosure forms beginning in February 2011.[38] The RFA could be referred to as the "Know Before You Regulate" statute, since it requires economic analysis and input from small business before finalizing a rule. As already noted, CFPB had to comply with certain provisions of the RFA — particularly the outreach requirement of § 609 and the analytical mandates of § 603.

1. Input on the Forms

From May 2011 to March 2012, the CFPB conducted one-on-one interviews with 92 consumer and 22 industry participants to receive feedback on the prototypes of the integrated disclosure

---

[33] The CFPB recognizes that this may be a problem and is seeking comment on exempting small lenders from this requirement. It is worth noting that even if CFPB permits an exemption, investment bankers that securitize mortgages, including Fannie Mae and Freddie Mac, may require electronic records before they purchase a lender's mortgage.

[34] The QM rule is required by Dodd-Frank. It will expand the scope of the current ability-to-repay requirements under Regulation Z that prohibit a creditor from making a higher-priced mortgage loan without taken into consideration the consumer's ability to repay the loan. It will also establish a "qualified mortgage" standard under which a loan is presumed to meet the ability-to-repay requirements. Regulation Z; Truth in Lending: Proposed Rule; Request for Comment, 76 Fed. Reg. 27,390 (May 11, 2011).

[35] The QRM rule is required under Section 941(b) of the Dodd-Frank Act. It will require financial firms, when they sell loans to investors, to retain 5 percent of the credit risk. Certain types of loans, Qualified Residential Mortgages, will be exempt from the 5 percent requirement. The intent of the law is to encourage responsible lending. Credit Risk Retention: Proposed Rule, 76 Fed. Reg. 24,090 (Apr. 29, 2011). This proposed rule has not been finalized.

[36] Letter from American Bankers Association, American Escrow Association, American Financial Services Association, American Land Title Association, Community Mortgage Banking Project, Consumer Mortgage Coalition, Mortgage Bankers Association, National Association of Realtors, and the Real Estate Services Provider's Council, Inc., to Richard Cordray, Director, CFPB 2-3 (Apr. 16, 2012) (on file with author).

[37] Proposed Rule at 8, 62-65.

[38] http://www.consumerfinance.gov/knowbeforeyouowe/. The CFPB hired a contractor, Kleimann Group, Inc., to design and test mortgage disclosure forms. Proposed Rule at 40.

forms.[39] The CFPB also posted the prototype disclosures on its website and received over 27,000 remarks from both consumers and members from the affected industry.[40] The CFPB also conducted outreach to consumer advocacy groups, other regulatory agencies, industry representatives and trade associations.[41] There is no doubt that CFPB made efforts to reach out to affected small businesses in developing the forms. That, however, is not sufficient for compliance with the RFA. CFPB must undertake dedicated outreach when developing regulations through a SBAR panel.

2. SBAR Panel Process

In February 2012, CFPB convened the SBAR Panel. An all-day outreach meeting with the small entity representatives (SERs)[42] to discuss the regulatory proposal was held on March 6, 2012. Sixteen SERs, including small commercial banks, credit unions, mortgage companies, mortgage brokers, settlement agents, and one non-profit housing organization, participated in the panel process.[43] The SERs were given a deadline of March 13, 2012 (one week) to submit written feedback. The CFPB received written feedback from 12 SERs.[44] The panel report, which includes findings and recommendations made by the SBAR panel regarding the potential compliance costs of the Proposed Rule on the affected small entities, was finalized on April 23, 2012,[45] but not made public until the Proposed Rule was posted on July 9, 2012. On initial glance, it appears that CFPB complied with the requirements of § 609(b). We now turn to the question of whether all the outreach efforts informed the agency's preparation of its IRFA.

B. Analytical Requirements

For the purposes of this memo, there are three key elements to CFPB's compliance with the RFA's IRFA requirement. They are: 1) identification of the affected entities; 2) estimate of the costs; and 3) development of less burdensome alternatives.

---

[39] Propose Rule at 45-46. The CFPB refers to these interviews as "qualitative testing" or "qualitative testing interviews." The process generally included one-on-one interviews with consumers and industry participants that involved providing them with different mortgage disclosure designs and asking them a series of comprehension questions. KLEIMANN COMMUNICATION GROUP, INC., KNOW BEFORE YOU OWE: EVOLUTION OF THE INTEGRATED TILA-RESPA DISCLOSURES XXIII, (July 9, 2012), *available at* http://files.consumerfinance.gov/f/201207_cfpb_report_tila-respa-testing.pdf. After each round of testing, the mortgage disclosure designs, both the Loan Estimate and Closing Disclosure, were revised based upon the feedback that was received. Proposed Rule at 45-46.

[40] *Id.*

[41] *Id.* at 47.

[42] The RFA requires federal agencies to assess the economic impact of their regulations on small businesses, small non-profits, and small governmental jurisdictions (collectively referred to in the RFA as "small entities"). The agency, in consultation with Small Business Administration's Office of Advocacy, identified small entities from the affected industries to serve as SERs.

[43] SMALL BUSINESS ADVOCACY REVIEW PANEL, FINAL REPORT ON CFPB'S PROPOSALS UNDER CONSIDERATION FOR INTEGRATION OF TILA AND RESPA MORTGAGE DISCLOSURE REQUIREMENTS 16 (2012), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0028-0003 (hereinafter "SBAR Panel Final Report").

[44] One may surmise that had the CFPB provided the small businesses that participated in the panel process more than one week to provided written comments, they may have received feedback from all 16 SERs.

[45] SBAR Panel Final Report, *supra* note 43, at 7.

1. Identification of Small Entities Affected

The IRFA estimates the number of small entities subject to the rule and describes the impact of the rule on those small entities. The CFPB identified six categories of businesses subject to the Proposed Rule: 1) commercial banks/savings institutions with up to $175 million in assets; 2) credit unions with up to $175 million in assets; 3) mortgage brokers with up to $7 million in annual revenue; 4) mortgage companies (non-bank lenders) with up to $7 million in annual revenue; 5) settlement (closing) agents with up to $7 million in annual revenue; and 6) nonprofit organizations that are not-for-profit, independently owned and operated, and not dominant in the field.[46] The agency provided an estimate of the number of affected small entities in the Proposed Rule:

Table 1: TILA-RESPA Integrated Disclosures: Estimated number of affected entities and small entities by NAICS code and engagement in closed-end mortgage transactions

Category	NAICS	Small entity Threshold	Total entities	Small entities	Entities engaged in closed-end mortgage transactions	Small entities engaged in closed-end mortgage transactions
Commercial banks & savings institutions[a]	522110, 522120	$175,000,000 assets	7,741	4,255	7,500	4,084
Credit unions[b]	522130	$175,000,000 assets	7,491	6,569	4,359	3,441
Mortgage companies (Non-bank lenders)[c]	522292	$7,000,000 revenues	2,515	2,282	2,515	2,282
Mortgage brokers[c]	522310	$7,000,000 revenues	8,051	8,049	8,051	8,049
Settlement agents[d]	541191	$7,000,000 revenues	8,261	8,131	8,261	8,131

Proposed Rule at 630. As the numbers show, the majority of the affected entities are small.

Although the Proposed Rule does not include new reporting requirements, it does impose new recordkeeping and compliance requirements on small entities.[47] The new recordkeeping requirement requires creditors to maintain electronic, machine-readable electronic records of the Loan Estimates for three years and the Closing Disclosures for five years.[48] Because small creditors may not currently have electronic filing systems or vendor software, the CFPB is considering exempting small entities from the electronic data retention requirements.[49] The CFPB fails to provide any cost estimate for small creditors that do not have electronic filing systems or vendor software, but states that the costs may be a "significant burden."[50]

[46] Proposed Rule at 620. The size standards specified by CFPB are those adopted by the Small Business Administration (SBA) for those industries (except the non-profit organizations). Technically, credit unions are not-for-profit organizations but are treated identically to small banks under SBA size standards.
[47] *Id.* at 631.
[48] *Id.* at 632.
[49] *Id.* at 634.
[50] *Id.*

The CFPB estimates that the total one-time compliance costs for small entities to upgrade software and systems and train their employees will be approximately $51 million. That includes $49 million in compliance costs for smaller creditors that maintain their own compliance software and systems and approximately $2 million in one-time costs for training employees to use the new forms and any new software and systems.[51] The agency again states that it believes that 95 percent of small creditors will not incur direct costs because the vendors for their software and systems will absorb the cost of changing and those vendors will not pass on the costs to their customers.[52] Instead, the software updates will be included in the regular updates. Thus, the bulk of the compliance costs, $49 million, will be shouldered by approximately the 490 small lenders who maintain their own systems.[53]

The agency acknowledges that the revised, broader definition of loan application may result in small creditors and mortgage brokers having to issue more Loan Estimates than under the current definition, but it does not attempt to estimate how often that will occur or whether it will impose substantial costs on small entities.[54] Nor does CFPB assess the consequences of maintaining the increased volume of Loan Estimates. The agency has no factual information to estimate how much the volume of Loan Estimates may increase or how many revised Loan Estimates may need to be reissued as a result of the definitional change.[55] The CFPB does assert that "if this were to impose substantial costs, creditors and mortgage brokers would mitigate this by adjusting their business practices surrounding the receipt of applications to gather other important information prior to, or at the same time as, they obtain the six items that together constitute an 'application.'"[56]

In considering the effects of the revisions to the current rule regarding the circumstances in which a consumer can be charged more at closing than the lender estimated in the Loan Estimate, the CFPB acknowledges that creditors may be required to absorb costs that may have been previously passed onto the consumer but does not attempt to quantify the cost of this part of the rule.[57] However, the CFPB does state that the Proposed Rule "may result in the increased use of affiliated service providers, so that creditors can more directly control changes in settlement costs, which could have a negative impact on independent providers who are typically small entities."[58] This negative impact may lead to reduced competition for settlement services which ultimately could lead to higher costs for the consumers,[59] thereby defeating one of the primary rationales for the rule.[60]

---

[51] *Id.* 638-39.
[52] *Id.* at 638. The CFPB provides no factual basis for this conclusion. In fact, economics dictates a contrary conclusion. If there are a limited number of sellers and many buyers, there is an oligopoly in which the sellers can and will raise prices.
[53] *Id.*
[54] *Id.* at 640.
[55] *Id.*
[56] *Id.* at 641. The CFPB is seeking to obtain data and comments on its plans for data analysis in regard to this issue prior to issuing final rule. *Id.*
[57] *Id.* at 643-44.
[58] *Id.* at 644.
[59] *Id.*
[60] If an agency undertakes rulemaking and the result is a rule in which the result is not rationally connected to the purpose of the rule, courts have considered such rules to be arbitrary and capricious. *See, e.g.*, *Mourning v. Family*

With regard to the Proposed Rule's requirement that the integrated Closing Disclosure be provided to the consumer three business days before closing in all cases, the CFPB states that this may result in delays that "could cause a transaction to fall through if a consumer is under a contractual obligation to close by a certain date."[61] The CFPB acknowledges that delayed or canceled closings will impose costs on small entities, including a loss of revenue and legal or reputational risks for creditors or settlement agents; however, the agency does not attempt to quantify those costs.[62] Small creditors have expressed significant concerns with this provision. They state that there are certain settlement charges cannot always be accurately determined three days in advance.[63] "[T]he appraisal may not be completed until just before closing and may require settlement charge adjustments, or issues that arise during the walk-through of the property may affect the settlement."[64] Settlement agents are concerned that this provision will lead to increased costs for small settlement agents and consumers. In essence, this provision will require small settlement providers to duplicate the settlement process: informally, three days in advance of the closing; and formally at the official closing.[65] They believe that consumer costs will be increased by delays in closings that increase the payoff amounts for many transactions they process such as the payoff of consumer and credit card debt.[66] Although CFPB provides some exceptions to the three-day rule for the provision of Closing Disclosures, it is unclear if those exceptions are broad enough to address the concerns raised by settlement agents.

TILA and RESPA required different parties to provide the final disclosures to consumers, but § 1419 of the Dodd-Frank Act amended TILA by adding 15 U.S.C. § 1638(a)(17) to make creditors responsible for disclosing settlement cost information. The CFPB's Proposed Rule considers two alternative approaches for assigning responsibility of providing the Closing Disclosure. The CFPB believes that assigning this responsibility solely to the creditor (Alternative 1) will likely place increased costs on small creditors including one-time legal fees and the need to hire additional staff to handle the increased workload.[67] Alternative 1 would shift the workload from settlement agents, who currently deliver final RESPA disclosures, to lenders. The CFPB acknowledges that this will change the role of settlement agents but does not attempt to analyze the impact that this will have on the economics of the settlement agent industry. Instead, the agency simply states that "[s]ettlement agents play a unique role in working through local real estate transaction requirements and practices, which creditors may be unlikely to take on."[68] No logical thaumaturgy is required to see that if settlement agents are required to do less, they will have less income. Recognizing this, it behooved the CFPB to make

---

Publications Serv. Inc., 411 U.S. 356, 369 (1973); *American Paper Inst. v. EPA*, 996 F.2d 346, 351 (D.C. Cir. 1993). In this case, the CFPB wants to increase consumer knowledge and therefore options with respect to service providers. In turn, the competition should result in lower prices. If lenders, as a result of the rule, use more affiliated service providers, it undermines CFPB's purpose for imposing the rule and thus is irrational, arbitrary and capricious. The point of the IRFA is to avoid such results.

[61] *Id.* at 646.

[62] *Id.*

[63] SBAR Panel Final Report, *supra* note 43, at 35, 77.

[64] *Id.* at 77.

[65] SBAR Panel Final Report, *supra* note 43, at 60.

[66] *Id.*

[67] *Id.* at 647-48.

[68] *Id.* at 648.

a greater effort to ascertain the economic consequences to settlement agents, almost all of whom are small businesses.

The other alternative approach, assigning the responsibility of providing the Closing Disclosure jointly to both the creditor and settlement agent (Alternative 2), will require some coordination. Under Alternative 2, the TILA-required information will be prepared by the lender and the RESPA-required information will be prepared by the settlement agent. Lenders and settlement agents currently coordinate in the closing process so the coordination process may just need to be changed due to the new forms and timing requirement, which may entail additional costs.[69] However, since the liability for disclosing settlement cost information has been shifted the lender, it is unclear how the lender will choose to coordinate the settlement process with the settlement agent. Finally, CFPB made no estimate of the potential cost changes that might be incurred as the result of Alternative 2.

2. Cost Estimates

Compliance costs include both upfront one-time costs and ongoing costs of compliance. The CFPB has attributed the compliance costs for the TILA-RESPA Rule to the revisions of software, compliance systems (which may or may not be software), production of new forms, and training of employees.[70]

To estimate the one-time costs to revise software and compliance systems, the CFPB looked at the costs involved with the revisions to both the integrated Loan Estimate and the Closing Disclosure.[71] The CFPB estimates the one-time costs of complying with the Proposed Rule will be approximately $100.1 million.[72]

In the mortgage industry, lenders either: 1) develop and maintain their own compliance software and systems; or 2) rely on outside vendors to provide compliance software and systems. Based on industry feedback, the CFPB believes that most larger creditors, those in the top 20 in mortgage origination volume, develop and maintain their own compliance software and systems.[73] The CFPB estimates that only 5 percent of the rest of the industry (which the CFPB refers to as "smaller creditors")[74] maintain their own compliance software and systems. Although the CFPB estimates that the vendors that provide software and compliance systems will need to spend approximately $500,000 to $2 million to design and update the software,[75] the

[69] *Id.*
[70] *Id.* at 577, 581.
[71] *Id.* at 578.
[72] *Id.* at 581.
[73] *Id.* at 579.
[74] For the purposes of their analysis, CFPB treats all creditors outside the top 20 the same. *Id.* The proposed rule does not provide any information on the amount (raw numbers or percentage) or dollar volume of mortgage originations for the top 20 mortgage originators versus the rest of the market, the smaller creditors. CFPB should provide this information to the public and industry because it may show that significant costs may be imposed on a sliver of the industry. This information should be reasonably available from industry sources, including the two government-owned mortgage securitizers—Fannie Mae and Freddie Mac. Further information also would be available from call reports provided to banking regulators. CFPB should mine these sources for appropriate data.
[75] The CFPB makes no estimate of the impact on these vendors even though some may be small and unable to absorb the costs without passing them on to their lender customers.

CFPB believes the cost of the software updates will likely be a part of regular annual updates.[76] Thus, under CFPB's analysis, the 95 percent of smaller creditors that rely on vendors will not incur the direct costs of the software upgrades. It seems logical to assume that the vendors may recover costs by raising prices, although CFPB states that it does not believe that will happen based upon their discussion with a leading technology provider, presumably a large business.[77]

Nevertheless, under CFPB's analysis, the creditors that maintain their own software systems, the remaining 5 percent (718 smaller creditors) will incur significant costs, $100,000 per creditor, to update their systems.[78] The total one-time cost for that group of smaller creditors is $71.8 million.[79] The compliance costs for the small businesses, which are a subset of the aforementioned smaller creditors, are $49 million or $100,000 per small business.[80]

Currently, the initial disclosures and the HUD-1 Settlement Statement are issued by different parties using different software systems. The CFPB believes that the vast majority of small originators use software services provided by two major vendors to produce the initial disclosures, and settlement agents use software provided by a small group of vendors to produce the closing disclosures.[81] Given CFPB's proposal that lenders provide the Closing Disclosure, it only analyzes the costs to lenders.

However, the other alternative, having someone other than lenders provide the Closing Disclosure, may impose costs on those parties. CFPB asserts that if settlement agents incurred the costs, the costs would likely be similar to those of creditors without providing data to support that assessment.[82] However, the settlement service providers that participated in the SBAR panel process stated in their written comments to CFPB Director Cordray that:

> [S]ince most software system providers recently absorbed the costs of the 2008 RESPA changes to their software, many have informed their customers that they will have to pass on these costs to the customer. For small businesses and other subscribers this cost increase . . . will likely run into the thousands of dollars based upon current estimates.[83]

---

[76] Proposed Rule at 579.

[77] *Id.*

[78] *Id.* at 580. CFPB estimates that for the most recent year for which complete data is available, there were 14,354 creditors (banks, savings institutions, credit union, and mortgage companies) outside of the top 20 that originated mortgages. *Id.* The number of affected smaller creditors is therefore 14,354*.05=718 creditors. The use of the term "smaller creditor" is not synonymous with the CFPB's definition of a small business that lends to consumers for purposes of purchasing real estate. In fact, some smaller creditors may be very large businesses but do not have a significant presence in the residential mortgage markets.

[79] Proposed Rule at 580.

[80] *Id.* at 638. According to CFPB's estimate of the affected small entities, there were 9,807 small creditors (4,087 commercial banks and savings institutions, 3,441 credit unions, and 2,282 mortgage companies). *Id.* at 630. The number of affected small creditors is therefore 9,807*.05=490 small creditors.

[81] *Id.* at 578 n.202. Nevertheless, these are suppositions and not an examination of the vendor market.

[82] *Id.* at 578. However, the CFPB requests comment on whether this assumption is accurate and whether settlements agents and mortgage brokers' costs would be different.

[83] SBAR Panel Final Report, *supra* note 43, at 58.

Based on the settlement service agents' comments to CFPB, it appears that the agency's assertion that settlement service agents' costs would "likely be similar" to those born by creditors is incorrect. The SERs from the settlement services industry also estimated that it will cost each software provider between $1.5 and $2 million to upgrade the software and require at least 18 months of testing.[84] Furthermore, they estimated that the implementing the changes will: cost as much as $800 per employee for up-front implementation and training costs; cost $2,360 to train lenders, realtors and other customers; increase yearly software maintenance fees by 20 percent; and decrease annual revenue by 20 percent due to lost productivity.[85] They also estimated that their employees would need two days of training.[86]

CFPB also estimated that the one-time costs associated with training employees to use the new forms and any new compliance software and systems is $8.3 million.[87] The agency estimates that small businesses will incur $2 million of those one-time costs.[88] To calculate these costs, the CFPB estimated that each loan officer or other loan originator will need to receive two hours training, and that one trainer could train 10 loan officers at a time.[89] As just noted, it is unclear if the CFPB training time estimate, two hours per loan officer or originator, is accurate. Given the costs identified or potentially imposed by the Proposed Rule, compliance with § 603 of the RFA requires CFPB to examine less burdensome alternatives.

3. Alternatives and SBAR Panel Report

Examination of alternatives that will lessen the burdens that the proposed rule will impose on small businesses is a key component of an IRFA. In the Proposed Rule, the CFPB notes that it made publicly available and presented the SERs with "an outline of the proposals then under consideration and the alternatives considered."[90] However, considering alternatives does not merely mean just considering different options; in an IRFA, the agency is required to describe "any significant alternatives to the proposed rule which accomplish the stated objectives of the applicable statutes and ***which minimize any significant economic impact of the proposed rule on small entities***."[91] The IRFA does discuss some alternatives,[92] but there is scant analysis on how the alternatives may reduce the economic impact of the TILA-RESPA Rule.[93] Instead, the CFPB punts and requests further comment on the alternatives. Furthermore, many of the items that CFPB describes as alternatives are really common-sense suggestions, for example testing the prototype disclosure forms on actual loans, which would improve the Proposed Rule and disclosure forms. Many of these suggestions were made by the SERs that participated in the SBAR panel process but are not necessarily designed to lessen burdens on small businesses.

---

[84] *Id.*
[85] *Id.* at 55.
[86] *Id.* at 62.
[87] Proposed Rule at 581.
[88] *Id.* at 639.
[89] *Id.* at 581.
[90] *Id.* at 48.
[91] 5 U.S.C. § 603.
[92] Proposed Rule at 661-69.
[93] For example, on page 647 of the Proposed Rule, the CFPB states that "[t]he most useful way to consider . . . alternatives, therefore, is to consider their respective costs." However, in considering the two alternatives for which entity will be responsible for providing the Closing Disclosure to consumers, the CFPB provides no cost information. It just provides a very cursory explanation of how the duties of the different entities may be affected.

The alternatives that CFPB describes are: 1) implementing a longer phase-in for compliance in order to upgrade software and systems and train staff; 2) improving the prototype forms by testing them on actual loan transactions;[94] 3) providing standard forms and clearer guidance;[95] 4) exempting transactions subject to the rule from the total interest percentage and average cost of funds disclosure; 5) using line numbers in the Closing Statement to reduce the cost of software upgrades; 6) providing additional guidance or revised language on the signature block for the consumer to acknowledge receipt of the closing disclosure; 7) adding additional specific items in the definition of loan application; 8) considering alternatives to expanding the application of the zero percent tolerance; 9) including a list of permitted changes after provision of the Closing Disclosure to mitigate the impact of the requirement for providing the Closing Disclosure three business days before closing; 10) exempting small entities from the electronic data retention requirements; and 11) excluding escrowed taxes and insurance from the more inclusive finance charge, unless those amounts would other be considered finance charges.[96]

While the CFPB incorporated some of the information that the SERs provided to the agency in the Proposed Rule, information that speaks directly to the potential for certain alternatives to lessen the burden on small businesses, is conspicuously left out of the analysis of alternatives. The SBAR Panel report included this information in its findings and recommendations. The SERs generally were supportive of CFPB's efforts to integrate the disclosure forms; however, they were concerned with the one-time software upgrade and training costs and asked CFPB to consider providing a longer phase-in period to allow small businesses time to make the changes required under the TILA-RESPA Rule.

The SBAR Panel recommended that CFPB provide small entities enough time to upgrade systems and train staff.[97] Based on the SERs recent experience upgrading software and training their employees due to changes to the GFE and HUD-1 forms in 2010, they were able to provide CFPB with information on the amount of time they will need to comply with the TILA-RESPA Rule. SERs were generally unanimous in recommending that they need 12 to 18 months to come into compliance with the new TILA-RESPA Rule after it is finalized.[98]

Several SERs also noted that the removal of line numbers, which exist in the current settlement statement, from the integrated Closing Disclosure will significantly increase the cost of software upgrades. "These changes of location or numerical reference cause significant system programming issues and are one of the largest drivers of software development costs and

---

[94] The design and comprehensibility of the disclosure forms were tested through one-on-one interviews with consumers and industry stakeholders, but the forms have not been beta-tested using real loans. Consumers have diverse needs and there are a variety of loan products in today's mortgage market to satisfy them. It would benefit both consumers and lenders if the disclosure forms were tested on real loans to ensure that they work with the loan products available in the marketplace.

[95] CFPB discusses the use of standard forms for mortgage loan transactions subject to RESPA but model forms for transactions only subject to TILA. Proposed Rule at 663. This is consistent with the provisions of the TILA statute. *Id.*

[96] The CFPB has proposed a revised definition that incorporates this suggestion. *Id.* at 669.

[97] *Id.* at 27. The CFPB has solicited comment on the compliance period.

[98] *Id.* at 39, 46, 48, 58, 70, 78.

implementation time."[99] The SBAR Panel recommended that CFPB solicit comment on this issue.[100] The CFPB is examining and soliciting comment on whether an alternative design or numbering format will impose a lower amount of software-related costs on small entities.[101]

SERs also raised concerns about the potential unintended consequences of changing the current 10 percent tolerance applied to affiliate fees and fees charged by lender-selected providers to a zero-percent tolerance.[102] The SBAR Panel recommended that CFPB consider alternatives to expanding application of the zero-percent tolerance and solicit comment on whether the current tolerances have improved the reliability of estimates that lenders provide to consumers.[103]

The section of the IRFA on alternatives includes very little discussion of how the alternatives may reduce economic burdens on small businesses. Moreover, many of the alternatives that the CFPB presents are not true alternatives. They are really common-sense suggestions on how to improve the quality of the Proposed Rule. To fully examine the merits of proposed alternatives, the CFPB should review the SBAR Panel Report's findings and do further analysis and research.

IV. Conclusion

The RFA requires agencies to assess the economic impact of their proposed and final rules on small entities and consider less burdensome alternatives. In promulgating the TILA-RESPA Rule, the CFPB has complied with the RFA insofar as it has convened a SBAR Panel and completed an IRFA. However, there appear to be holes in some of the agency's assessments of impacts and costs to small entities. This is critical because identifying impacts and costs informs the process for developing and assessing alternatives.

Small businesses are hopeful that the TILA-RESPA Rule is beneficial to consumers, is cost effective, and does not cause major disruptions to the mortgage industry. However, while the analysis done by the CFPB may be strictly in compliance with the law, it leaves something to be desired in its compliance with the spirit of the RFA. Given the significant potential consequences on a multi-trillion dollar industry, it behooves the CFPB to do more in ensuring that it has complied with the RFA.

---

[99] SBAR Panel Final Report, *supra* note 43, at 58.
[100] *Id.* at 28. The CFPB is soliciting comment on whether numbering or an alternative design may reduce the costs associated with software changes. Proposed Rule at 664-65.
[101] Proposed Rule at 665. It seems that CFPB could explore this alternative by contacting the major software providers to gain an understanding of the programming challenges involved with removing the current RESPA settlement statement line numbers and how that may drive up the cost and time involved in making changes.
[102] SBAR Panel Final Report, *supra* note 43, at 29.
[103] *Id.*