Thursday, March 27, 2008

Board of Governors of the Federal Reserve System
Ben S. Bernanke
Donald L. Kohn
Kevin M. Warsh
Randall S. Kroszner
Frederic S. Mishkin

Proposed Rule Amending Regulation Z

Gentlemen,

My name is Tim Bendel and I am the owner of a small mortgage Broker operation in Minnesota called Five Star Financial Services, Inc., which I have owned and operated since January of 1997.

Minnesota mortgage Brokers and state chartered banks are regulated by the Minnesota Department of Commerce (DOC). Mortgage Brokers are licensed as companies (not as individual originators) and they must insure all originators complete 15 hours of compliance education and a criminal background check prior to employment and any origination activities. Mortgage Brokers operate under chapter 58 in Minnesota law. Mortgage Bankers operate under chapter 50.

The MMA supports the goal of the Federal Reserve in it's efforts to clarify disclosure and set up a fair, uncomplicated system for consumers to shop, understand, and complete a fair and equitable mortgage transaction in the marketplace. We do not however support the curtailment or elimination of premium compensation based on the terms and structure of the mortgage, which is proposed in the current rule amending Regulation Z.

Mortgage Brokers currently disclose (YSP/SRP) compensation on the Good Faith Estimate (GFE) at the time of origination and again at the closing on the HUD-1 settlement statement. Bankers (or anyone using their own funds to close and fund a mortgage transaction) are not required to disclose their compensation on the back side of the loan in any way; although we all know that these instruments have a value to the Lender when they are sold.

Yield Spead Premium is a critical element in structuring loans, as well as profitablity for Brokers and in fact the entire industry. Let me suggest some examples:

Yield Spread Premium (YSP) is a fee paid to mortgage Brokers by a mortgage Lender, based on several lending factors as they relate to the value of the mortgage note (instrument). YSP is a significant and important factor in lending. YSP provides profit; coverage for FNMA/FHLMC and Lender delivery fees, as well as loan "structure" opportunities for both borrower(s) and Broker(s), an example would be a "no closing cost" loan.

Mortgage Broker Profit

Brokers have many issues to contend with in their businesses. These include but are not limited to: data encryption, data security, and data privacy with regard to personal data, as well as compliance with a myriad of state, federal, and in some cases local laws. Additionally, there are costs such as licensing, bonding, net worth, employee benefits, taxes and the list goes on. YSP is a critical factor in the bottom line for mortgage Brokers just as SRP (service release premium) or GOS (gain on sale) are to the banking community when they are originating loans to the public. I estimate that the removal of YSP from the Broker channel would reduce operating revenue to mortgage Brokers by approximately 40-50%, maybe more.

Delivery Fees to FNMA/FHLMC

When a borrower goes to a mortgage Broker and applies for a loan, most people don't realize the many nuances there are in lending today. Almost every situation is unique and has its own parameters, just as the financial "profile" of borrower(s) varies widely. Each loan in today's market is a "snowflake". When borrowers want to get cash out on a refinance, 100% LTV financing (zero down payment/equity), or purchase an investment property, FNMA/FHLMC has set pricing to try to access the "risk" of that particular type of loan. The fee to compensate FNMA/FHLMC for this feature is called a "delivery fee". These delivery fees are charged by FNMA/FHLMC to the Lenders/Banks that fund loans (and passed on to Brokers) and package and sell them to FNMA/FHLMC. There are many situations in which these fees are levied, more than I listed above. Following, find an example of YSP used to offset the delivery fee for a zero down loan.

A mortgage Broker has a rate on a 30 year fixed FNMA loan at a rate of 5.75% that pays the Broker a profit of .655% YSP (this is .655% of the loan amount). But this particular borrower wants to do a zero down payment 100% LTV (loan to value) loan. FNMA has a "product" for this type of situation called "My Community". The My Community 100% LTV loan carries a 2.000% FNMA "delivery fee". This would "wipe out" the Broker's profit margin on this loan "and" still leave 1.345% fee unaccounted for, or to be passed on to the borrower(s). The Broker will normally look up the rate sheet to a higher interest rate that pays a larger YSP. In this example let's say an interest rate of 6.375% pays 2.750%, then we subtract the 2.000% delivery fee for the product. This leaves .750% YSP as a profit to the Broker, and saves the borrower(s) from having to shell out an additional 1.345% fee to close on this transaction. On a $200,000.00 house purchase, 1.345% is $2,690.00. This is designed for borrowers looking to get into a home but they just don't have the cash to put down, however, they do qualify (from an income perspective) to afford the payment.

Loan Structure Options

Another way mortgage Brokers (and banks for that matter) use YSP is to structure costs/options for borrowers. Let's say a borrower has a $300,000.00 home and has a mortgage balance of $240,000.00 with a current interest rate of 7.250% with 27 years left to pay. If this borrower does a typical refi and rolls in the approximately 2.75% closing costs ($6,600.00), they will have an 82.2% (LTV) loan to value percentage ratio on this transaction, which is greater than 80%; thus, triggering the need for mortgage insurance which is an additional monthly cost to the borrower(s). Let's use the same 5.750% rate with a YSP of .655%. This Lender will pay a YSP of 3.375% at a rate of 6.625%. The Broker will use 2.750% of the YSP to pay al the costs of the refinance, title, MRT, appraisal, underwriting, recording, survey, plat, etc, as well as his own normal Broker fees. The borrower has no costs, a higher rate, but no mortgage insurance and no "payback" for the costs as they are free, old rate 7.25% new rate 6.625%. YSP is a very useful, in fact, critical tool for both mortgage Brokers as well as borrowers. Did I remember to say that banks use this tool too? It just has a different name and they don't have to disclose what the value (of the Gain on Sale, GOS, or Service Release Premium, SRP) is to the borrower(s).

As you can see, the removal or restriction of YSP in the mortgage Broker community will put Brokers at a competative disadvantage to their bank counter parts. This will also upset the competative balance of banks and Brokers in the Cities and Towns across Minnesota, as well as America.

It is also my opinion that while consumers have a wide variety of choices in both product as well as puyveyors, including but not limited to Brokers, Bankers, Lending Institutions, Credit Unions, even Wall Street Firms. In this area, Brokers are treated differently than their counterparts based on the differences in "funding" loans, not the "origination" function of loans, this is what the consumer sees, is involved in, and many times confused by. Consumers are not able to understand why Brokers disclose YSP and other channels do not. In fact, many seek to confuse this issue by simply saying that Brokers are a rip off and YSP is an illegal kickback. Why are the Brokers being singled out so as not to benefit from the (YSP) value created when they originate loans? Not letting the Broker community participate in this revenue is detrimental to their small business, and sets up an unfair and uneven playing field on main street of America. Why not have all originators disclose the profit on the "backside" of the tranaction, whether it is actual or estimated, at time of origination? Mortgage Brokers have originated an estimated 60% of the loans in America and they have attained that market share honestly and fairly, by being the overall low cost channel of distribution throughout the industry.

Disclosure, while it is a cornerstone of fair dealing and best business practices, and we agree on the benefits to the consumer of early disclosure, it is imperative that we as Brokers and Lenders have all the data required to make an accurate disclosure to the borrower(s). It is unreasonable to expect an accurate disclosure of fees prior to knowing the loan amount and product or Lender, as these vary by institution and we as Brokers work with several institutions, not just one. In Minnesota, we have a "mortgage registration tax" that is calculated based on the loan amount. The origination fee, discount points and title insurance are also calculated based on the loan amount. Mortgage Lenders and Brokers must know the loan amount and terms of the loan in order to make a fair and accurate fee disclosure. We must communicate and consult with the borrower(s) to discover exactly what they seek to acomplish with their transaction. Repeated and changing diclosures throughout the process can only lead to furthur confusion in an already complicated and paper intensive transaction.

Lastly, I wish to suggest to the Federal Resrve that it consider an "all originator" approach to any and all regulation of our industry. If a depository bank wants to sell insurance or securities, does that institution need the appropriate licensing and training and education for its employees to participate in that business? The mortgage transaction is an area of expertise, and proper consultation to discover a best choice for the consumer is critical. Why sell this idea short and only ask Brokers to act in a professional manner? As we have seen, and likely will continue to see, by our current mortgage lending issues and problems, everybody involved from Wall Street to Main Street needs to be better educated and deal with more transparency for the benefit of all concerned.

Mortgage Brokers currently abide by a miriad of state and federal laws with regard to disclosure, cost and fee limitations, fair lending, and best business practices. We at the MMA, as well as NAMB, also adhere to a strict code of ethics for our membership. In Minnesota, Mortgage Brokers have an agency relationship with borrowers and a fee cap of total compensation that may not exceed 5.0% of the loan amount.

Please feel free to contact me with any questions or concerns that you may have with regard to my examples, or even just a general nature. Cell (612) 327-5325
Work (952) 906-0022 xt 202

Thank you for considering my comments on this very critical issue.

Sincerely,

Timothy T Bendel

Timothy T. Bendel
President, MMS