should identify “Docket No. R-1305” in the subject line

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Comment:
I am writing to express my support and reservations about the rule proposed by the Board to amend Regulation Z, which implements the Truth in Lending Act and Home Ownership and Equity Protection Act.

It is a laudable goal to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices. While doing so, the Fed also states that it intends to preserve responsible lending and sustainable homeownership. Clearly, the Fed recognizes that there is tension between its goals.

Since I agree with certain parts of the proposed rule, albeit with some reservation, in the interest of brevity, I will limit my comments to the parts where I believe the Fed has erred. Those two areas are the proposed disclosure of mortgage broker fees and the trigger for higher-priced loans.

On the surface, the Fed’s prohibition against a lender paying more to a mortgage broker than the borrower agreed to allow the broker to be paid seems harmless although of questionable value. The entire basis for this concept is that a broker who did not present a rate, program and fees to the borrower at application would be influenced to “find” a loan that would result in the highest payment for the broker. Of course, the Fed has no idea what percentage of mortgage brokers present themselves to borrowers as merely “finders” rather than offering choice of products. Most brokers believe it is a small minority and no one knows for certain the practice’s prevalence. The Fed admits it has anecdotal evidence, at best. There has been no clear evidence that borrowers who claim the broker “marked up” the rate would have received a better rate or program had lender compensation been fixed at the onset. Usually, such claims are based only on comparing credit scores, which is highly misleading. The Fed bases it prohibition on many faulty assumptions that I will proceed to enumerate.

The rule reveals a bias in the Fed that clearly is tilted against mortgage brokers. It cannot be overlooked that the Fed is very closely connected to commercial banks while no parallel relationship exists between the Fed and mortgage brokers. Had these banks purposely written certain portions of this rule to promote their business at the expense of mortgage brokers and used the Fed as their vehicle, the difference between their methods and the Fed’s would not be readily apparent. Bank subsidiaries that essentially broker loans under the guise of using “a bona fide warehouse line of credit” are exempt from all of the negative aspects of the rule directed at mortgage brokers. They are exempt from all of 226.36(a) Creditor payments to mortgage brokers. These regulations are quite onerous and will have a chilling effect on the business of mortgage brokers.

To accomplish a distinction without a difference, the Fed is forced to redefine the term Creditor and define mortgage broker to include anyone who does not use "a bona fide warehouse line of credit." This, of course excludes bank subsidiaries that are extended such a line from the bank. The rationale is that RESPA's regulations look to the "real" source of funds. Supposedly, funds given to the broker by the ultimate lender are not the "real" source although entities using a warehouse line are often funded the same day by the "real source of funds." This is a myth that HUD's general counsel, who was known to be impetuous, created in what appears to be another attempt to weaken mortgage brokers. The Fed willingly follows the myth, accepting implausible explanations as to why these favored entities cannot disclose in the same fashion that the Fed would impose on mortgage brokers. This is particularly questionable since TILA is not subject to the same settlement cutoff that applies to RESPA.

The rule proposes to create a distinct new agreement, not merely a disclosure, that would force the mortgage broker to enter into a contract with the borrower stating precisely how much the broker would receive as a dollar amount. This approach conflicts with state laws and the new RESPA rule that allow the fee to vary according to the loan amount. The net result would be all brokers would certainly disclose the maximum they could possibly make. Since it is a contract, the borrower would be responsible for paying it, even if a state law conflicts since the rule purports to preempt state law where it conflicts. The effect on the various state laws regulating broker fees and broker agreements would be very consequential. Brokers are prohibited in some states from offering specific terms, locks and commitments. The Fed has not counseled with the various states nor has it extensively researched how this rule would conflict with the various states' laws.

The Fed reveals that it does not recognize that the broker provides goods, services and facilities by the sentence, "Thus, consumers potentially benefit from having an option to pay brokers for their services indirectly by accepting a higher interest rate." This presumes that the broker only provides services while the Fed thinks that lender branches provide goods, facilities and services. Since the broker effectively provides the exact same goods, service, facilities as the lender branch, but at a lower cost to the lender, the Fed errs in its presumption. It also errs in stating that the borrower pays the broker indirectly by accepting a higher rate. Make no mistake, the lender is paying the broker, merely hoping to recover what the lender paid to originate the loan through the servicing revenue stream. That stream has three components, the rate, fees and cost, and the duration of the servicing stream. What the Fed has missed is that it only recognizes rate which is only one independent variable in the mathematical function. If the independent variable of duration is very small, the lender will never recoup what it paid the broker. The lender cannot go back to the borrower, unless they charge a prepayment penalty, to pay what the Fed says the borrower agreed to pay the broker. In reality, the borrower never agreed to pay the broker, not even when a Yield-Spread Premium exists; the lender did.

Another basis for the Fed's broker agreement is "…creditor payments to a mortgage broker can influence the broker to offer certain loan products or terms to the consumer that are not in the consumer's interest." It is strange that the rule uses doubletalk when it purports to bring honesty to the mortgage industry. In the preceding item, the borrower has agreed to pay the broker fee even if the lender advanced it. Now, when it fits the Fed's argument of the moment, it is a "creditor payment." This almost presumes that the creditor is paying the broker to bring them loans that are not good for the borrower. That is a highly subjective statement. We do not lack for disclosures of the terms and descriptions of loan products both at the federal and state level. If certain borrowers cannot understand these disclosures as to the terms and rate of their mortgage, why should one suspect that they will understand the far more complex topic of how broker fees and projected loan servicing revenue will impact those terms? Doesn't the borrower have the ultimate choice of what terms and product fit their needs? If the borrower cannot understand the loan product, no amount of disclosure will change that. Counseling may help but it comes with its own set of negatives such as cost and time consumption. Counseling is only as effective as the education level and capacity of the borrower. As with most of this section of the proposed rule, this has been foisted on mortgage brokers only. We know that lenders and their employed loan officers are just as likely to offer higher rates and similar terms to mortgage brokers. There is no such contract required of lenders or their loan officers. How soon we forget that HFC and Ameriquest were not mortgage brokers.

The "Agreement" is stacked against brokers and in favor of lenders. Lenders can change what they are making with no contract. Brokers are forced to limit their profits. Lenders may take advantage of any market movement in their favor to make more profit. Brokers are prohibited from doing so. The Fed reasons that borrowers should always reap the benefit of market movement. If so, why mandate that only for brokers? Shouldn't lenders have to tell borrowers how much profit they intend to make if they sell the loan within six months and refund the excess profit if the market moves in their favor? One must also question why borrowers are more favored than brokers. Why should the borrower benefit from market movement rather than the broker? The borrower is allowed to gain at the expense of the broker. Both are people and citizens of this country and should be treated equally under the law. Many brokers offer borrowers discounted rates and absorb the loss if the market moves against them and make a gain if the market moves in their favor. I can understand why borrowers would be unhappy if they chose to float based on a particular index and either a broker or a lender changed the margin to only benefit themselves. That can easily be rectified by tying borrowers to a particular index upon entering into a "float" agreement. Both lenders and brokers would be affected equally and borrowers would be protected.

Again, in the same paragraph, the Fed delves into the area of subjectivity. They accuse brokers of providing loans that "…are not the most favorable the consumer otherwise could obtain." While we have heard many accusations that borrowers were provided "subprime" loans who could have qualified for a "prime" loan, when one investigates these claims, they usually are not as presented. Many borrowers did not want the rigors of applying for a prime loan. Others had speed as a prime consideration. Still others could not adequately document either income or assets. There is no lack of mortgage originators in the United States. It is a highly competitive business that regularly claims casualties due to the slim profit margins. One only need open the Yellow Pages in any town or city and find hundreds of listings for mortgage companies. Shouldn't the borrower bear some responsibility for shopping for their loan? Research shows that they do despite what the Fed seems to think. No one offers the best loan program the borrower could obtain. There is undoubtedly someone, somewhere, who had better terms. Again, this impossible task is directed only at mortgage brokers and not lenders or their loan officers.

When one realizes that the lender is actually paying the broker for goods, facilities and services similar to a lender branch, much of the substance of 36(a) becomes implausible. Item (ii) is based in a faulty understanding of who pays the broker as outlined in the preceding paragraphs. We now know that the statement "…because the creditor recovers such payments through a higher interest rate" is often not true.
Item (iii) is also faulty in logic. It is based on subjectivity and innuendo as noted above. It creates a standard impossible to achieve and doesn't impose it on lenders.

This "agreement" is the cornerstone of the Fed's rule for brokers. However, there is more than its flawed logic, suppositions and unlevel treatment of mortgage brokers. It is illogical in its timing and requirements. The broker is supposed to enter into this agreement before the broker knows anything about the borrower. There is no knowledge of how much work the broker will have to perform or what loan product the borrower qualifies for. It would be like the government creating a new agency with vaguely defined tasks and giving it a budget that could not be modified. An astute director of such an agency would ask for the largest possible budget lest he or she would fall short. The same is true of any rational mortgage broker. The contract would by necessity have to be high enough to cover the loan officer's commission and staff salaries and still net a profit. Rather than lowering costs, it seems most likely the contract would raise fees. Various state regulations conflict with the concept of a "total fee" where lender compensation is balanced against borrower compensation. Most states recognize only what the borrower pays as the broker fee. That fee may not float or be balanced against what the broker receives from the lender. Unless the Fed regulates that lenders may not change their compensation to the broker for any reason, the broker is caught in a virtual squeeze of federal and state regulation.

The presumption of the agreement is that the borrower will suddenly see how much the broker is being paid by the lender and demand a lower rate. That conjecture assumes that the broker is making too much on the loan and that they can afford to work for less. If the Fed had evidence that brokers are becoming wealthy, they could have a logical argument. But, like most of this rule, it is based on supposition, accusations and little research. The life span of the average brokerage is less than five years because the profit does not justify the workload and the extreme competition keeps it that way. We do see owners of large lenders becoming very rich but this rule is not directed at them.

By freezing broker compensation, the broker has no incentive to negotiate better rates or programs. The compensation is already in place so why work harder to get the borrower a better rate or program? As the Fed admits proudly "§ 226.36(a) would limit creditor payments to mortgage brokers to an amount the broker had agreed with the consumer in advance—before the broker could know what rate the consumer would qualify for—." Supposedly, this is to protect borrowers who have no ability or will to shop. This agreement is meaningless to such borrowers because they only care if they are getting the loan, the amount they need, the payment they can afford and proceeds they anticipated. For borrowers who are well qualified, the Fed admits that they are not the intended target of these protections nor do they need them

Since the agreement under 226.36(a) is entered into prior to the disclosure of a rate or program, it would be the basis for how the borrower shops. The Fed, again working on conjecture, believes that the broker who agrees to earn the least is the best choice. Even being gentle, that is patently nonsense. Different lenders pay differing amounts to brokers for the same programs. What one lender considers to be an acceptable payment to support a branch or broker may be very different than what another lender is willing to pay. Depending on what broker agreements the broker may have, the lender payments for an identical program could vary significantly. I can give an exact example as of April 3, 2008. Many of our lenders offer an FHA three-year adjustable-rate mortgage at 5.5% costing us 1.75%. One of our investors we think portfolios them rather than selling them to Ginnie Mae and their rate is 5.5% paying us 1.018%. If a borrower shopped at a broker who did not have that second investor, they could present an agreement receiving only 1.25% while we may present an agreement showing that we would receive 2%. However, on a $300,000 loan, the borrower would pay fees of $9,000 under broker #1 and less than $3,000 with us. If this is the type of scenario that the Fed is promoting, it is hardly in the best interest of the borrower.

There seems to be a syndrome that resents brokerss earning a fair wage. The focus has begun to rest on what the broker is being paid by the lender. It is automatically assumed that the broker is overcharging and the borrower is better prepared when they make a thorough search of what brokers are making. If one considers the logic under girding such broker disclosure, it is obviously mistaken. I recently had a fairly sophisticated individual hand me the benefit brochure for working at a major bank. The brochure said employees would pay no appraisal fee, no origination fee and no points. He said "That's really good isn't it?" My response was "What is the interest rate and what are the settlement costs?" He said "Oh, I guess I didn't think about that." He had been misled into focusing on things that matter much more to him than lender compensation to a broker but he had missed the most important elements of the loan by having his focus diverted. This is precisely what the Fed is proposing to do.

Perhaps the most prominent feature of this rule is to divert the focus of the borrower to what the mortgage broker is being paid and make it contractually binding immediately. The Fed reasons that if the borrower sees how much the broker is making more prominently, competition would force the broker to make less. A properly designed disclosure would focus on interest rate and fees and the loan program so the borrower can actually use competition correctly. The Fed's form of disclosure intrinsically drives borrowers to lenders who have no such disclosure and agreement even when the lender's interest rate and fees are higher and the program less desirable. The Fed has lenders and brokers competing in the wrong area. The Fed is sophisticated enough to realize that what the broker is being paid by the lender is not an accurate gauge of rate, fees and the appropriateness of the loan program. This entire portion of the rule is merely a red herring that cause borrowers to come to wrong conclusions.

Even the timing of the broker-only disclosure will harm borrowers. The disclosure is made before a loan program is selected, an interest rate is locked and settlement costs are known. Therefore, the broker fee is taken totally out of the context of the loan. There is no way that the borrower can gauge the validity of the fee. They can only judge the credentials of the broker and how much the broker is making. Neither of these may produce the best, or even the best-priced, loan program. When a program has been established and a rate lock with fees is available, then the borrower can be reasonably assured what they really have. Of course, when a rate lock with fees is being presented, the Fed admits in its comments that what the broker is making becomes irrelevant.

If the Fed wants to make proper reforms, the present Truth-in-Lending disclosure would be completely revised and disclosures based on the Federal Trade Commission's extensive studies would be developed. Instead, the Fed is proposing an embarrassingly uninformed set of revisions for brokers that will mislead consumers. That is hardly what the Fed intends.

The Fed states "The goals of the amendments are to protect consumers in the mortgage market from unfair, abusive, or
deceptive lending…" I cannot believe that the Fed would require an agreement that would ultimately lead to borrowers being deceived. This section of the rule is neither balanced nor does it provide less deceptive lending. The Fed admits to the limits of disclosure. It knows that most borrowers need less complex disclosures and agreements. That is not the case here. The Fed also admits that it is working on anecdotal evidence. The Fed should not allow itself to be bullied into inappropriate rule making that will actually harm borrowers more than help them.

I shall now move on to the second major item of disagreement, the establishment of thresholds for "higher cost" loans.

Fortunately, this section does seem to treat brokers and lenders somewhat equally. I understand the Fed's concern that an unacceptable number of loans have become unaffordable. The blame for this has been far-ranging, even including former Fed Chairman Alan Greenspan. Many factors beyond the control of lending or the Fed create unaffordable lending. General economics and public sentiment also play a significant part.

There certainly is merit to consideration of whether a loan is affordable at its onset. This must be carefully weighed when the property is to be the individual's primary residence.

Speculation should always have a place in transactions that do not involve the borrower's primary residence and it appears the Fed has wisely recognized this. Part of the Fed's approach to this problem is setting thresholds for "higher-priced" loans. These are not the type of loans previously only covered by HOEPA. The loans covered in this category are numerous as I shall explain.

The rule proposed sets the threshold for higher-priced loans at three percent above the comparable Treasury Security. Second liens are marked at five percent. This is a particularly unfortunate index because it does not have a direct correlation to mortgage interest rates. Often, the Treasurys move inversely to mortgage-backed securities.

Such a crude choice of index will undoubtedly create artifacts that the Fed never intended. Like much of the proposed rule, the Fed seems unaware of what is currently happening in the market place. The declared design was to capture subprime loans and some Alt-A loans. Perhaps two years ago, this scheme would have been appropriate. Today, it is embarrassingly out of touch. Subprime loans barely exist. Few, if any, of the characteristics that contributed to the mortgage crisis we face today even exist. No one is giving high loan-to-value mortgages to individuals with low credit scores and certainly not without proof of income. The market selected out this practice and it is unlikely that we will ever see such a scenario again. Thus, the Fed is somewhat tilting at windmills.

With the exit of subprime and most of Alt-A, we are left mainly with Fannie Mae, Freddie Mac and FHA with a few institutional investors and banks intermingled. The GSEs have taken radical steps to offer prime rates to only a selected few borrowers who either have good scores and lots of equity or who have the very highest credit scores. The idea of subprime has apparently moved to people who would have been considered prime borrowers only a few months ago. Massive fees have been added to most of the loans intended to be sold to the GSEs. It is likely that over fifty percent of the loans being written today would fall into the "higher-priced" category. I do not believe the Fed intended to capture the majority of mortgages being made.

The Fed, again in a several year-old paradigm, assumes that the margin expected by the GSEs and others, even to their own mortgage-backed securities would remain similar; it has not. Margins, which had generally hovered around two percent, have been raised close to three percent or more. This trend endangers all loans being deemed higher-priced. This would make the distinction meaningless, something it is close to now.

The problem has been that loans distinguished as high-cost are not marketable. Judges regularly rule more harshly against such loans, assuming that the borrowers were put at a disadvantage. With a market suffering from a lack of participants, the last thing we want is to frighten more investors from the mortgage market.

I am not convinced that this is the time to greatly diminish the margins to declare a mortgage abusive or deceptive simply because this where the Fed derives its power to make such a rule. ("TILA Section 129(l)(2), which authorizes the Board to prohibit unfair or deceptive practices in connection with mortgage loans, as well as to prohibit abusive practices or practices not in the interest of the borrower in connection with refinancings. 15 U.S.C. 1639(l)(2).") A real question must arise whether the Fed is exceeding its power since it unlikely that anyone can believe that the majority of all loans today are not in the interest of the borrower.

If the Fed wants to create such a distinction beyond HEOPA, it must take steps to create an appropriate index. That could be done by creating an index based on weekly surveys of mortgage rates. Even that could be unreliable because rates vary, sometimes significantly, between various parts of the country. Perhaps a threshold of three percent above the survey average would be usable but it would not be that different from HOEPA since HOEPA is based on the previously indicated inappropriate index as well.

If the Fed truly believes the four items it intends to ban are abusive, they should not be offered. It seems the Fed sees merit in these practices but does not believe they are appropriate for everyone. I would think these prohibitions should be intensely disclosed but, if they have merit, not keep them from borrowers who may not get the very lowest rates.

I realize that the Fed has taken positions out of pressure from many sides. It is often appropriate to respond to pressure. However, I hope that the Fed is wise enough to not stand rigidly on this rule simply because it promulgated it. We all want what is best to ensure that borrowers are not abused while walking the tightrope of unnecessarily impeding the flow of mortgage funds to all who can benefit. Our economy depends on everyone, and especially federal regulators, making wise decisions. I hope the Fed will listen closely and act prudently.

Sincerely,

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