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Subject: Reg Z - Truth in Lending

Comments:

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Proposal: Regulation Z - Truth in Lending - Closed-end Mortgages
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Comments:

I understand that on August 26, 2009, you, the Federal Reserve, proposed an amendment to regulation Z. You are inviting public comment on the proposal until December 24, 2009, after which you will determine if the amendment should be adopted, altered, or withdrawn. In my opinion I do not believe this amendment will translate well into practice. Its complexity and shortcomings will lead to reduced competition, fewer consumer choices, and an increased risk of improper steering. I, Michael L. James, request that this portion of the rule be withdrawn for the reasons explained below. My concern is related to the portion of the amendment that proposes to regulate loan originator compensation by requiring compensation agreements between lenders and loan originators that will fix future compensation. It seems to me that a separate agreement would need to exist between the broker and every lender from whom the broker wishes to receive YSP. After reviewing the limited choices available to meet this requirement, I believe the most likely arrangement that would be adopted by the industry is a "flat-fee. Under this mandatory agreement, whenever any of the broker's compensation is paid through YSP, the broker is barred from concurrently collecting any origination fee from the borrower. This is not acceptable. Is it OK for you to vote for a pay increase while you promote legislation to reduce my income as a broker by more than 50%? ... I don't think so! If a broker worked with 10 funders, it could have 10 agreements all with different flat fee amounts. There is no minimum or maximum on the size of the flat fee. In practice, whenever a broker received compensation from YSP, the agreement in place with the lender offering the YSP would control the dollar amount regardless of loan amount, interest rate, type, term, or the underwriting process. Improper Steering As indicated above, the proposed rule would encourage brokers to create compensation agreements with many different lenders. There could be different "flat-fees" associated with each of these agreements. A higher flat-fee would require a greater rate bump, hence a higher rate to the consumer. The proposed plan would create an environment

where loan originators have a financial incentive to send the loan to the lender who will pay them the highest flat fee (regardless of loan product.) If not further regulated, this scenario would inevitably result in higher borrower interest rates - one of the occurrences you are trying to control. In recognition of the steering incentive the proposed rule would create, you request comment on enlarging the rule to include an anti-steering clause Under § 226.36(e)(1), a loan originator may not direct or steer a consumer to a loan to increase the amount of compensation that the originator will receive for the transaction unless the loan is in the consumer's interest." In order for me, the broker to determine if a loan is in the consumer's best interest, I would have to compare (and defensively paper-trail) the loan offered to the consumer with other possible loans that I have to offer. . To be included in this comparison, I would have to have a good faith belief the consumer was likely to qualify for the loan. To complete this process, multiple loans from multiple lenders must be compared in complex mixture of interest rate contexts § 226.36(e)(2), for each type of transaction in which the consumer has expressed an interest, the loan originator must present the consumer with at least three loans that include the loan with the lowest interest rate, the loan with the second lowest rate, and the loan with the lowest total dollar amount for discount points and origination points." If this complex interplay between mandatory compensation agreements and anti-steering language is to be adopted, I envision two outcomes - the "bad" broker will cash-in while the "good" brokers (that would be me) will be driven away. The unscrupulous broker for whom these rules continue to be devised will use compensation agreements to their advantage without too much fear of repercussions. Consumers will not have any information that a compensation agreement even exists, let alone that several other more advantageous ones also exist, and who will monitor that unscrupulous broker? The funding lenders will not know what other compensation agreements the broker may have with other lenders. So you cannot have them police and theoretically they cannot be later indicted in a steering scheme. So how can this new steering regulation even be enforced? The true answer is it cannot reasonably be enforced! The Truth in Lending Act provides for three methods of enforcement: administrative agency enforcement, criminal penalties, and private civil liability, which has become the dominant mode at least as measured by the number of lawsuits. Criminal sanctions have been rarely invoked, and for the most part administrative enforcement has been sporadic. Under the proposed rule, private attorney generals who seek the attorney's fees awards allowed by Truth in Lending will attack brokers who use YSP as part of their "forensic review" process, hoping to get lucky. So your proposed rule will be enforced after-the-fact through private lawsuits. Therefore the honest brokers will become targets while the bad minority will work the unsupervised system until targeted by a civil lawsuit, at which time they will disappear. Less Competition Because our Liability will Skyrocket. The majority of us brokers who currently use YSP to our customer's advantage will find the complex process through which you require us to defend and paper-trail our loan offerings too expensive and too risky. I would like to pose this question: under the rule would it be OK for a broker to choose a lender who can fund in 10 days and who pays a higher compensation instead of a second who will take 30 days to fund but pays a few hundred dollars less? And tell me which option is going to be more important to the consumer! You are forcing us to basically dictate to the consumer what is more important for them. So if I determine the former is in "the consumer's best interest" should I risk my business to an expensive lawsuit? In practice, I will need to restrict my product offerings to my customer's disadvantage or close up shop. There will be less competition because Lenders will choose not to participate: Because of the steering opportunity created for the small minority of bad brokers, and the potential

legal actions described above and their unknown outcomes, broker originations better known as third party originations, will become less attractive to investors. This will cause increased costs for lenders who produce TPO loans. They will then need to raise prices or punitively clamp down on all their broker relationships. This clamp down will likely include substantial reductions in YSP loan offerings, resulting in less and less competition in the marketplace. The reduced competition will be further exacerbated as lenders choose to avoid a multitude of complex compensation agreements that may carry liability that will remain unknown until some sue happy private attorney general motivated by attorney fee clauses begin the process of peeling the onion. How about a better alternative Your obvious stated goal in developing your compensation related rules are "to eradicate incentives to provide consumer's loans with higher interest rates or other less favorable terms." But in the real world, your proposal will effectively do the opposite. Unscrupulous steering that cannot be monitored except through civil lawsuits will be promoted. The majority of us as brokers, who perform a tremendous service in communities sometimes where others won't visit will at best be able to offer a substantially limited product line, because we will want to avoid liability and as lenders withhold product options due to complexity, cost, and potential future liability. At worst, I as a small business owner will become a victim and have to shut down my business and collect unemployment compensation .. No wait, I'm self-employed so cannot collect unemployment compensation .. Maybe I could get job .No not likely in this poor economic climate. What is left .welfare? You get my point! You must obviously be familiar with HUD's attempt to address these same issues in Regulation X. Per your statement: "Although HUD recently adopted disclosures in Regulation X, implementing RESPA, that could enhance some consumers' understanding of mortgage broker compensation, the details of the compensation arrangements are complex and the disclosures are limited. A creditor may show the yield spread premium as a credit to the borrower that is applied to cover upfront costs, but is also permitted to add the amount of the yield spread to the total origination charges being disclosed. This would not necessarily inform the consumer that the rate has been increased by the originator and that a lower rate with a smaller origination charge was also available. In addition, the Regulation X disclosure concerning yield spread premiums would not apply to overages occurring when the loan originator is employed by the creditor. Thus, the Regulation X disclosure, while perhaps an improvement over previous rules, is not likely by itself to prevent consumers from incurring substantial injury from the practice." While I agree that it is possible that Regulation X disclosure concerning yield spread premiums would not apply to overages occurring when the loan originator is employed by the creditor. A simple solution would be to make it apply to all !! This would make all originators equally transparent to the benefit of the consumer. I do find it amazing that you seem to completely discount the multitude of testing HUD has performed to validate the impact of its new Good faith estimator consumers! HUD's approach, may not be perfect, but I feel it is more in line with our fair market system where two parties are free to negotiate in good faith. The new GFE demands that every dollar from all sources be disclosed, and that the broker declare its compensation clearly in a dollar amount. This good faith disclosure of personal compensation is well beyond that required of almost any other party to a business transaction in this country. So if the retail loan officer (employee) was required to do the same, the consumer would be armed with all available information; there could be no secret retail overages. Yet you choose to continue forward with such a complex system of multi-faceted agreements and remedies instead of giving the much simpler GFE a chance, Is there some urgent danger that the GFE cannot address? No there is

not! This emergency preemption might be understandable if there was evidence that we were today, steering consumers into the unacceptable products like those that existed a few years ago. But that is not happening - no such products even exist today. Granted, the new GFE will not insure that a loan originator will not charge an overage, but, at least in the case of the broker, it will insure the consumer sees the fee and is in an informed position to decide if the transaction in question warrants it. You have not offered any evidence that there is such a desperate need for a rule change that you cannot at the very least wait and measure the impact of the new GFE. I now request that you, the Board place this portion of the proposed rule on hold until the impact of the new GFE is known. Also, I request that in your review, you reassess the real potential for steering that this proposed rule creates. You should also be concerned about the negative impacts that would flow from enforcement through civil liability. Sincerely, Michael L. James