From: Brad Allen

Subject: Reg Z - Truth in Lending

Comments:

Comments on Proposed changes to Regulation Z, Docket R-1366
Thank you for considering my comments on the following sub-sections
226.36(a)(1): Broken down the sentence says, to me, that there are three circumstances wherein a creditor is to be considered a "loan originator" under this section: (a) "The term [loan originator] includes the creditor if the creditor does not provide the funds for the transaction consummation out of the creditor's own resources"; (b) "The term [loan originator] includes the creditor if the creditor does not provide the funds for the transaction consummation out of deposits held by the creditor"; and (c) "The term [loan originator] includes the creditor if the creditor does not provide the funds for the transaction consummation by drawing on a bona fide warehouse line of credit". The sentence would seem to say that if a creditor provides funds "by drawing on a bona fide line of credit", it is not a "loan originator" for purposes of this section. Entities that make loans by drawing from lines of credit (in my region these are generally known as correspondent lenders) are only one small step removed from those that "table fund". Correspondent lenders generally utilize the underwriting of a creditor from which there is a commitment to purchase the loan thus underwritten for a price that has been agreed to beforehand. The creditor, having thus underwritten the loan, completes the transaction by "purchasing" the loan within a very short time after the loan has funded from the correspondent's line of credit. This definition of "loan originator" would seem to exclude "correspondent lenders" from being regarded as "loan originators" for the purposes of this section.
This exclusion opens the door to considerable confusion on the part of the consumer and leaves open the door to the very harms that this section is intent on preventing. It is common (in my region) for entities to function under "two hats". They may have relationships with one or more "wholesale lenders" (not "loan originators") as true brokers and simultaneously have relationships with other creditors as "correspondents". In a given transaction they may begin under one hat and end under the other. Thus, by excluding so called "correspondent lenders" from the definition of "loan originator", the rule changes proposed leave ambiguous the rules that might apply in the course of a given transaction. An entity may simply "change hats" in mid transaction in order to take advantage of pricing shifts to enhance the compensation to the entity contrary to the interests of the borrower.
226.36(d): Alternative 1: I support the proposed Alternative 1 as the proposed language of 226.36(d). Loan originators provide loan origination services and should be reasonably compensated for the provision of those services. However, the services provided are unrelated to any loan terms or transaction terms including interest rate or principal amount of the credit extended. It has become common practice for loan originators to charge a fee based on a percentage of the amount of the credit to be extended. For example, it is common for originators to set total compensation at 1.5 - 2% of the amount of the credit being extended. This scheme results in an originator's compensation for a $500,000 loan that is 5 times that of the compensation for a $100,000 loan. However, all other factors being equal the work involved, the time, effort, training and experience involved are exactly the same whether the loan amount be $100,000 or $500,000. There is virtually no other service provider industry that accommodates such a disparity between the services provided and the compensation paid for those services based on factors

unrelated to the level of service. In most service provider industries, relative transparency in the disclosure of charges and the explanation of services results in competitive market action to minimize or eliminate such disparity, arriving at a reasonably fair arrangement in which the needs of consumers and service providers are fairly served. Such transparency and clarity have long been absent in the mortgage transaction, consequently the competitive forces associated with a free market have been impaired in arriving at a fair balance between the needs of borrowers and those of origination service providers. The Board acknowledges the difficulty that the borrower faces in identifying costs related to origination services and relating those costs to the level of service provided and the roll this lack of transparency plays in creating practices that are unfair to the borrower. This sub-section seeks to prohibit practices that have in the past created an environment conducive to unfair practices that prove costly to borrowers. In light of this worthy effort it makes no sense to allow the practice of charging for services based on any arbitrary factor unrelated to the service provided. I encourage the Board to adopt Alternative 1 that will effectively prohibit originator compensation related to anything other than the level of service provided under circumstances wherein such compensation is or can be obfuscated, i.e., when such compensation is provided by means other than a direct charge to the borrower. The proposed rules appropriately do not impose such restrictions on charges that are charged directly to the borrower and are disclosed in a clear and straightforward manner. Where such charges are clear and transparent, i.e., charged directly to the borrower, free market competition should become an effective arbiter of the value of the services provided.

226.36(e)(2): This sub-section discusses two "types of transactions" which are differentiated in sub-paragraphs (i) and (ii) based on whether the "annual percentage rate" can or cannot change after consummation. The term "annual percentage rate" or "APR" is commonly used throughout the mortgage regulations to refer to a constructed rate based on selected non-recurring closing costs which may and often does differ from the interest rate of the note issued by the creditor. The APR is a construct based on specific closing costs related to originating the loan. As such, APR is a fixed value determined in the course of loan origination and closing. It has little meaning after closing and is not subject to re-determination after consummation, i.e., it does not vary. On the other hand, the note rate or interest rate of the note may be fixed over the term of the loan or may vary over the term of the loan according to conditions and circumstances specified in the note. I believe that 226.36(e)(2)(i) and (ii) are meant to refer to a "note rate" or "note interest rate" rather than an "annual percentage rate" that may or may not change after consummation. I recommend that the term "note rate" or "interest rate" be used instead of "annual percentage rate" in this context.

Thank you for considering my comments,

Brad Allen,