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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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TO: Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW. Washington, DC 20551. RE: 12 CFR Part 226 [Regulation Z; Docket No. R-1366] Truth in Lending ACTION: Proposed rule; request for public comment From: Paul E. Skeens Owner / Broker Colonial Mortgage Group 3261 Old Washington Road Suite 1011 Waldorf My. 20602 301-932-4610 Issues Concerning Originator Compensation, and Recommended continuance of Yield spread premiums. Congress enacted the Truth in Lending Act (TILA) based on findings that economic stability and competition would be enhanced among consumer credit providers. By removing the payment of yield spread premiums much of that competition and consumer choice would be eliminated. The Board is proposing additional protections related to limits on loan originator compensation. The objection is with the proposed limits on originator compensation through changes to Regulation Z. The proposal is not a limit on compensation but the elimination of Yield Spread Premiums. The proposed changes are identified as follows: Loan Originator Compensation. The proposal contains new limits on originator compensation for all closed end mortgages. The proposed changes include: Prohibiting certain payments to a mortgage broker or a loan officer that are based on the loan's terms and conditions. Prohibiting a mortgage broker or loan officer from "steering" consumers to transactions that are not in their interest in order to increase the mortgage broker's or loan officer's compensation. The first issue is that the Federal Reserve is even considering these changes to Regulation Z. It is unproven and unclear at best, that compensation paid based on the loans terms or conditions is the cause of consumer injury: Yield Spread Premiums are the "Originator Compensation" referred to in this proposed regulation. If a limit on that compensation is the only goal, then that goal has been recently met through the passing of the "Higher-Priced Mortgage Loans" (HPML). The Federal Reserve recently issued these rules as amendments to Reg Z and were subsequently adopted under Reg C and HOEPA. Although this regulation was designed to eliminate the return of

sub-prime loans, it also effectively limits the compensation that can be paid to a mortgage originator regardless of the loan type. There were many reasons that the mortgage marketplace contributed to the credit crises and subsequent housing collapse. It is true that complicated mortgage products, poor credit standards and lax underwriting guidelines allowed people to borrow more money that they could afford to repay. That does not mean that all the products were bad or that all the tools at the disposal of the consumer are to blame.
Regarding the issue of "Loan programs", there are probably several products that should never return to the market place. Loans offered to poor credit borrowers without a mandatory escrow account. One hundred percent financing that does not require verification of income. Deferred interest loans that begin at 95% LTV and prepayment penalties that extend past the ARM initial adjustment are a few examples. But that doesn't mean that some types of these loans (maybe at lower LTV's or with better credit evaluations) are always a bad idea. The consumer needs these choices. In many cases these loans benefit the consumer and are profitable to the institution. We should not jump to over regulate this industry out of fear or ignorance. Careful evaluation of the products, tools and system used to facilitate appropriate lending and taking good credit risks are always appropriate. Regulation changes should be considered but without the exclusion of common sense. The flexibility of options creates consumer choice and the freedom to do what is in his or her best interest. The current system supports consumers because the overall cost of a transaction can be very high and this is the best way to reduce those up front fees.
The Board claims to recognize these benefits but dismisses them as insignificant. Here are some examples 1) A purchaser trying to come up with a down payment. With 100% financing no longer available and the gift grant programs eliminated many consumers have a difficult time with this. A married couple that combines to make 50 k a year may qualify to buy a "HUD median income" home, but generating that down payment from savings is difficult. 2) Consumers currently have the choice of paying the closing costs or financing them into the loan. Eliminating this choice does not create a benefit for the consumer. The new HPML regulations and High Cost loan regulations already provide limits that protect consumers. A client who wants to refinance but believes they may only live in the home for another two years may strategically decide that they want to finance all of the closing costs associated with the transaction. This s called a "no cost refi and is a great tool of sophisticated
borrowers and cost conscious consumers looking to protect their equity.
Because of YSP, consumers have the choice of financing closing costs 3) Someone who needs help navigating the process of gathering documentation. Especially if they do not have a complete education or there is a language barrier. Many times these clients are self-employed, paid tips, work part time or have been part of the underground economy. They were paid cash and in many cases did not even file tax returns. When they are referred to us it is because they want to purchase a home. This creates a certain trust and often the clients are in need of guidance in preparing their information. They often come to me after being sent away by a bank. Because of our relationships with various professionals we can help them navigate the complicated process. Again this is done for no "up - front" fee. Our compensation from the loan origination is our only fee charged. There have been "non-profits" or credit repair services which have provided good advice and professional service.
Unfortunately there have been abuses in those industries that have been well documented. 4) Third Party compensation provides the option of financing up front fees. If an up front fee had to be paid for every loan origination, the consumer would always pay 100% of the total fee. They not always have the

money available to pay the fee and therefore would not receive the service at all. While it's true that a lower rate is available with an up front fee, that is not always in the consumers best interest. The most basic example is that of the Zero point loan. Most consumers don't like The up front fees on loans and points are the single largest expense. By financing the origination fee the consumer may never pay it in full. The system of the end lender paying the fee on behalf of the consumer is clearly a benefit. The cost of .25% to the rate adds about $15 per 100,000 financed to the payment. Therefore if the total broker compensation was $2000 and the rate was raised .5% to accommodate the payment the consumer pays at a rate of $30 per month toward the financed fee. In that scenario it takes 66 months to pay just the pay the principle. The average mortgage is paid off in less than 5 years, in which case the consumer never pays the full fee. This is an educated consumer making an appropriate financial decision. There is no argument that the originating institution creates value to the consumer, only on how to pay for that service. Here are some of the unintended consequences of eliminating YSP 1) Risk based price charges from Fannie and Freddie are now the industry standard. These additional costs are based on a variety of factors but are ultimately fees to the consumer. These charges increase the up front cost of the loan to the consumer unless they are finance into the loan rate by the use of YSP. These adjustments are often layered and can easily reach one to two percent of the loan amount even for the most well qualified borrowers. 2) Competition among lenders, banks and brokers would be greatly reduced. There is no doubt that the last 20 years was driven by a desire to make mortgages available and affordable. This has been one of the great positives to come from the policies supporting home ownership and fairness in lending. This is a classic "don't throw the baby out with the bath water" scenario. It was only from 2003 to 2007 that the products available and became over aggressive. Yield spread premiums and the system of delivering mortgage choice to consumers has been around for decades and has PROVEN BENEFITS. If this regulation passes and only banks are left to delver mortgages to consumers, far fewer will qualify and all will suffer from limited options regarding, price, service and quality. 3) Minorities and financially challenged consumers would be harmed the most. Those who are new to the country or lack the knowledge to evaluate or understand the mortgage process often need the most help in getting a loan. If banks are the only source of financing for these groups or if they require the broker fees up front, than many of them will be ineligible for financing. Those groups are consistently underserved and regulations have been passed many times to support lending to these groups. The availability of products, services options and a qualified mortgage professional all help to support these people who need the help the most. Many times highly educated sophisticated borrowers with financial means can negotiate the best deal for themselves. Unfortunately other consumers just don't have the skill set or financial strength to do this. The system of granting these people access to a skilled professional is there best chance at getting a loan. When these people can't afford to pay the fee in cash, it is quite a luxury for them to be ble to finance its cost. What if we told everyone that you can buy a car, but you have to pay cash? How many people would own one? 4) Credit impaired consumers would be under served. Someone who needs help disputing inaccuracies on their credit. Many people have never seen their credit report let alone have any idea how to interpret the data or make changes. Mortgage brokers frequently assist borrowers (without any fee charged at all) in navigating this process. The Incentive is that we will be paid at settlement. If we had to rely on an up front fee paid at settlement the client may never undertake the challenging. The system provides incentive for mortgage professionals to help these people 5) The days of "Red lining" would almost certainly return, because banks would be the only ones originating loans. In the late 1980's, before mortgage banking and brokering became a valuable option, there were many instances of this occurring. Without competition banks tend to cherry pick from the preferred customer base. There was customarily exclusion of certain groups based on both ethnicity and geographical restrictions, 6) Market choices will be harder to obtain and identify. The entire marketplace is easily identified through brokers such as Lending Tree, Bank Rate, or a local broker referred by a friend, the market is easily identified through these services. The Board asserts that mortgage loan officers don't represent the clients' best interests because of a "conflict of interest" regarding interest rate. Regardless of that point, there is no doubt that brokers and lenders provide a variety of options to consumers, which allows them to get the best price. 7) Mortgage Brokerage and Banking would effectively be eliminated further harming the consumers pricing power and options. In the summer of 2009, The NAMB reported brokers originated only 14.9% of all loans. This number certainly fall even further because even less people will have access to the cash needed to pay the up front fees which would be required. A business has a responsibility to pay its people and stay current with technological and regulatory advances. The cost of running a business is pretty high, about $ 4200 per loan including commissions. (Compare that to a realtor commission of 3%, it is somewhat less based on the median price, although similar). Elimination of a service industry such as mortgage brokerage would hurt the banks that need them as a sales force and the consumers who depend on their expertise. One Agent told me she refuses to work with banks because they can't even get a prequalification letter out in two weeks. 8) Cost to Banks would increase, and then be passed along to consumers. Banks currently have the option of providing wholesale services to the mortgage brokers and mortgage bankers. This allows them to have access to an enormous sales force without the enormous overhead. Because they are 100% commission, there are tremendous cost savings to the consumer. When rates drop 1% like they did in December 2008 consumers all rush to refinance their homes. The banks and credit unions are overwhelmed quickly. They cannot process files in a timely manner, return phone calls or lock loans. (One credit union said they would have a loan officer return a call within 30 days, but you could not lock in). A national bank offered a higher than market rate and required a "120 day" lock to process the loan.). If Banks have to staff up at a great expense to meet the demands of the entire population if we loose our Mortgage service companies. These costs will be passed along to the consumer in addition to the poor service, Other reasons that this regulation is unnecessary 1) The steering of clients to other products was not prevalent as inferred. 2) Many products have already been eliminated from the marketplace, and regulated to the point of no return (HPML). 3) Impact on housing will be significant and adverse if you reduce client's options and raise the up front costs to consumers. They are already having a difficult time coming up with a required down payment since the elimination of 100% financing and the FHA's gift / grant programs. If you add even more cost it will continue to adversely affect the market. Additionally even more borrowers would not qualify because they would not have access to mortgage brokers services. 4) Allow new regulations and continuing education a chance to work there are already new regulations in place that are designed to protect the consumer. The HVCC, the HPML, and a vast network of improved licensing and continuing education have already been put in place. In addition the industry workforce has contracted by about 70%, so many of the undesirables that may have gravitated to the industry are now gone. The barrier of reentry has thankfully been strengthened. Over reaction and unnecessary regulation are going to hurt consumers and the housing markt. Lets give the rational plans and regulations that have already been put in place a chance to work. In the upcoming section I will address additional items on which comment was requested. " The Board also seeks comment on an optional proposal that would prohibit loan originators from directing or "steering" consumers to a particular creditor's loan products based on the fact that the loan originator will receive additional compensation " The loan programs that existed during the boom real estate years all had YSP compensation associated with them. The reason clients received one loan versus another was almost exclusively based on how they qualified. If a client had 680 scores or better and fully verifiable income, then they were eligible for an 80/20 combo with no MI and a fixed rate loan. (Many times they wanted the 5/1 arm with the interest only option, but that's a different discussion and the compensation was about the same.) There doesn't need to be a new system because the market has eliminated the products. They have been recently regulated so that they cannot return. As long as the YSP is consistent across all product lines and with a similar coupon (which it is), than there is no incentive but to provide the options and let the consumer decide. Yield spread premiums may provide some benefit to consumers because consumers do not have to pay loan originators' compensation in cash or through financing. However, the Board believes that this benefit may be outweighed by costs to consumers, such as when consumers pay a higher interest rate or obtain a loan with terms the consumer may not otherwise have chosen, such as a prepayment penalty or an adjustable rate This statement recognizes the benefit of have Yield Spread Premiums, yet summarily dismisses it as inconsequential. As I have illustrated in the preceding there are substantial and meaningful ways that having YSP is a benefit to the consumer and the industry. The example of landing a client in an ARM or a loan with a prepayment penalty has nothing to do with yield spread premiums. Those loans offered no better YSP than fixed rate loans. A 102 price was generally available on both fixed rate and ARM loans, and on loans with and without prepayment penalties. The reality is those loans offered lower rates as an incentive to the consumer and when given the choice they regularly wanted the lower payment associated with those loans. The Board solicits comment on an alternative that would allow loan originators to receive payments that are based on the principal loan amount. These two requests can be answered buy the same answer. Simply require the yield spread to be disclosed on the GFE and the HUD. The Board asserts that consumer confusion is a big part of the problem. If banks, lenders and brokers all had to disclose the same information in the same way, than it would be consistent and therefore easy to compare the options. When you couple that disclosure with the APR and the newly implemented HPML, you have limits on costs and effective tools for comparison. Yield spread premiums clearly accommodate the payment of many types of costs. Whether it is "risk based pricing charges" direct from Fannie Mae or Freddie Mac, or a mortgage broker fee, the YSP reduces up front costs to the consumer and allows the freedom to make that choice. If you have any comments or questions regarding this material please don't hesitate to contact me. Paul Skeens