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MORTGAGE

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October 16, 2009

Mr. Ben Bernanke
Chairman of the Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Proposal:	Regulation Z – Truth in Lending – Closed End Mortgages
Document I.D.:	R-1366
Section:	36(d)
Release Date:	7/23/2009

Dear Mr. Bernanke:

Thank you for the opportunity to comment on the proposed changes to Regulation Z, as set out in R-1366.

The stated goal of the proposed regulation is to improve the disclosures that consumers receive in connection with closed-end mortgages and home-equity lines of credit (HELOC). I support this goal. During 30 years in the mortgage business, I have found that many consumers do not have a good understanding of how mortgages work. My staff and I have always spent the time necessary to be sure that our customers understand their home financing options and are able to make informed decisions about which option is best for them.

Having said that, I believe that the changes you propose in section 36(d), prohibited payments to loan originators, will have the effect of driving the most professional mortgage brokers out of the business and will thereby harm consumers.

About Myself and My Business

I have been in the mortgage business for my entire career, a period of 30 years. Ten years ago, after having sold my interest in one of the East Coast's largest privately-held mortgage firms, I established a boutique mortgage brokerage firm that specializes in the high end market. This business – Hourglass Mortgage – is headquartered in Washington Depot, Connecticut. During the last five years, Hourglass has closed an average of $75 million of new mortgage loans each year. As a result of this performance, I am recognized by *Mortgage Originator* magazine as being one of the country's top mortgage brokers.

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The loans that Hourglass brokers range in size from $500,000 to $6 million. Our typical client has substantial financial assets (usually in the millions), a well-documented record of earnings, and credit scores of 730+. Loan-to-value ratios are typically at or below 65%, even with today's dampened real estate values. These clients are willing and able to provide full documentation of both income and assets.

The Value of Mortgage Brokers

It seems to me, as an admittedly interested observer, that the public is being presented with a distorted view of mortgage brokers.

<u>The Value of Mortgage Brokers to Clients</u>. My clients are entirely capable of approaching a bank directly for mortgage financing. They choose to work with Hourglass for the following reasons:

1. They rely on us to know the market: to have relationships with a broad range of institutions, and to know, at any given time, which institutions provide the mortgage products that best meet their needs. They do not have the time or the inclination to call ten or twenty banks to find out which ones will underwrite their desired loan and on what terms. (As an example of the kind of issue that arises: I have clients with substantial assets and stellar credit whose mortgage applications would be turned down by many banks because their properties are larger than 10 acres, and hence considered agricultural. I don't waste the client's time or the bank's time applying where there is no match.)
2. Customers count on us to guide them through the application process, which has become increasingly complex and time consuming. In today's environment, there is more work than ever involved in assembling a mortgage application and shepherding it through the underwriting process. We have applications that are literally five inches thick, with all the required documents! Our customers – most of whom are repeat customers – know that my staff and I will sweat the details needed to get them from application to closing.

<u>The Value of Mortgage Brokers to Banks</u>. Many banks have salaried loan officers on staff. As a practical matter, on-staff salaried loan officers are not effective at reaching high net worth individuals. For that reason, banks that want to originate jumbo and superjumbo loans work hard to establish relationships with mortgage brokers who have an established network of relationships with their target customer base, who are known to do a good job of vetting the customer before ever submitting an application on the customer's behalf, and who will not waste the bank's time on applications that do not meet the bank's criteria

Understanding the Yield Spread Premium

Historically, I – like most mortgage brokers - have been paid for my services through a yield spread premium (YSP). The Yield Spread Premium is often described in the popular press as an interest rate premium that is tacked onto the customer's rate by the mortgage broker – a premium that increases the interest rate that the customer will pay on his mortgage loan.

In fact, the yield spread premium represents the amount of money that the originating bank is willing to pay to a mortgage broker for the valuable service of finding a qualified customer and shepherding the loan through the mortgage underwriting process. The yield sheets that I receive daily from the banks with whom I do business show the rate that they will charge to a customer for a loan meeting specific criteria – for instance, a 10/1 ARM – and then *the amount that the bank is willing to take out of its own profits to pay me*: the yield spread premium.

You may ask, why are banks willing to pay yield spread premiums to brokers? For the same reason that any company with a product or service is willing to pay salespeople: to capture the customers that they want. If you look across the broad spectrum of American business, you will find that salespeople are paid widely varying amounts, depending on how much value they bring to the business. The clerk who simply assists a customer courteously and rings up a purchase generally earns no commission. The professional salesperson, by contrast, must take time to establish a rapport with a customer, understand their needs, work with the manufacturer to present a product that meets the customer's needs, and present a compelling case against competitors' products. The professional, skilled salesperson, in any field, is typically paid on commission and is able to earn significant compensation because of the value they contribute.

<u>The Value of the Yield Spread Premium to Customers</u>. Using the YSP as a payment mechanism enables the customer to pay the broker over the life of the mortgage, rather than having to pay an up-front fee. Furthermore, the broker who is paid through a yield spread premium can use that premium to cover the customer's closing costs, enabling the customer to refinance without any up-front transaction costs at all. This is a valuable service to customers of all income levels. We frequently cover the customer's closing costs out of the YSP, providing them with a loan that has no closing costs or even closing credits.

Recent Changes in the High End of the Mortgage Market

Let me now discuss the high end of the mortgage market. While public attention has been focused on other segments of the market, the high end of the market has also experienced a shakeout. Many national lending institutions have exited this business, not because of portfolio problems in this segment, but because of problems in their other lines of business. Additionally, the secondary market for jumbo- and super-jumbo mortgages has evaporated. As a result, there is a vacuum of products for the best clients. Nevertheless, these clients continue to have mortgage financing needs, both for purchase and for re-finance. I have been placing them with strong local and regional banks, portfolio lenders with stringent underwriting requirements.
If the Fed takes away banks' ability to compensate mortgage brokers based on loan size – whether by prohibiting the use of Yield Spread Premiums or by other approaches that

severely limit broker compensation – the best and most professional brokers will leave the business.

Eliminating high-end, experienced brokers will have Draconian effects on the high end of the market. It will severely hamper the ability of high-end consumers to obtain mortgage financing and re-financing. In the past decade, this group of consumers has chosen to rely on 5/1, 7/1 and 10/1 interest-only ARM products more than on fixed rate, fully-amortizing mortgage products. Many of these products are currently due to re-set to fully amortizing payment programs. If this group of homeowners is not able to refinance, it will at best cut into their ability to help the economy recover through personal consumption; at worst, it will lead to a wave of foreclosures in the upper end of the housing market. Forcing the independent broker out of the market will exacerbate the problems that do exist in the higher end of the market.

Specific Critiques of Proposed Alternative Payment Methods

In the regulations, you set out alternative payment methods that you would consider acceptable. For instance, you say that it would be acceptable to pay a broker over a period of time based on loan performance.

The problem with that approach is, independent brokers are business owners who have bills to pay in the present time. My business has fixed expenses of $200,000 per year. I cannot tell my landlord or my staff – or the phone company, or the utility company - that I will pay them over a period of ten years. The YSP does not simply go into my pocket. I use it to cover overhead, including compensation to a small but high caliber staff. A fee that is paid over the life of the loan does not support my company's current year infrastructure requirements.

You also suggest that the customer could pay a fee based on the amount of time that we spend to close their loan. Our customers prefer to have their fee included in the interest rate they pay, so that it is amortized over time. Give anyone a choice between paying a certain sum today, and paying that same sum over 30 years; the customer will always choose to pay over 30 years.

What Do I Recommend?

In medical school, students are taught "*Primum non nocere*" – "First, do no harm."

I believe that the proposed elimination of the yield spread premium will do substantial harm to all segments of the mortgage market. In particular, I believe that it will drive the best and most professional brokers out of the market without changing the behavior of those people who have given mortgage brokers a bad name. Thus, I believe that this is bad public policy.

What do I recommend in place of the proposed changes? Fundamentally, I believe that consumers will be best served if regulators focus on enforcing existing regulations against predatory lending practices. Putting laws in place does not stop bad behavior. Laws must be enforced with enough consistency and public visibility that people are motivated not to break the law.

Additionally, I believe that we would be well served as a society to put more resources into financial education. Many people do not have a good understanding of how to develop and manage to a budget, how to manage debt, and how to maintain a strong credit rating – let alone how to read and interpret complex mortgage documents. As a country, we would benefit by adding courses in personal financial management to our high school curricula.

Mr. Bernanke, this has been a long letter. I thank you for taking the time to consider it.

Sincerely,

Craig M. Cooper
Principal
Hourglass Capital, LLC