

COMMENTS REGARDING PROPOSED RULE MAKING TO REGULATION Z – Truth in Lending Act

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The goal of the proposed rule making is to inform and protect the consumer of closed-end residential mortgage loans. I support this goal. However, the means with which we choose to “educate” and “protect” the consumer are vital to maintaining a free marketplace for residential mortgage consumer credit that fosters competition and that employs the most educated and professional originators to serve the consumer during these significant financial transactions.

I have little concern with the proposed added layers of disclosure. While the timing triggers may delay a consumer’s mortgage transaction, providing additional disclosure and educating the consumer about “their” transaction are beneficial, and can aid in protecting them from predatory lending practices.

Where I do have concern involves the proposed rule making’s approach to mortgage broker / loan originator compensation. Predatory lending practices can take place at both the originator and creditor levels. The proposed rule making fails to address predatory lending on the part of creditors. Secondly, predatory lending rules already exist. The problem has to do with enforcement. I believe in the general philosophy that government is most effective when there is clear and concise legislation combined with robust regulation. The problems that exist regarding predatory lending practices do not involve how originators get compensated or the lack of sufficient legislation. The problem involves insufficient regulatory oversight and enforcement.

Having expressed my general concern above, I would like to provide some specific comments and suggestions which I believe will provide the desired result of the proposed rule making without stifling the free market or curbing competition within the residential mortgage lending industry. First, we must look at the profession of mortgage broker and loan originator to gain a proper understanding of the role these individuals play in the process of mortgage lending, and thus better understand the methods of compensation. There are basically two types of mortgage loan originators: order takers and sales professionals / financial advisors. The order-taker originator is someone that sits behind a desk and waits for a client to come to them for a loan. These individuals are typically not very knowledgeable on the details of the loan products and the financial aspects of the transaction, and they are often not equipped to make critical recommendations to their clients. Nor are these order-taker originators skilled in the profession of sales. The order-taker originators are essentially processors. These order-taker originators are typically compensated hourly/salary, with a small “spiff” for each unit they originate, regardless of loan amount. In addition, order-taker originators typically produce at a significantly lower volume than their professional counterparts. A professional mortgage broker / loan originator however, must possess a multitude of skills to be successful at their profession. A professional loan originator must be an adept salesperson, possessing diverse sales skills combined with detailed product knowledge and financial and

economic knowledge. A professional loan originator, like most professional salespeople, is compensated entirely on commission. Therefore, unlike the order-taker originator, they cannot afford to wait for a customer to walk in the front door. The professional originator must go out into the marketplace and network to make sales. Because the professional originator brings business to the creditor, they are typically compensated better than the order-taker originator. Because the professional originator has no base salary, they typically originate at a much higher volume. With 100% commission based compensation, if a professional loan originator does not possess the robust skill set necessary to succeed, they typically wash-out in fairly short order. However, it is important to note that there are always exceptions to the general rules I've described above. And during the recent housing boom, without the proper licensing requirements in place, it was possible for "unprofessional" originators to enter the industry and succeed without possessing the proper skills. Now that a national licensing requirement has been established, a satisfactory barrier has been established to prevent individuals from entering the professional loan originator occupation without possessing a minimum skill set to benefit the consumer. Natural selection will continue to ultimately determine their long-term success.

In addition, consumers are often willing to pay more for a highly skilled professional advisor (e.g. doctor, lawyer, realtor, investment advisor, etc.). Why should it be any different with their mortgage loan originator (within reason)? The proposed rule would eliminate this natural free market phenomenon.

The proposed rule making would cause the highly skilled professional loan originators to seek careers in more lucrative fields that are commensurate with their abilities and expertise, leaving only the order-taker originators behind to serve the borrowing public. This would do a great disservice to all borrowing Americans. Additionally, the proposed rule would force many small originator/creditor shops to close. Combined with the exodus of highly trained loan originators fleeing for more lucrative careers, competition in residential loan marketplace would be greatly reduced. The proposed rule making could ultimately result in a marketplace dominated by retail banks with order-taker originators on staff. The banks would make even larger profits on the money spread due to the regulated lower origination overhead, and the consumer would be worse off than before, at the sole mercy of the big banks.

I would also like to point out the multitude of professionals involved in the residential housing industry that earn their compensation based on the loan amount or sales prices of the transaction. Realtors, title agents, appraisers, insurance agents, etc. all earn their compensation based on the size of the transaction. To single out the loan originator is completely side-stepping the issue of consumer protection. Laws currently exist to prevent predatory lending and fraud. These laws simply must be enforced! Also, the creditors make their money based on the amount of money loaned and the yield spread. It would be completely inappropriate to eliminate the originator's ability to share on a pro rata basis in the creditor's earnings. Because without the loan originator, the creditor would have never gotten the business in the first place. This goes back to one of my original comments that creditors have the same opportunity to be predatory as do

originators. The government must regulate out the bad ones, not legislate away an otherwise functional free market system.

I must also comment regarding the issue of compensation based on yield spread (paid by the creditor) or points/fees (paid by the borrower). At face value this would appear to be an issue because the compensation comes from a different source, and the ability to thoroughly disclose to the consumer is a challenge. However, I argue that this is simply a non-issue. It is much-ado about nothing. Ultimately all of the originator's compensation comes from the consumer, either immediately at the closing of the transaction, or from the creditor for the future value of the loan. Having the ability to be compensated in either fashion a valuable option for the consumer. Whether the borrower is loan savvy or naïve, there are valid reasons for structuring the broker's compensation via upfront fees, yield spread by a slight increase over the creditor's base rate, or a combination of both. Removing this option is not in the best interest of the borrower. The total compensation to the originator can be adequately disclosed to the consumer.

The standard methods for loan originator compensation are all satisfactory (i.e. hourly, salary, flat fee, yield spread & percentage of loan amount). None of these methods should be eliminated. They provide the free market system the ability to differentiate between the type of lending institutions offering loans and the skill sets of the individuals providing loan origination services. Instead, the proposed rule should consider a cap on the amount a loan originator can be compensated. This cap should be based as a percentage of the loan amount. The cap should not involve an additional dollar amount cap so as not to discriminate against the jumbo and super jumbo loans which are often much more difficult and labor intensive to originate and get approved. I would suggest a cap of 3% (300 basis points) as a compensation cap. This allows flexibility to accommodate sufficient compensation on some of the more difficult loans that could be at lower loan amounts while ensuring that the originator cannot act in a predatory manner for self gain. The 300bps cap would be on total compensation based on loan amount. Therefore whether the compensation was in upfront fees or yield spread would be inconsequential. In addition, the ability to disclose upfront and at transaction close would be very direct and straight forward. This cap is also comparable to what realtors typically make for their involvement in a real estate transaction. It is very important to note that the free market and competition will make it very difficult for a loan originator to earn 300bps on a normal transaction. Should an originator try to charge a consumer in a predatory manner, the lender will lose business to the competitor. And in no case would an originator be able to earn more than 300 bps regardless.

And regarding the issue of steering, I don't believe this is an issue when it can be shown that there is no direct harm to the consumer. Loan originator steering should be considered acceptable if (1) it benefits the consumer with more favorable loan terms; or (2) the total cost to the consumer in rate and fees is reasonable (e.g. no more than a total of 50bps). Loan originators need the discretion to be able to place a loan with different creditors for various reasons (e.g. underwriting criteria, file processing times, etc.).

because it may difficult for an originator to defend some of the more intangible benefits for directing a loan to a particular creditor when it also results in increased compensation to the originator, it makes great sense to place a threshold (e.g. 50basis points) below which is considered minor and does not warrant scrutiny. Any benefit to the originator above 50bps from what the originator would have received had he/she placed the loan with a comparable lender and comparable qualified loan program, or total compensation exceeding 300bps, must be passed on to the consumer in the form of a commensurate rate reduction or rebate against fees/closing costs. Please note, that just with the rule as written, this requirement would be difficult to enforce upfront, but auditable after the fact.