From: Thomas F McNutt

Subject: Reg Z - Truth in Lending

Comments:

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Proposal: Regulation Z - Truth in Lending - Closed-end Mortgages
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Name: Thomas F McNutt
Affiliation:
Category of Affiliation:
Address:

City:
State:
Country: UNITED STATES
Zip:
PostalCode:

Comments:
Federal Reserve Board Re: Proposed Changes to Regulation Z in relation to compensation To Whom It May Concern: My name is Thomas Ford McNutt, I would like to give you a little bit of background first on me and why I started my company and then discuss the impact of the proposed changes and why I think it is ultimately harmful to the consumer. I am owner of Professional Choice Mortgage, a mortgage broker company based. My company is comprised of myself and one other originator. I started my company almost 5 years ago. I have 18 years in the mortgage industry. I worked for Freddie Mac for 4 years and then worked at a large bank for 9 years as a Mortgage Originator and then as Branch Sales Manager. The reason I started my company was to provide a better value to my clients. I felt my former bank was not very competitive with pricing loans and often originators there would take overage on top of the already higher rates on loyal bank customers. I have built
a very solid business based on treating clients as I would want to be treated, providing excellent service and providing some of the best rates available. I have clients that work for banks come to me versus using their own bank because they know they can get a better deal with me. I am very fair with my pricing and once I have reached my target profitability, and the Yield Spread Premium (YSP) will provide more profit, I typically will give a credit back to the borrower to help reduce their closing costs. If the proposed changes would be implemented, where indirect compensation or YSP is no longer allowed, it would more than likely eliminate the mortgage broker or at best case scenario hinder how they do business, and the options they can provide clients. I think brokers provide a very valuable service to consumers and by eliminating the broker you reduce competition and consumers will ultimately ending up paying more for their loans over time, because the broker will not be there to keep the rates as competitive as they are today. Even if you

switched to a flat fee, you will drive some of the best and honest originators/brokers out of the business. The banks will make more money, because they will pay less for the loans, and you will be left with mediocre people providing mediocre service with higher rates and more profits for the bank. Again I think a flat fee will harm the consumer, because you will again eliminate competition. In the past, there were a lot of people in the mortgage industry that should not have been. With the sweeping changes that have taken place in the industry most of them are gone and the new changes should prevent most unqualified people from entering the industry. A lot of the bad things that happened were usually with sub prime mortgages and not prime loans (conforming and non conforming conventional loans). These changes will impact the prime loans. The Proposed Rule, as written with regards to restrictions on
compensation, will require consumers to pay for services rendered in connection with obtaining a loan either all up front or all on the back end through the rate. This will severely limit a consumer's choice in deciding how to finance a mortgage loan and eliminate their ability to choose to finance only some or all of their costs. The Federal Reserve Board (FRB) fails to recognize the potential consequences that have arisen through requirements and limitations proposed in the rule, specifically, unintended consequences that will hinder a consumers' right to decide the most suitable way to buy a home. The proposed rule will remove interim rate financing options for consumers, potentially limiting their ability to obtain loans or forcing them to take on more debt over time. For example, if a consumer desires (or is required in order to qualify) to pay some up front fees to reduce the overall costs to be financed over the life of the loan and hence partially reduce their monthly payment (as opposed to financing any costs through the rate); they would not be allowed to do so. Instead, if they do not have enough cash to cover all of the costs up front, (or simply want to preserve some cash on hand), their only choice would be to finance all of the costs through the back end at a higher interest rate, higher payment and overall higher debt. Furthermore, the misconception that created the acronym "YSP" has given rise to disclosures which now obscure rather than illuminate and confuse rather than clarify. Studies cited by the FRB and other governmental agencies have demonstrated that the current disclosures do not achieve their objectives with respect to improving the consumer's comparative shopping experience. The result of the flawed idea about "YSP" has led to a new Good Faith Estimate being implemented January 1, 2010 which will hurt consumers by reducing rather than increasing transparency and reducing choice while it hurts mortgage lon originators by forcing estimates that will necessarily be higher and will disserve the very goal of accurate estimating. The FRB has proposed changes to Regulation Z. Some of the changes are also based on the long standing misconception that a "premium" or "discount" value assigned to one interest rate versus another represents a "kickback" or "rebate", instead of simply the calculated present value of the expected future revenue generated by the asset. The changes resulting from the flawed idea that created the term "YSP" have led to proposed compensation changes that will have a negative impact on both consumers and loan originators. Further, the continued focus on how lenders choose to use the revenue generated from their mortgage loans only distracts from the important issues of competitive pricing and consumer protection, while it sabotages the intended goal of creating disclosures which allow simple, clear consumer loan comparison shopping. Loans are offered to consumers for the simple
reason that they are revenue producing assets. The revenue produced by the combination of closing costs and the interest payments is used to pay for the costs associated with mortgage sourcing, marketing, origination, and servicing

processes; including collection, credit risk management and of course, some amount of profit. Regardless of whether the lender or a third party performs any or all of these functions, the consumer ultimately bears these costs either on the front end or through the interest paid over the life of the loan. This simple fact has been lost in the unproductive debate about the artificially created and carved out item called Yield Spread Premium. With the emergence of independent mortgage brokers and originators, lenders gained access to a large, efficient and competitive variable expense based third party distribution channel to market and originate the lenders' loan products. In response, lenders created "rate sheets" which are functionally similar to any other product manufacturer's price sheets. The rate sheets facilitate the lenders' need to communicate the amount they are willing to pay the third party for the performance of its services based on the revenue the lender expects to receive from the loan at any given price. In this case the lender's price is represented in the interest rate. In its simplest form, the consumer pays the lender in some combination of front end costs plus interest and the lender must pay for all expenses associated with marketing, originating and servicing from those consumer payments. While it goes without saying that if the lender receives more revenue, e.g. from a higher interest rate, everything else being equal that loan offers more value and the lender may reward the originator for that value in the form of a higher payment for the services provided. That in no way "hides" anything from the borrower that facilitates comparison shopping. Referring to this lender payment for services rendered as "indirect compensation" as has been done previously and as continues in the FRB proposed changes to Regulation Z is a misnomer. Rather, it is simply a payment made by someone other than the consumer for services rendered during the loan process or when the asset or its servicing is sold to the secondary markets. Whether it is called "Yield Spread Premium" which represents lender compensation to a third party for services rendered through the origination and funding of the loan, or "Service Release Premium" which represents the secondary market's calculated present value of the future revenue flow negotiated for purchasing either the asset or the servicing rights; disclosing the amount of such so-called "indirect compensation" provides no relevant additional information to improve the consumer's ability to comparison shop. Employing a cost effective third party marketing and origination function, instead of building and maintaining this capability internally, is simply a lender's business decision. Restricting the lender's ability to decide whether to "build" or "buy" services will damage lender access to a valuable alternative distribution channel, will result in an overall reduction in competition, will drive a derivative increase in consumer front end costs and will create access issues for home buyers and homeowners attempting to refinance. The August 26, 2009 proposed changes to Regulation Z demonstrate a fundamental misunderstanding of the overall loan pricing dynamic. It is ironic that while the Board expresses its concern, ". . . that creditor payments to mortgage brokers are not transparent to consumers . . ." it suggests that it has no issue with lenders globally increasing their interest rates. This allowable increase requires no justification or transparency, yet if used would represent an increase in the largest component of consumer costs without any required disclosure except that, if a loan originator is compensated that portin paid to the originator must be disclosed. If the originator is an employee this amount may never be disclosed even if the increased rate results in a higher premium payment to the lender when the loan is pooled and/or sold. All lender and originator compensation is included in the front end costs and in the periodic loan payments derived from the stated interest rate. The interest rate is disclosed to the borrower. Further disclosure of the portion of the lender's revenue used to pay for services rendered is irrelevant to the consumer's ability to

comparison shop. I suggest that the Board would better serve consumers and the objectives of Regulation Z by abandoning the unproductive debate about "indirect compensation" and instead, by directing their effort to working with HUD to integrate the requirements of Regulation X to produce one set of disclosures that are easily understood and useful to consumers. Both agencies' efforts must be turned to a simplified consumer disclosure that allows for an informed
consumer shopping experience based on relevant product and financial information. There is a group called IMMAAG that offers the idea that a one page addendum to the existing (pre-January 2010) Good Faith Estimate will resolve the issues related to comparison shopping with out the side effects inherent in the newly mandated GFE and without the inappropriate restriction on the market freedom to decide on its own how services should be compensated. The IMMAG solution overcomes the problems created by the misconception detailed above. They offer a document that delivers a simple, useable attachment for the consumer to compare alternative loan program prices. This document is very similar to software that I use for my clients that shows the total cost of the loan over a specific period of time and can compare up to four loan scenarios at once. (If you would like more information on the software it is provided by Mortgage Coach which can be found on line). If the real objective is to enable competitive, cost-based comparative shopping for the consumer, there are only two costs necessary to evaluate: First, is the front end cost associated with obtaining the loan, Second, is the interest rate and its derivative debt service cost over a particular period of time. (APR, in the context of mortgage loans, lost its usefulness in the 1970's when "discount" loans ceased to exist.) Nothing else is needed for a consumer to compare prices. To the extent that consumers decide which mortgage product meets their needs based on price, all of the other ostensibly "transparent" fully disclosed financial aspects of the transaction are moot. If one lender offers a $250,000; 30 year fixed rate mortgage with total closing costs of $5,000 at an interest rate of 5.00% and another offers the same mortgage with total closing costs of $4000 at the same 5.00% rate, it does not require disclosures of originator compensation or APR to determine which loan "costs" less over any chosen
time frame. Given the absolute front end costs, and the monthly payment derived from the loan terms, all the consumer needs to accurately compare and "shop" these loans is the element of time. IMMAAG's proposed disclosure when combined with the details contained on the current Good Faith Estimate can be used by anyone to evaluate the cost aspect of the shopping experience. When the concept is adopted, the proposed disclosure will certainly need to be modified for form. In conclusion, it is my opinion that if HUD and the Board fail to acknowledge and act on correcting the on-going misconception of "YSP" and "indirect compensation", the disclosure solutions being forced on consumers and the industry will only continue to cause confusion and added consumer expense while interfering with developing a meaningful solution to the comparison shopping problem and to informed borrower decision making. It is also my opinion that if the changes presented by the FRB regarding YSP and flat fee compensation are implemented it will ultimately harm the consumer by eliminating competition and creating higher cost loans for them. Many procedures have been put into place with the National SAFE Act that should preclude the problems that we had in the sub prime arena. In addition on the prime side, most lenders have capped the amount of compensation a broker can receive so that the max compensation is 3% of the loan amount. This should clearly take care of any of the bad apples that may still be in the business.
I think you should at least see how these new processes are working, before making changes will ultimately harm the consumer and eliminate good and healthy competition. Thank you very much for your time. If you would like to contact

me, I can be reached at 814-861-3310, ford@pcmortgagesoltuions.com, or 1427 Ridge Master Drive, State College, PA 16803. Sincerely Thomas Ford McNutt Comparison hopping Disclosure Example As indicated in the position statement, a consumer can easily comparison shop when the interest rates are the same and only the front end costs differ. If the interest rates and costs being compared are different or if costs such as mortgage insurance or prepayment penalties are included in the loans, the consumer needs more information. By using a table such as the one offered below, these varying loan characteristics may be presented in a very simple, easy to understand format to use to comparison shop. IMPACT Mortgage Management Advocacy and Advisory Group (IMMAAG) offers the following disclosure as a simplified mortgage loan comparison shopping tool. By simply modifying Regulation X to require inclusion of the interest rate and by making this disclosure an addendum to the detail provided on the existing GFE the consumer can identify the total cost of (cash used) for alternative loan programs. For the purpose of the comparison, "cost" is defined as cash used to support the acquisition and payment of the loan. Total Loan Amount $250,000 Term 360 Months Loan 1 Loan 2 Interest Rate 5.00% 5.63% PÌPayments $1,342.05 $1,439.14 Front End Closing Costs Origination Fee $2,500 $0 Broker Fee $790 $0 Lender Fees $1,000 $0 Title Fees $950 $0 Total Front End Closing Costs $5,240 $0 Combined Cost to Borrower Loan 1 Loan 2 Total Cash Used - 36 mos $53,554 $51,809 Point of Indifference - 54 mos $77,711 $77,714 Total Cash Used - 60 mos $85,763 $86,348 Total Cash Used - 120 mos $166,286 $172,696 Total Cash Used - 240 mos $327,332 $345,394 Total Cash Used - 360 mos $488,378 $518,090