From: Colorado Association of Mortgage Brokers

Subject: Reg Z - Truth in Lending

Comments:

Date: Dec 24, 2009

Proposal: Regulation Z - Truth in Lending - Closed-end Mortgages
Document ID: R-1366
Document Version: 1
Release Date: 07/23/2009
Name: Colorado Association of Mortgage Brokers
Affiliation:
Category of Affiliation: Other
Address:

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

Comments:

From: The Colorado Association of Mortgage Brokers (CAMB) Government Affairs Committee Douglas L Braden and Kenneth T. Orogoglioso Subject: Reg Z - Truth in Lending, Document ID: R-1366 Comments: Proposal: Regulation Z - Truth in Lending - Closed-end Mortgages - Document Version: 1 Release Date: 12/24/2009 Name: Douglas L Braden and Kenneth T. Orogoglioso Affiliation: CAMB, NAMB Category of Affiliation: Government Affairs Committee Colorado Association of Mortgage Brokers / www.camb.org / 303-991-2240 For Clarity we have taken time to restate some historical information and have included Board proposed rule content and requests Overview: Congress enacted the Truth in Lending Act (TILA) based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. One of the purposes of TILA is to provide meaningful disclosure of credit terms to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit. TILA Section 105: Mandates that the Board prescribe regulations to carry out the purposes of the act. TILA authorizes the Board to prohibit acts or practices in connection with mortgage loans that the board finds to be unfair, deceptive, or designed to evade the provisions of HOEPA; and refinancing of mortgage loans that the Board finds to be associated with abusive lending practices or that are otherwise not in the interest of the borrower. Exempt from all or part of TILA: any class of transactions if the Board determines that TILA coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. The Board must consider factors identified in the act and publish its rationale at the time it proposes an exemption for comment.15 U.S.C. 1604(f). TILA Section 129(l) (2). In 1995, the Board revised Regulation Z to implement changes to TILA by the Home Ownership and Equity Protection Act (HOEPA). 60 FR 15463; Mar. 24, 1995. HOEPA requires special disclosures and substantive protections for home-equity loans and refinancing with APRs or points and fees above certain statutory thresholds. Numerous other amendments have been made over the years to address new mortgage products and other matters, such as abusive lending practices in the mortgage and home-equity markets. While HOEPA's statutory restrictions apply only to creditors and only to loan terms or lending practices, Section 129(l)(2) is not limited to acts or practices by creditors, nor is it limited to loan terms or lending practices. The Board's authority is not limited to regulating specific contractual terms of mortgage loan agreements; it extends to regulating loan-related practices generally, within the standards set forth in the statute. HOEPA does not set forth a standard for what is unfair or deceptive, but the Conference Report for HOEPA indicates that, in determining whether a practice in connection with mortgage loans is unfair or deceptive, the Board should look to the standards employed for interpreting State unfair and deceptive trade practices statutes and the Federal Trade Commission Act (FTC Act),Section 5(a), 15 U.S.C. 45(a).8 The FTC has interpreted these standards to mean that consumer injury is the central focus of any inquiry regarding unfairness. Consumer injury may be substantial if it imposes a small harm on a large number of consumers, or if it raises a significant risk of concrete harm. The FTC looks to whether an act or practice is injurious in its net effects. The FTC has also observed that an unfair act or practice will almost always reflect a market failure or market imperfection that prevents the forces of supply and demand from maximizing benefits and minimizing costs. In evaluating unfairness, the FTC looks to whether consumers' free market decisions are unjustifiably hindered. The Board's Review and Rulemaking Authority pertaining to the current Proposed Rules: These rules would be proposed under the Board's HOEPA authority to prohibit unfair or deceptive acts or practices in connection with mortgage loans. 36(d) Prohibited Payments to Loan Originators. The Board is proposing to use its authority in HOEPA to prohibit unfair or deceptive acts or practices in mortgage lending to restrict certain practices related to the payment of loan originators. See TILA Section129(l) (2) (A), 15 U.S.C. 1639(l) (2) (A). For this purpose, a 'loan originator 'includes both mortgage brokers and employees of creditors who perform loan origination functions. The 2007 HOEPA Proposed Rule covered only mortgage brokers. However, a creditor's loan officers frequently have the same discretion as mortgage brokers to modify loans' terms to increase their compensation, and there is evidence that creditors' loan officers engage in such practices. Accordingly, the Board proposes to amend the regulation to provide a definition of 'loan originator' in § 226.36(a) (1), which would include persons who are covered by the current definition of mortgage broker but also would include employees of the creditor, who are not considered 'mortgage brokers.' Existing§ 226.36(a) defines the term 'mortgage broker' because mortgage brokers are subject to the prohibition on coercion of appraisers in § 226.36(b). CAMB's Comments on The Board's Review and Rule Making Authority - CAMB believes that the Board is exceeding its statutory authority under Section 129(1)(2) of HOEPA and further believes the Board has failed to meet the standards adopted by the FTC and the courts, and codified in 15 U.S.C. sec. 45(n), for determining whether a practice is unfair or deceptive, and hence allowing them to alter our compensation structure under that premise. This section provides empirical support of CAMB's position and highlights the failures of the Board to substantiate its regulatory authority to do so. The Boards Analysis: A yield spread premium is the present dollar value of the difference between the lowest interest rate the wholesale lender would have accepted on a particular transaction and the interest rate the broker actually obtained for the lender. This dollar amount is usually paid to the mortgage broker, though it may also be applied to reduce the consumer's upfront closing costs. The creditor's payment to the broker based on the interest rate is an alternative to the consumer paying the broker directly from the consumer's preexisting resources or from loan proceeds. Preexisting resources or loan proceeds may not be sufficient to cover the broker's total fee, or may appear to the consumer to be a more costly way to finance those costs if the consumer expects to prepay the loan in a relatively short period. Thus, consumers potentially benefit from having an option to pay brokers for their services indirectly by accepting a higher interest rate. Yield spread premiums can represent a potential consumer benefit in cases where the amount is applied to reduce consumer's upfront closing costs, including originator compensation. An above par interest rate (or the addition of other loan terms) may be used to generate additional income to compensate the originator, in lieu of adding origination points or fees that the consumer would be required to pay directly from the consumer's preexisting funds or the loan proceeds. This can benefit a consumer who lacks the resources to pay closing costs in cash, or who might have insufficient equity in the property to increase the loan amount to cover these costs. Further, some consumers prefer to fund closing costs, including origination fees, through a higher rate if the consumer expects to own the property or have the loan for a relatively short period, for example, less than five years. For those consumers there are potential benefits. In such cases the yield spread premium does not increase the amount of compensation paid by the borrower to the originator, who would receive the same amount whether the loan has a higher rate or a lower rate accompanied by higher upfront fees. The Board's Proposal Under §226.36(d) (1), proposes to prohibit any person from compensating a loan originator, directly or indirectly, based on the terms or conditions of a loan transaction secured by real property or a dwelling. This prohibition would apply to any person, rather than only a creditor, to prevent evasion by structuring loan originator example, secondary market investors that purchase closed loans from creditors would not be permitted to pay compensation to loan originators that are based on the terms or conditions of their transactions. Under the proposal, compensation that is based on the loan amount would be considered a payment that is based on a term or condition of the loan. This would not apply to direct payments to loan originators. Under §226.36(d) (2), however, if the consumer compensates the loan originator directly, the originator would be prohibited from receiving compensation from the creditor or any other person. Because the loan originator could not receive compensation based on the interest rate or other terms, the originator would have no incentive to alter the terms made available by the creditor to deliver a more expensive loan. A creditor would be under the same restriction in compensating its loan officer. For this purpose, the term 'compensation' would not be limited to commissions, but would include to the originator, who would receive the same amount whether the loan has a higher rate or a lower rate accompanied by higher upfront fees. Salaries or any financial incentive that is tied to the transaction's terms or conditions, including annual or periodic bonuses or awards of merchandise or other prizes, such as payments that are based on the interest rate, annual percentage rate, or the existence of a prepayment penalty. Examples of loan originator compensation that is not based on the transaction's terms or conditions are listed in proposed comment 36(d) (1)-3. These include compensation based on the originator's loan volume, the performance of loans delivered by the originator, or hourly wages. The Board recognizes that loans originators may need to expend more time and resources in originating loans for consumers with limited or blemished credit histories. Because such loans are likely to carry higher rates, originators currently rely on higher yield spread premiums to compensate them for the additional time and efforts. Paying an originator based on the time expended would be permissible under the proposed rule. Although the proposed rule would not prohibit a creditor from basing compensation on the originator's loan volume, such arrangements may raise concerns about whether it creates incentives for originators to deliver loans without proper regard for the credit risks involved. The Board expects creditors to exercise due diligence to monitor and manage such risks. The Board shares concerns, however, those creditors' payments to mortgage brokers are not transparent to consumers and are potentially unfair to them. CAMB's Comments on The Boards Analysis - CAMB believes that the Board's analysis is flawed, biased and irrelevant to informed consumer shopping, decision making and consumer protection. Currently, creditors can increase their closing fund revenues or creditors can pay a funding revenue to loan originators in the form of 'yield spread premiums" which are the present dollar value of the difference between the lowest interest rate the creditor would have accepted without a fee for the offered interest rate and the interest rate the broker actually obtains for the borrower for the lenders proposed asset. Additionally, "Service Release Premiums" which are the secondary market's calculated present value of the future revenue flow negotiated for purchasing either the note or the servicing rights of their mortgage at an offered interest rate can be earned or shared by the creditor after obtaining the asset. Some or all of this dollar value may be paid by the creditor as a form of compensation or applied to the borrowers closing costs by the loan originator, though it may also be retained by the creditor in a direct loan. The creditor's payment when offered to the broker based on the interest rate is an alternative to the consumer paying the broker directly from the consumer's current reserves and/or equities. The consumer's current reserves and/or equities may not be sufficient to cover the broker's total fee, or may appear to the consumer to be a more costly way to pay for those fees if the consumer expects to prepay the loan in a relatively short period. Thus, consumers who may not have qualified for a refinance or home purchase or wish to retain their other investments benefit from having an option to pay brokers for their services indirectly by accepting a higher interest rate. "The Board recognizes that loans originators may need to expend more time and resources in originating loans for consumers with limited or blemished credit histories", yet the board does not seem to recognize that loan origination costs and overheads are much higher in some locations in our country or that home loans and valuations are much lower in others. Because such loans are likely to carry higher rates, originators currently rely on higher yield spread premiums to compensate them for higher costs and overhead or the time and effort it takes to make a smaller loan. "Paying an originator based on the time expended would be permissible under the proposed rule. Although the proposed rule would not prohibit a creditor from basing compensation on the originator's loan volume" or increasing offered interest rates and retaining the additional revenue without disclosure, "such arrangements may raise concerns about whether it creates incentives for originators to deliver loans without proper regard for the credit risks involved". CAMB finds the Board's concern "that creditors' payments to mortgage brokers are not transparent to consumers and are potentially unfair to them" only partially correct. On November 2, 1992 (57 FR 49600) the Department of Housing and Urban Development (HUD) issued a major revision of Regulation X, the rule interpreting RESPA. The rule defined the term 'mortgage broker' for the first time and ,under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and(c).) Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement. However, this rule does not apply to "creditors" and CAMB finds it biased and ironic that "the Board expects creditors to exercise due diligence to monitor and manage such risks" instead of enjoining creditors to the Board's proposed rules. Loan Originator Compensation Proposed Rule: The proposed rule 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 Boards Request: The Board is soliciting comment on an alternative that would allow loan originators to receive payments that are based on the principal loan amount, which is a common practice today. 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 unless that loan is in the consumer's best interest. The Board solicits comment on whether the proposed rule would be effective in achieving the stated purpose. In addition, the Board solicits comment on the feasibility and practicality of such a rule, its enforceability, and any unintended adverse effects the rule might have. The Board is expressly soliciting comment on whether the rule would be effective in achieving the stated purpose. Comment is also solicited on the feasibility and practicality of such a rule, its enforceability, and any unintended adverse effects the rule might have. CAMB'S Comments on The Board's Request Regarding Loan Originator Compensation Proposed Rule: CAMB believes that the proposed rule containing new limits on originator compensation for all closed end mortgages misconceived, gravely detrimental to consumers and would create a unbalanced trade practice. Prohibiting creditors from paying a portion of interest revenue to only a certain portion of our licensed industry professionals while allowing them to retain it in their own transactions would only restrict more consumers with demographic and credit challenges from buying a home or refinancing and instead allow creditors to impose global interest rate increases without disclosure or justification. Combined with the total closing costs, a loan's offered interest rate includes all of the proposed revenues that will afford its marketing, sale and servicing and is fully disclosed to every consumer for them to compare with other loans. In our research regarding broker compensation throughout the regulated financial industries, no such requirements prohibiting a portion of a similar revenue are in effect under the rules of HUD, the Federal Home Loan Bank Board, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the successor agency to the FHLBB, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Securities and Exchange Commission, the National Association of Securities Dealers (NASD), the North American Securities Administrators Association NASAA, the Financial Industry Regulation Authority (FINRA). And yet, the portion of this revenue in a closed end mortgage as disclosed by mortgage brokers is currently the most transparent and disclosed compensation in our financial industries. CAMB'S Comments on The Board's Request Regarding Loan Originator "Steering" Proposed Rule: CAMB agrees that the practice of steering or switching a consumer to a particular product solely to increase profits is inappropriate, however removing a consumers choice of how they pay for the origination service; either by paying the fees themselves up front or accepting a higher rate and allowing the origination costs be paid by a lender to the originator, or a combination of both, will cause severe restrictions for consumers. It's interesting that the Board states, "although the proposed rule would not prohibit a creditor from basing compensation on the originator's loan volume, such arrangements may raise concerns about whether it creates incentives for originators to deliver loans without proper regard for the credit risks involved. The Board expects creditors to exercise due diligence to monitor and manage such risks". All compensations are fully disclosed in the closing costs and interest rate. Excessive increasing of the rate simply to increase compensation should only result in a loss of business through competition. Consumers expect a loan originator or financial broker to share their knowledge, training and resources to assist them in making an informed decision. The true benefit of using an independent broker originator was our ability to source many options for our consumers. Now we will not have the ability because of the restrictions of the new GFE and the lack of portability of appraisals. This function has been solved in the investment industry with a test of "Suitability" done in their consumer disclosure with a "fact finder" and "risk analysis". This has been equally addressed by RESPA with the "Uniform Loan Application" and now by The Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act of 2008 with the "Net Tangible Benefit Disclosure". Please allow these new measures to have an effect before further limitations are imposed limiting choices for consumers. The Board anticipates working with the Department of Housing and Urban Development (HUD) to ensure that TILA and Real Estate Settlement Procedures Act of 1974 (RESPA) disclosures are compatible and complementary, including potentially developing a single disclosure form that creditors could use to combine the initial disclosures required under TILA and RESPA. The two statutes have different purposes but have considerable overlap. Harmonizing the two disclosure schemes would ensure that consumers receive consistent information under both laws. It may also help reduce information overload by eliminating some duplicative disclosures. CAMB Comments on Finance Charges, APR, rules implementation period and working with HUD: 15 U.S.C. 1605(b) and (c) statutory exclusions should remain and all other fees should be included. A single calculated table figure should be used to offer a consumer comparison. However, APR is no longer useful. Please refer to our published joint position statement (below) and simple disclosure solution with IMPACT Mortgage Management Advocacy & Advisory Group (IMMAG) to fully understand our position in support of our comments. Position regarding the misconception of Yield Spread Premium and consumer loan comparison shopping It is the position of The Colorado Association of Mortgage Brokers (CAMB) and IMPACT Mortgage Management Advocacy & Advisory Group (IMMAAG) that the perception of "Yield Spread Premium", adopted into the mortgage industry over 17 years ago, is a misnomer and has caused so much effort based on a misconceived premise that we have collectively lost focus on the real issue - transparency and illumination of loan costs for consumers to effectively comparison shop and make informed decisions. Existing disclosures obscure rather than illuminate their published objectives. Studies cited by the Federal Reserve Board (FRB) demonstrate that current disclosures actually complicate the consumer's comparative shopping experience. The current proposed FRB rule and subsequent debates are based on the misconception that a "premium" or "discount" value assigned to one interest rate versus another represents a "kickback" or "rebate", instead of the present value of the future revenue generated by the lender's proposed asset. Continued focus on how lenders choose to allocate revenue generated from their mortgage loans serves only to distract everyone from the important issues of competitive pricing and consumer protection, while it sabotages the intended goal of straightforward consumer loan comparison shopping. Loans are offered to consumers simply because they are assets that produce revenues. Revenue produced by the combination of closing costs and interest pays for the mortgage sourcing, origination and servicing process. Regardless of whether a lender or a third party performs any or all of these functions, the consumer bears these costs. These facts have been lost in the misconceived debates. 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 their products. In response, lenders created "rate sheets", functionally similar to any other product manufacturer's price sheets necessary to communicate the amount a lender is willing to pay a third party for the performance of its services rendered from the revenue the lender expects to receive on the sale of the asset at a given interest rate. Referring to this form of compensation as "indirect" is a misnomer. As used in the proposed changes to Regulation Z, "indirect compensation" is a direct 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 marketing and origination services, 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 a lender's business decision. To restrict their ability to decide whether to "build" or "buy" services could destroy competitive wholesale lending. This would only result in the unintended consequences of an industry wide reduction in price competition, retail increase in costs to consumers and cause further access issues to loans for both new home buyers and home owners who need to refinance. Information regarding how different lenders determine their interest rates or choose to market or sell their loans is of no value and instead complicates the consumer's ability to comparison shop. CAMB and IMMAAG find the Board's proposed changes to regulation Z regarding compensation and transparency inconsistent. While the Board expresses its concern, ". . . that creditors' payments to mortgage brokers are not transparent to consumers . . ." CAMB and IMMAAG find it ironic that the Board's proposal would allow direct lenders to pass along global increases in their interest rates to borrowers without any justification or transparency. Lender compensation to a third party for services rendered is fully included in the interest rate disclosed to the borrower. Further disclosure of this portion of the lenders revenue is irrelevant to the consumer's ability to comparison shop. The Board would better serve consumers and the objectives of Regulation Z by abandoning the unproductive debate about "indirect compensation" and by directing their effort towards working with HUD in the effective integration of the requirements associated with Regulation X to produce one set of disclosures that are easily understood and useful to consumers. Both agencies' efforts must be turned to a straightforward consumer disclosure that allows everyone shopping for a mortgage to understand and compare both the initial costs and the total combined cost over the life of a loan. The disclosure proposed by CAMB and IMMAAG, provides a consumer all that is necessary to loan comparison shopping. Given this simple tool, every borrower can be empowered to competitively price shop without multiple pages of confusing information and instructions. A draft solution of this concept developed by IMMAAG and supported by CAMB is included herein. If the true objective is to enable competitive, cost-based comparative shopping for the consumer, there are only two costs to evaluate: First, is the front end cost associated with obtaining a loan. Second, is the interest rate and its derivative debt service cost over a particular time frame. 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 on a mortgage product based on price, all other ostensibly "transparent" fully disclosed financial aspects of the transaction are irrelevant. If one lender offers a $250,000; 30 year fixed rate mortgage with total closing costs of $5000 for an interest rate of 5% and another offers the same mortgage with total closing costs of $4000 at the same 5% rate, it does not require disclosures of originator compensation or APR to determine which loan costs less. Given this information, all the consumer needs to accurately compare and price these loans is the added cost of their payments to term. In conclusion, it is the shared position of CAMB and IMMAAG that if the Board and HUD fail to acknowledge and act on correcting their misconception of "indirect compensation", the solutions they offer will cause additional confusion and added consumer expense instead of producing a meaningful disclosure for consumer comparison shopping and informed borrower decision making. CAMB and IMMAAG believe that HUD should immediately delay the January 1, 2010 GFE and HUD 1/1-A changes and work with the FRB as the Board considers their Regulation Z changes proposed on August 26, 2009, with the objective to produce a simplified, integrated disclosure that facilitates the spirit, intention and combined goals of both Regulation X and Regulation Z. Comparison Shopping Disclosure Example As indicated in the position statement, consumers can easily comparison shop when the interest rates are the same and only front end costs differ. If the consumer wishes to consider different rates or other costs such as mortgage insurance or a prepayment penalty, more information is needed. By using a shopping disclosure as the one offered below, different rates and costs can be presented in a simple format for consumers to effectively comparison shop and make informed decisions. . The Colorado Association of Mortgage Brokers (CAMB) in support of the concept designed by IMPACT Mortgage Management Advocacy and Advisory Group (IMMAAG) joins in offering the following disclosure as a conceptual solution to simplify and clarify competitive cost-based mortgage loan comparison shopping: Loan Amount $250,000 Term Fixed 360 Months Loan 1 Loan 2 Interest Rate 5.000% 5.625% P&I Payments $1,342.05 $1,439.14 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 Total Combined Expense Loan 1 Loan 2 Total Expense - 36 months $ 53,554 $ 51,809 Break Even Expense - 54 months $ 77,711 $ 77,714 Total Expense - 60 months $ 85,763 $ 86,348 Total Expense - 120 months $166,286 $172,696 Total Expense - 240 months $327,332 $345,394 Total Expense - 360 months $488,378 $518,090