Position Statement
The Yield Spread Premium Myth & Solution

It is the position of Mortgages on Main that the term "Yield Spread Premium", thrust into the mortgage industry taxonomy over 17 years ago, is a misnomer. The term has caused so much debate and effort in the name of clarification and transparency, that we have collectively lost focus on the real issue – to make it easier for consumers to effectively comparison shop and to make informed decisions.

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 Federal Reserve Board (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 loan 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.

The Yield Spread Premium Misconception

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 portion 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.

Mortgages On Main suggests 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.

Respectfully,

Sandy Mohlenkamp

Sandy Mohlenkamp
Mortgages on Main