

## Additional Comments on SHB 2770 rulemaking – “Disclosure Summary”

At the June 2 meeting, Kim Justice of the Statewide Poverty Action Network reported that most people do not know what YSP is and therefore suggested that we add a definition to the form regarding YSP. I agree that most people don’t know what the term YSP means and that the disclosure form that has been proposed fails to make it clear. However, adding a definition of YSP that will truly add clarity is likely impossible. We must keep in mind the task from HSB 2770: this form must make disclosures in “*plain language terms that are reasonably understandable to the average person without the aid of third party resources*”.

The Statewide Poverty Action Network suggests that we define YSP as a “*payment a mortgage broker receives from a lender for delivering a loan with an interest rate higher than the borrower qualifies for.*” I have to disagree with this suggested definition for three reasons.

First, this definition rests on the meaning of “the interest rate the borrower qualifies for”. Borrowers do not qualify based on interest rate. In general one cannot point to a “rate that the borrower qualifies for.” And if the borrower’s income, assets, loan amount, etc. happen to produce a maximum rate at which the borrower qualifies, then logically it follows that any “rate higher than the rate the borrower qualifies for” is a rate that the borrower doesn’t qualify for. Lenders offer above par pricing (YSP) for loans with above par interest rates. A given borrower may qualify for a loan at all of the interest rates offered. In such a case, there is no “rate higher than the borrower qualifies for.” This definition applied to such a case would suggest that there is no YSP – yet YSP will still be paid on all rates above par. This definition presumes that borrower loan qualification is a direct function of interest rate, which it is not. One variant on this definition that has been proposed in other documents is that YSP is paid on loans written at a rate higher than the *lowest* rate at which the borrower qualifies. This definition also fails a logic test. Generally, there is no *lowest* rate at which a borrower qualifies. And even if there was, the payment of YSP has no relationship to such a rate. So linking the YSP definition to the definition of “interest rate at which the borrower qualifies” doesn’t solve the problem of helping the borrower understand the disclosure of YSP. Not only does this definition fail to add clarity, but it is technically flawed.

Second, any disclosure or explanation that suggests that lenders pay brokers some kind of bonus for the delivery of loans at higher interest rates defies common sense and constitutes a misstatement at best and is generally misleading. Misstatements and misleading statements are prohibited by HSB 2770 (at least). How can one suggest that there is some kind of bona fide service agreement between a lender and a broker by which the lender pays no fee for services provided by the broker if the loan interest rate happens to be below par, but pays an increasingly large fee for services if the loan interest rate happens to be increasingly above par. Not only does this make no sense, but it is not true.

Third, the payment from a lender to a broker simply for the delivery of a loan above a given rate is likely to be found to be illegal. HUD Statement of Policy 2001-1 discusses at length how one can determine if and when lender payments to brokers are illegal. Although their discussion fails to define a clear point at which an otherwise legal payment becomes illegal, they cite court cases where there is some clarity. According to HUD, “the courts have held that a jury could find that yield spread premiums were illegal kickbacks or referral fees under RESPA where the lender’s payments were based exclusively on interest rate differentials reflected on rate sheets.” The proposed definition suggests just such a situation and to disclose this as the basis for or definition of YSP would put the broker in legal jeopardy under RESPA.

So I think we have to reject the definition of YSP offered by the Statewide Poverty Action Network.

Adam Stein of WAMB said that WAMB agrees with the Statewide Poverty Action Network to the extent that the form must include a definition of YSP to be clear. However, Mr. Stein suggests that we use the “HUD definition YSP” which he says is, “*a payment from a lender to a broker for goods and services provided.*” I have a few problems with this definition as well.

WAMB wants to include a definition of YSP which Mr. Stein’s reports is the “HUD definition of YSP”. Let’s set the record straight. HUD has not defined YSP as “*payment from lenders to brokers for goods and services provided*” as WAMB contends. Although I have searched at length, as near as I can tell HUD has not attempted to define YSP at all. The term cannot be found in their glossary of important mortgage terms. HUD Statement of Policy 2001-1, HUD’s best and most recent attempt to formally add clarity to the determination of the legality of YSP, fails to offer a definition. What HUD did, in HUD Statement of Policy 2001-1, was to treat YSP generically as representative of a payment from a lender that is aggregated with payments from the borrower to compensate brokers for goods and services provided inseparably to both parties. Bear in mind that HUD was discussing tests for the legality of lender payments to brokers. They were not attempting to define YSP.

But HUD said so much more about YSP in Statement of Policy 2001-1. They preface the discussion of disclosures by telling us that in this policy statement HUD offers “*a description of disclosures that it considers to be best practices.*” Best practices! That’s an interesting and important qualification. In general, best practices cannot be legislated and regulated. Regulations serve to define minimum acceptable standards and practices. *Best practices* are the realm of fiduciary responsibility and are often aspirational. Fiduciaries are required to serve the best interests of their clients. Fiduciaries must aspire to and embrace “*best practices.*”

In the discussion leading to their description of “best practices” with regard to YSP disclosure HUD says that, while current practices require the disclosure of YSP, they fail to disclose the purpose of YSP. And what is the purpose of YSP, according to HUD, that current disclosure practices as well as DFI’s proposed disclosure form fail to make clear?

According to HUD Statement of Policy 2001-1, the purpose of YSP is to **lower up front costs to borrowers**. HUD does not define YSP, but they are clear as to their opinion regarding the purpose of YSP.

WAMB asks us to use their claimed “HUD definition of YSP”, but WAMB is giving us an incomplete report of HUD’s view of YSP. I presume that when WAMB says we should use the HUD definition, they mean the complete definition. While HUD does not write a straight forward definition of YSP, after studying HUD’s Statement of Policy 2001-1 one must conclude that HUD believes YSP to be, “*a payment from the lender as some or all of the compensation to the broker for goods and services that are provided to both the borrower and the lender (inseparably) for the purpose of lowering the up front costs to the borrower*”.

HUD goes on to say that the *best practice* is to combine “early disclosure regarding mortgage broker compensation and **the entry of yield spread premiums as credits to borrowers** on the GFE and the HUD-1 settlement statement.” According to HUD, “**these methods of disclosure offer greater assurance that lender payments to mortgage brokers serve borrower’s best interests**.” And in light of SSB 6381 serving the borrower’s best interests is no longer an option. Any argument over the obligation of brokers to serve the borrower’s best interest ends on June 12, 2008.

We must reject the inaccurate and limited definition of YSP offered by WAMB.

A technically correct definition of YSP is: the difference between the loan face amount and the present dollar value of projected loan payments based on an above par interest rate discounted at the par interest rate and taking into account assumed loan prepayments. Or more simply, the amount that a lender or investor will pay for a mortgage note, less the note face amount, which is originated with an interest rate above the current par rate. This correct definition raises the interesting question, “from whom is the lender or investor purchasing the note?” While technically correct, such a definition would not be “*reasonably understandable to the average person without the aid of third party resources.*” Our consumer financial literacy is at such a low state that we cannot use a technically correct definition and be understood - sad.

The only answer to the question of how to handle the disclosure of YSP that is consistent with HUD’s stated purpose of YSP, HUD’s description of best practices, the imposition of fiduciary responsibility, and the mandate in SHB 2770 to provide a disclosure that is clear to the borrower without need to refer to a third party is to avoid the use of the term YSP altogether and simply require brokers to credit YSP to borrowers. Once brokers are no longer able to use YSP to create an open ended compensation structure, once brokers state in a single, clear, dollars and cents figure what they intend to charge for origination services they provide, YSP simply becomes a tool that borrowers, with the help of their broker, can use through the selection of the interest rate on their loan to produce the optimum balance of up front costs and monthly payments.

Any attempt at yet another disclosure form, such as the one being contemplated, must not only emphasize the purpose of YSP but must also provide the borrower with clear demonstration of how YSP is being used for that purpose. Such clarity and demonstration are required of fiduciaries. Neither the proposed draft disclosure nor any existing disclosure measure up.

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