

Thank you for another opportunity to comment on the rulemaking regarding SHB 2770.

**With regard to the revised draft one-page disclosure of YSP:**

1. The proposed disclosure contains a statement that the broker may be paid YSP. The statement that the broker may be paid YSP by the lender is a misstatement and is misleading. The mortgage broker industry has been claiming for many years that the Yield Spread Premium (YSP) is a payment from lenders to brokers “for goods and services provided” in the course of originating a loan. This claim has persisted for two reasons. First, so long as borrowers are unaware of the significance of YSP, they are not only denied the opportunity to be an informed party to the selection of their interest rate, but they are often charged substantially more for origination services than what might reasonably be warranted<sup>1</sup>; and second, so long as brokers hold to this definition as the basis for YSP, the collection of YSP is not in and of itself illegal under RESPA<sup>2</sup>. But is it a true that lenders pay brokers YSP as compensation for goods and services provided? I ask you to consider three questions:

- Assuming that lenders pay brokers for goods and services, would it not seem likely that the compensation arrangement would be spelled out in the broker-lender agreement?
- Does the YSP as compensation for goods and services claimed by brokers even make sense?
- How is this supposed payment for goods and services made?

2. Exhibit 1 is a sample of an agreement between a broker and a lender. While I cannot claim to have read every such contract available in the industry, I have read many. This one is, I believe, representative. As you can see, this contract between a broker and this particular lender represents the “entire agreement”. It is a thorough contract detailing every likely concern that might exist or arise in the course of the business conducted by the two parties. What you will not find in this contract is any list of compensable services. Nor will you find any language whereby the lender agrees to compensate the broker for any goods or services whatsoever. Would it not seem reasonable that if there was an agreement by which the lender is to compensate the broker for goods and services that those goods and services deemed to be compensable would be discussed in such an agreement? And does it not seem reasonable that the terms under which this supposed compensation would be paid and the rate of payment would be discussed in such an agreement? Furthermore, common sense tells you that if any such agreement did exist, any reasonable list or description of compensable services would be unrelated to either interest rate or loan amount related to an application. So it seems highly unlikely that an agreement exists wherein a lender agrees to pay a true broker an amount equal to yield spread premium for any goods or services provided by the broker.

3. Exhibit 2 is a sample of a wholesale lender’s ratesheet. This is, in my experience, typical of a wholesale lender ratesheet. In it you will see a listing by loan program of the

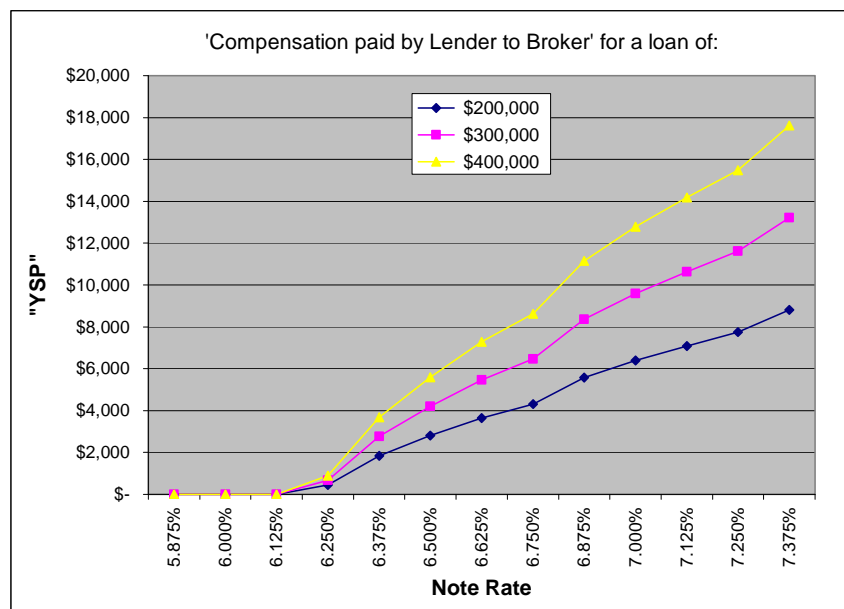
---

<sup>1</sup> As documented in “A Study of Closing Costs for FHA Mortgages” released by HUD in May 2008

<sup>2</sup> See HUD Statement of Policy 2001-1

price offered for each note interest rate. Most lenders also offer pricing beyond that which is shown on their daily ratesheet – at either end of the spectrum. You will see myriad price adjustments based on LTV, credit score, occupancy, impounds, geographic location, etc. In using this ratesheet, the practitioner is faced with the fact that lenders offer a virtual continuum of prices for loans over a wide range of interest rates. There is no qualification or distinction that would suggest that one end of the scale there is a fee being paid by the borrower and that on the other end of the scale there is a bonus being paid to the broker. What you will not find is any indication of a fee that the lender agrees to pay to the broker for goods and services provided nor any hint of a fee that the lender agrees to pay the broker for delivering a note at a higher interest rate. This sheet simply quotes the currently offered price for notes of different interest rates under each program.

4. Based on the prices shown in exhibit 2 for a conforming 30 year fixed rate mortgage with no additional price adjustments, I have prepared a graph (exhibit 3) showing what the YSP-based broker pricing model looks like. This is what many brokers would have you believe this wholesale lender is willing to “pay the broker for goods and services provided” in originating a mortgage loan. Exhibit 3 shows that at interest rates of 6.125% or less the lender, presumably, will pay nothing for those goods and services, i.e., there is no YSP. But for interest rates above 6.125% the lender, presumably, will pay for those same services. Further, the amount to be paid will increase dramatically according to the interest rate on the note and the loan amount. I think you must ask yourself if such a complex compensation scheme (that is not even mentioned in the broker contract) makes any sense. Is it reasonable that a lender would value broker provided goods and services at \$0 if the note rate is 6.125% or less, but will value those same goods and services at several thousand dollars if the note rate is 7.125%? Does it make sense that the lender would not only pay more for increased interest rates but also more for larger loans? Any specification of “goods and services” provided cannot reasonably be so substantially influenced by loan amount and interest rate. If true, this very unusual compensation scheme creates a significant conflict of interest for the broker in his relationship to his customer.



**Exhibit 3**

5. It has been suggested by many brokers that lenders pay brokers using the very unusual compensation schedule described above because lenders value higher interest rates more than they do lower interest rates. While that explanation seems logical, it is absolutely false. Lenders and investors choose to fund loans (invest money) based on the expected investment yield that will be produced. It can be readily demonstrated that the price schedule shown in Exhibit 2 for any given loan program is derived from calculations based on a common expectation for yield. That is to say, for example, that the lender sees essentially the same investment value in a 30 year fixed rate loan at 6.125% as it does at 7.125%. That yield is the value that lenders and investor seek. A simple analysis of the price-to-yield relationship demonstrates that the prices offered in Exhibit 2 do not vary as a result of varying value (yield) to the lender, but only as a result of different assumptions for prepayment rates together with the straightforward mathematical relationship between price, note rate, and yield. One must conclude from a proper analysis that a lender or investor looking for particular yield is essentially indifferent as to the interest rate on the note. There is no reason why such a lender or investor would prefer a higher interest rate note to a lower interest rate note. This story often told by mortgage brokers in explaining YSP is simply not true.

6. Lenders do not send a payment to the broker “outside of closing” as is commonly reported on the closing settlement statement. In my experience, lenders send an amount to escrow equal to the price the lender is paying for the note (not the “loan amount”) less any up front interest and less any specific lender fees (no discount point “fee” to be found). The broker is paid out of escrow according to the broker’s instructions to escrow. There is generally no instruction from the lender to pay the broker for goods and services performed as one might expect if this were an agreed upon form of compensation.

7. Describing and disclosing YSP as any form of a lender payment to brokers is false and misleading. Permitting the continued claim many brokers have long made regarding YSP serves to perpetuate a long standing and significant conflict of interest with regard to the recommendation of loan interest rates. This is not only unfair to borrowers, it is a misstatement, it is misleading, it is and contrary to the intent of SHB 2770 which is to help clarify these issues for borrowers, not simply regurgitate disclosures already made elsewhere. Furthermore, the imposition of fiduciary responsibility on mortgage brokers by the passage of SSB 6381 requires that brokers work to eliminate any such conflicts and clearly disclose any that cannot be eliminated. Conflicts of interest with regard to YSP are readily eliminated by crediting all YSP to the borrower in the 200 section of the settlement statement, in the manner described in HUD Statement of Policy 2001-1 as a best practice for mortgage brokers.

8. The disclosure statement regarding YSP contained in the proposed disclosure form will likely open brokers to legal liability under RESPA. RESPA, particularly as clarified by HUD Statement of Policy 2001-1, holds that the broker may not charge a fee or receive compensation that is determined solely on the basis of interest rate. The disclosure statement as written leaves the reader with the understanding that YSP is paid to the broker based on interest rate alone. The implication is that YSP is paid to the broker for delivery

of a higher interest rate loan and as such this form of compensation would constitute a violation of RESPA.

**With regard to the disclosure of the cost associated with a low or no documentation loan:**

1. While I am not sure I agree with the logic of disclosing that there is a cost associated with a no/low documentation loan relative to a full documentation loan but not disclosing costs associated with other loan options, SHB 2770 requires this disclosure – it is not optional. This disclosure is inadequate in the draft one-page disclosure form. The proposed form says merely that there may be additional costs. SHB 2770 requires a definitive disclosure. At the June 2 meeting WAMB reported that this cost is not determinable since the borrower who is unable to fully document income does not qualify for a “full documentation” loan. I must respectfully disagree with WAMB’s claim that this cost cannot be determined; it is readily determinable. The determination of this cost has nothing to do with whether the borrower would qualify for one or the other program. It is an academic exercise, not a qualification examination. SHB 2770 requires a disclosure that there IS (not “may be”) an additional cost related to a no/low documentation loan. This disclosure would be more meaningful if the dollar amount of this cost is also disclosed.

**With regard to the disclosure of the possibility of the borrower having to pay a fee for “discount points”:**

1. Referring back to exhibit 2, a close examination of the lender’s daily ratesheet will fail to identify not only a payment from the lender to the broker, but will also fail to identify any fee to be paid by a borrower in exchange for a lower interest rate. There simply is no such fee in the brokered transaction. The proposed disclosure form asks brokers to disclose “discount points” as a fee being charged. To suggest such a fee exists is a misstatement and is misleading. The wholesale lender pays a “price” for the borrower’s note. It is customary to disclose in the 200 section of the closing settlement statement the principal amount paid by the lender. In the true brokered transaction, the lender does not disburse the “principal amount of the loan” – the lender pays a price as indicated on the rate sheet in effect when the loan is locked. It is my view that the most accurate complete and clear practice would be to disclose the price the lender is paying the borrower for his note. This price should be disclosed on the GFE and in the 200 section of the closing settlement statement in lieu of the current practice of disclosing the “principal amount of the loan”. By disclosing the actual price offered or paid, the need to fabricate a fee called “discount points” and a “compensation” called YSP is eliminated. Such disclosure makes plain and accurate the true nature of the transaction that occurs between lender and borrower in the brokered transaction. Such disclosure would eliminate the myth of discount points and YSP and the confusion these artifacts create. Such clarity is in keeping with the purpose of SHB 2770 and serves the borrowers best interest as is required by SB 6381 in the brokered transaction.

**With regard to the distinction between brokers and “lenders”**

1. As of June 12, brokers in our state are fiduciaries with an obligation to serve the best interests of the borrower. Lenders serve their own interests. This distinction is recognized

by RESPA and TILA and shows up in the differences in the details of the transaction that must be disclosed to the borrower. Perhaps it would make sense to create two disclosure forms, one for use by those who have a fiduciary responsibility to the borrower and one for use by those who do not owe this duty to borrowers.

**With regard to listing the borrower's income used on the loan application on the disclosure form:**

1. I like the idea of listing the income used on the application. I would modify the disclosure statement to read: "Your loan is based on your monthly income of \_\_\_\_\_ , which you have certified to be true and accurate."

On behalf of my clients and borrowers throughout the state, thank you for considering my comments,

Brad Allen,  
bradleyallen@earthlink.net  
Poulsbo, Washington