

Department of Financial Institutions
c/o Susan Putzier
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Thank you for this opportunity to comment on the sixth draft of the proposed mortgage disclosure summary form. Unfortunately, I will be unable to attend the public hearing today, October 7, 2008, but I ask that my comments be added to those of others testifying at that hearing.

In my view as a practicing fiduciary and an expert in the application of fiduciary standards to the financial services industry, the proposed form fails as a tool for a fiduciary and it fails as a tool to make some critical factors simple, plain, and understandable to the borrower. I suggest, as an alternative to the language regarding broker fees, discount points, and YSP the following:

The total fee you will pay the broker for services provided in the origination of your loan is \$ _____. If you select a loan interest rate that is greater than the market rate, some or all of this fee and third party fees will be paid by funds provided by the lender called Yield Spread Premium. The higher the interest rate, the greater the YSP. If you select a loan interest rate that is lower than the market rate, you will have to pay additional closing costs in the form of Lender Discount Points. The lower the interest rate, the greater the discount points. At the interest rate you have selected and based on current market information, you will pay/receive \$_____ discount points/YSP. Market prices may change frequently and without warning if your loan is not locked.

Discussion:

Earlier this year the legislature passed amazingly bold legislation imposing fiduciary responsibility on mortgage brokers (SB 6381). This is a legal status requiring mortgage brokers and the loan officer's representing them to act in the best interests of the borrower. The mortgage broker industry has fought against the imposition of fiduciary responsibility for decades and continues to fight it across the country. How meaningful was this move? That remains to be seen. But I contend that, had mortgage brokers operated as fiduciaries for the past 10 years, we likely would not be in the mess we are in today. A mortgage loan officer acting in the borrower's best interest cannot knowingly put a borrower into a loan that he cannot afford – even though the lender's underwriter might approve the application. A mortgage loan officer, acting in the borrower's best interest cannot permit the borrower to sign and submit an application knowing it to contain false information about the client's income. A mortgage loan officer, acting in the borrower's best interest, cannot arrange to receive compensation for origination services that is more than a reasonable amount for those services and cannot deceive the borrower as to the nature and amount of compensation he is receiving.

Besides declaring that Washington mortgage brokers have fiduciary responsibility, the legislature said, in effect, "enough of the confusing, pile of paperwork that befuddles so

many borrowers.” The state legislature cannot do away with the pile of paperwork as it is mandated by federal regulations. But in HB 2770 they did call for a single page “*simple, plain language, disclosure that is reasonably understandable to the average person, without the aid of third party resources*” so that the borrower could have a meaningful summary of the critical information that he should be considering.

I acknowledge the work done on this disclosure form so far. It looks better than the starting point. BUT – it’s still a product designed less to inform the borrower in *simple, plain language* and more to placate lawmakers while supporting brokers who want nothing more than to continue business as usual in spite of the bold changes called for by the legislature. Put simply, this form fails as a tool for a fiduciary and it fails as a tool to make some critical factors simple, plain, and understandable to the borrower.

Is it in the best interest of the borrower for the loan originator to muddy the truth about what the client will be paying for origination services? Simple plain language is a single figure that says, “this is the dollar amount I charge for origination services”. If the broker wants to explain how he came to that figure, let him do that elsewhere. But a form designed to provide disclosure in simple plain language should have a single line for a dollar amount entry for the amount of total compensation the broker intends to charge for his origination services. In doing so, the borrower can plainly see what he will be paying a broker for those services. This is consistent with the broker’s fiduciary responsibility and it is in keeping with HUD’s Statement of Policy 2001-1 – “*In HUD’s view, meaningful disclosure includes many types of information: what services a mortgage broker will perform, the amount of the broker’s total compensation for performing those services*”.

Is it in the best interest of the borrower for brokers to continue to operate as though lenders pay a separate fee for services provided in the form of YSP? Even if true (and it’s not) treating YSP in this manner creates a clear and substantial conflict of interest. Fiduciaries must seek to eliminate conflicts of interest and where they cannot be eliminated, manage them transparently. This conflict of interest is easily removed. There is a simple strategy that every broker can employ that will eliminate the conflict without jeopardizing the ability to charge a fair fee for services provided. That strategy is to credit YSP to the borrower. By crediting YSP to borrowers the need for the endless debate over the definition of YSP is eliminated. The crediting of YSP to borrower’s is eminently consistent with broker’s fiduciary responsibility and is in keeping with what HUD described as “best practices” in HUD Statement of Policy 2001-1 – “*HUD believes that improved 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 are both useful and complementary forms of disclosure. The Department believes that used together these methods of disclosure offer greater assurance that lender payments to mortgage brokers serve borrowers’ best interests.*”

Is it in the borrower’s interest to hold to anything other than the highest standards of clarity and fairness in describing the services provided by the originator and its total cost to the borrower? Absolutely not. The industry continues to buck the notion of fiduciary

responsibility by insisting on a disclosure form based on a lower standard of care. The disclosure of broker compensation in the manner presented in the current proposed form is inconsistent with mortgage broker fiduciary responsibility. If this traditional obfuscation is adopted, the DFI will be letting the borrowers of Washington down, just as the regulators of FNMA and FHMLC let the country down.

Fiduciary responsibility, a fact for mortgage brokers in the State of Washington since June 12 of this year, demands clarity in the brokered transaction. HB 2770 demands clarity in the form of a simple, plain language disclosure. HUD Statement of Policy 2001-1 called for this clarity seven years ago and has largely been ignored. The current financial crisis is in no small part due to the lack of clarity that existed and exists in each mortgage transaction that adds to the flow of mortgages to bank balance sheets or bundled into mortgage backed securities.

HUD, in its Statement of Policy 2001-1, reiterates that broker compensation must be fair and reasonably related to the value of the services being provided. HUD said that it will not attempt to separate broker compensation into component parts to determine if each part constitutes fair compensation. They stated that in determining whether broker compensation was reasonable, one should look at total compensation. The disclosure form proposed not only subdivides broker compensation into component parts (origination fee, broker fee, YSP) but separates them on the form as if to suggest that they represent things that should have different meaning to the borrower. These component parts have no meaning to the borrower and disclosure in this manner only serves to obfuscate the one feature that does have meaning to the borrower in judging whether he is paying a fair and reasonable fee for origination services – the total compensation. HUD has said it. Clarity under fiduciary responsibility demands it. Mortgage brokers apparently must be forced to do what they themselves would require of any other service provider – mortgage brokers must be tasked to disclose in a single figure, not by way of some litany spread out across the page, exactly how much they intend to charge for origination services.

In the brokered transaction the borrower must consider that the lender pays him a price for his loan. That price may be less than the note amount resulting in the payment of the difference in the form we call “discount points”. This occurs when the note interest rate is lower than the lender’s par rate. At the other end of the interest rate spectrum, the price the lender will pay exceeds the note amount resulting in a premium that we call yield spread premium. Neither of these manifestations of the price of the note has anything to do with broker services and so neither has anything to do with broker compensation for services provided. Brokers should state clearly, plainly, in a single figure, what their services will cost the borrower. The borrower should be free to select, ideally with the help of a fiduciary, an interest rate that serves his interests. He should have the ability to plainly see the extent to which selection of lower than par interest rates will increase his total closing costs or the extent to which the selection of higher than par interest rates will reduce his closing costs. In practice we should be crediting YSP to the borrower just as we charge discount points to the borrower.

The broker industry has a longstanding history of confiscating YSP. This practice creates a tremendous conflict of interest that cannot be permitted to continue now that brokers are fiduciaries. YSP should be credited to borrowers just as discount points are charged to borrowers, they both arise from the same pricing mechanism. The consequences of this treatment are: (1) removal of conflict of interest that results when brokers are able to enhance their compensation on the basis of higher interest rates and largely without the knowledge and consent of the borrower. By treating YSP as a credit to the borrower, the borrower sees the total compensation plainly and clearly. Not only can the borrower judge whether the fee to be paid is fair, but the borrower is free to compare the fee of one broker to that of another. (2) Clarity – by crediting the YSP to the borrower, the broker's compensation is no longer a function of an amount disclosed as broker fees or origination fees plus some mysterious component that the borrower does not understand. The total fee to the broker becomes something that can be expressed in *simple, plain language that is reasonably understandable to the average person, without the aid of third party resources*. (3) Crediting YSP to the borrower does not diminish the fair fees currently charged by brokers. If a broker can justify \$5,000 as compensation for his services, he should present his fee and his justification for that fee to the borrower using plain language and let the borrower judge whether the price is justifiable. The only people who should fear this kind of disclosure are those who are charging fees that cannot be justified.

Common sense and HUD's Statement of Policy 2001-1 tell us that the basis of fairness, with regard to broker compensation, is that the total compensation to the broker be a reasonable price for services provided. How can fairness be achieved when we break that total compensation up into myriad component parts and when we do not even put all those parts in one place on the form. The form proposed, rather than improving clarity as called for in HB 2770, serves to perpetuate the obfuscation of the past by supporting the myth that there no relationship between YSP and the cost of broker services ultimately paid by the borrower.

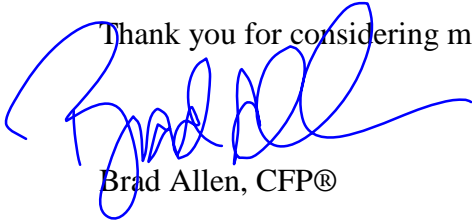
The form proposed is, for purposes of disclosure in brokered transactions, not only not in keeping with the best practices described in HUD Statement of Policy 2001-1, it is contrary to the spirit of HB 2770, and it fails as a tool to promote and support the legislatures' declaration that mortgage brokers are to be fiduciaries to their clients and obligated to serve their client's best interests.

I ask you to do the following:

Require brokers to credit all YSP to the borrower in section 200 of the GFE and HUD 1. Require brokers to make a simple dollar amount statement of the total fee they will charge for origination services on this form, not three days after an application, but prior to taking an application, that fee to be based on the work involved in the origination of the loan – not on interest rate, not on loan amount.

As an alternative to the manner in which the broker fees and YSP are disclosed on the proposed form I strongly urge the adoption of language similar to that presented at the opening of this letter.

Thank you for considering my comments,

A handwritten signature in blue ink, appearing to read 'Brad Allen', with a stylized flourish extending to the right.

Brad Allen, CFP®