DealPoints

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Grading MDIA: A Consumer Perspective

By Emil Fanelli

The Mortgage Disclosure Improvement Act ("MDIA") could not have been better telegraphed, and yet many originators are just now beginning to fully comprehend the impact of the new regulations. At this stage, the long-term effects on the structure of the mortgage lending industry are still very unclear. While the jury may be out on whether or not the beleaguered wholesale lending model can successfully adapt to the new regulations, this much is sure: MDIA has forever changed the residential lending landscape. While the Darwinian laws of regulatory adaptation will continue to reshape the mortgage business over the next year or two, you must be sure you have the right origination strategy in place. Your institution's ability to serve your customers' needs while walking the RESPA tightrope will depend as much on understanding the new risks to your organization as much as it will on understanding new regulatory procedures. More importantly, you should fully understand your institution's strategic priorities.

The Consumer Side of the New RESPA Changes

The implication of each of the Good Faith Estimate ("GFE"), and HUD-I changes are more easily understood when framed in the context of the regulatory agenda. Far and away, the principal objective of these changes is the government's attempt to ensure that every consumer is provided with a tool that insures a standard of disclosure and measurement that forces lenders into a more competitive environment. The idea being, of course, that competition will drive down the costs of lending. Let's examine and apply a subjective grade to the key aspects of the GFE. It is important to note

that the following analysis is expressed from a consumer's viewpoint and not that of an originator.

The new GFE implements plain language in the disclosure that effectively states the important financial terms of the loan product that the borrower and lender have selected. Going forward there should be less borrower confusion on important terms such as the loan amount, interest rate, payment changes, prepayment penalties or the potential for negative amortization, to name a handful. However, this document does fall a bit short of hitting the target. Noticeably missing are the monthly tax and insurance portion of a payment. (This is the TI piece of the borrower's PITI.)

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Also, the final settlement costs line labeled A + B on the GFE could easily cause an applicant's pulse to accelerate. For some reason, the architects failed to provide a line item calculation of the estimated cash to close, thereby failing to take into consideration any buyer deposits that will serve as a credit against the final settlement cost calculation. In addition, some seller-paid charges related to the settlement must be included in the "B" portion of the calculation. Although the cash to close requirement is addressed in the HUD-I, that document doesn't arrive until prior to closing. To overcome this oversight, many lenders have developed – or are in the process of developing – a supplemental document to be provided with the GFE that better explains the settlement. Grade: B

The new GFE completion guidelines seek to hinder bait-and-switch tactics. To accomplish this, there are well-defined completion instructions that are far more rigid than in the past. The introduction and definition of zero tolerance fees and 10% tolerances will effectively create an environment where originators now have to know Service Providers fees when an application is taken. In effect, the new GFE form represents a better estimate and a virtual ceiling for settlement costs (excluding the 10% variance on some Service Provider fees.) The penalty for exceeding the zero and 10% tolerance is simple: Originators who misquote fees on the low side will be forced to absorb or refund the consumer the difference between the high side tolerance and the actual settlement costs. Grade: A

The new GFE creates standardized guidelines for the preparation of the GFE, enabling apples-to-apples comparisons between lenders. To those originators that

See backside to continue

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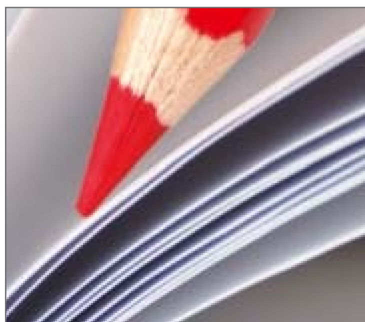
pride themselves on fair pricing and full disclosure, this should be a welcome benefit. However, one can never underestimate the ingenuity of some originators when it comes to navigating…uh…OK…let's be honest…circumventing regulatory laws. On the surface, the form and its rigid guidelines should be effective. The Shopping Chart on page three of the GFE should reinforce the idea of seeking competitive bids from other lenders. If the consumer uses this tool it could go a long way towards achieving these objectives. Since we are anticipating some creative "salesmanship" that may evolve from this disclosure, we will shave about three-quarters of a grade. *Grade: B+*

The GFE seeks to communicate and fully disclose that the consumer has a right to shop for service providers. The former GFE structure fell way short of this goal, and made it easier for the originator to steer the consumer to service providers that may not have afforded the best pricing. This piece of the GFE puzzle should accomplish its objectives and could take a big bite out of some service providers' entertainment budgets. However, once again the formidable ingenuity of a motivated loan officer, combined with the complacent nature of the consumer, may hinder some progress in this category. *Grade: B*

The GFE intentionally creates a regulatory hurdle that seeks to create a competitive disadvantage to originators that broker their loans. Ok, so we have to be fair about this one. The architects of this legislation would never describe it this way. We chose to use provocative language that more properly frames the viewpoint of many originators. However accurate this viewpoint may be, you'll never hear a regulator admit to favoring one lobbying party over another. ***The regulatory architects would tell you that the new GFE disclosure requirements are designed to hinder the practice of steering unwitting consumers into higher-cost mortgages.*** Given that this is the published objective of the new GFE requirements, at best, we feel that the regulators got it half right.



As is often the case, when it comes to government intervention there can be unintended consequences, including leading the consumer right down the very path that the legislation purports to avert. Provocative conspiracy theories aside, early returns could lead you to believe that this most important piece of the GFE pie is driving former broker/originators into the arms of awaiting bankers and mortgage bankers who seek to expand their own retail interests.

Why would broker/originators give up their independence? It all comes down to whether or not they believe that Box 1 of the GFE will have a material impact on their business. To be sure a retail banker will tell clients that Box 1 is the most important box when choosing a lender. They will say something like, "I get paid out of the origination fee and my fee is far lower than a broker's".

Naturally, a broker/originator will direct the customer to focus on Box A of the GFE. If a broker is successful at securing better pricing from a wholesaler, combining this with a reasonable income target (whatever that is) the broker originator should be able to compete very well on Box A.

The fact that the same originators can change business cards and effectively hide what used to be called Yield Spread Premium ("YSP") is one reason why this category scores poorly. The other reason for a lower score is that consumers could easily be confused by the tug of war between Box 1 and Box A sales tactics. *Grade: D*

On balance the new GFE/HUD-I requirements may have fallen just a bit shy of their intent. To be sure we give regulators a very good score on the majority of the new GFE approaches. Minus the Box 1 and Box A conflict, we would rate the positive intent of this regulation somewhere between a B to a B+. In regulatory terms this is a terrific score for the consumer.

However, "internal" YSP has the most significant impact on borrower interest rates and settlement costs, and (mortgage) bankers, are not required to disclose "internal" YSP. Because broker/originators can easily change employment to an origination-friendly mortgage banker and still generate high income opportunities as a loan officer, we'd have to say that the consumer's interests have been partially served.

While it is still too early to predict how this will all shake out, the early indications are that the law of unintended consequences will force us to grade the new GFE with a C+, at best. Of course, there are other subtleties to be considered. For example, a broker/originator may be forced to originate loans for as little as 1% plus fees in order to effectively compete with the banker/originator. Also, there appears to be a sea change in the economy at large (and in mortgage banking specifically) that is driving down loan originator compensation packages. If this trend continues, we believe that the new disclosure environment, combined with a more consumer-friendly originator compensation environment, will ultimately benefit the consumer.

Emil Fanelli is a mortgage banking executive with 20 plus years of mortgage banking sales, capital markets and operations experience. Emil has sales and operational experience in retail, wholesale and correspondent lending.

In the next edition of *Deal Points* we will contrast broker and banker lending models in light of the new GFE environment.

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