

WHERE O' WHERE DOES MY YSP GO?

Is the spread a bit too thin?

BY JOSHUA WEINBERG



Among the confusion in complying with HUD's new RESPA Rules, it is likely no issue has raised quite as much concern as the treatment of Yield Spread Premiums (YSP). As an industry leader, Calyx feels a responsibility to help do part to clear up some of the confusion. We are proud to be the first major LOS to bring the new Good Faith Estimate (GFE) to market (August 2009 with Point 7.1) and through of our close collaboration with HUD, we're also very confident our implementation is accurate and compliant.

Throughout the design and execution of our 7.2 release this past November, we had the opportunity to analyze and consider many facets of the RESPA Rules and the required implementation changes. We also had a chance to speak with many interested industry participants and through this "in the trenches" experience have discovered several issues we feel the industry needs help understanding.

As of January 1, 2010, YSP will ONLY be considered a credit to the borrower. The concept of "front-end" and "back-end" compensation disappears, and all compensation the Originator expects to receive must be clearly indicated upfront, and may not change. This means Originators are required to enter any and all amounts they desire to be compensated in Block 1, "Our Origination Charge" of the GFE.

Since originators must include the exact amount they will be compensated in Block 1, YSP does not affect the originator's compensation directly; it simply reduces the borrower's closing costs, which may be used to pay the

originator's compensation.

So what about YSP? Well, it would be helpful to erase the phrase YSP from our vocabulary. Moving forward, we need to gain an understanding that the specific interest rate chosen by the borrower may provide an indirect payment that is credited to them for the acceptance of an above par interest rate. Or, the specific interest rate chosen may require the borrower's payment of a charge (Discount) in order to receive the interest rate they desire. This concept reinforces HUD's repeated mantra that "a credit and a charge [for the specific interest rate chosen] cannot occur together in the same transaction."

Because this is all new and a little confusing, using some real life scenarios may make this easier to understand.

1. Let's assume a loan amount of \$100,000 and that the originator wants to make 2percent on the deal. There are processing fees of \$300 and underwriting fees of \$450. Block 1, "Our Origination Charge" would display \$2,750 ($2,000 + 300 + 450 = 2750$). The borrower says they want an interest rate of 5.5percent. Checking today's rate sheet shows that 5.5percent is exactly PAR (no payment or charge for the specific interest rate chosen).
 - a. If the originator is a Lender, they may check the first checkbox in Section 2, "Your credit or charge for the specific interest rate chosen" which indicates any credits or charges for the interest rate are included in "Our Origination Charge."
 - b. If they are a mortgage broker, they may check either the second or third checkboxes, and \$0 ➤

would be displayed in the amount column.

Block A, "Your Adjusted Origination Charges" would display \$2750.

2. Using the same scenario, let's say the borrower decides they want an interest rate at 4.875percent. Based on the rate sheet pricing, 4.875percent has a charge (discount) of 1.5percent. The interest rate selected by the borrower has no impact on the compensation the originator receives. Block 1 still shows \$2,750. However this time, regardless if the originator is a Lender or a mortgage broker, the third checkbox in Section 2 must be checked, indicating the borrower is paying a charge for the specific interest rate chosen. \$1500 would be included in the Amount column and Block A would display \$4,250 ($2750 + 1500 = 4250$).
3. Finally, again using the same scenario, the borrower decides they can afford a higher monthly mortgage payment and would prefer not to pay as much at the closing table. The originator looks at the rate sheet and determines that an interest rate of 6.5percent provides an indirect payment to the borrower of 2percent. This point is so important it's worth repeating one more time. The interest rate selected by the borrower has no impact on the compensation the originator receives. Block 1 still shows \$2,750.
 - a. In this scenario, if the originator is a mortgage broker, they must check the second checkbox in Section 2, indicating the credit to the borrower reduces their settlement charges. In the amount column -\$2,000 would be displayed. Block A would display \$750 ($2750 - 2000 = 750$) and indicate the borrower's adjusted origination charges are reduced to \$750 because they are indirectly paying \$2,000 by accepting the above

par interest rate.

- b. If the originator were a Lender, they have the option of checking the first checkbox in Section 2, indicating the charge for the interest rate is included in the amount in Block 1; however it is likely the originator would be paid internally from the lender and their 2percent origination charge would be subtracted from Block 1. If that were the case, Block 1 would display only \$750. Section 2 would display \$0 and Block A would display \$750.

Working through these examples highlights a very significant component of the RESPA Rules. Originators will no longer be compensated based on the pricing related to the interest rate. HUD believes borrowers were taken advantage of and that interest rates were used as a sales tool; an opaque method of increasing originator's compensation.

"HUD's intention of the revised Rules is to increase transparency of the costs for obtaining a mortgage and to increase shopping, which they estimate will reduce the cost of financing by \$668 per loan", according to Ivy Jackson, Director, Office of RESPA and Interstate Land Sales US Department of Housing and Urban Development in written testimony on 5/22/08.

While the treatment of YSP has generated much debate, the creation of a bright line separation between originator's compensation and the borrower's selection of the interest rate is probably a good thing. Again, the amount listed in Block 1, "Our Origination Charge" cannot change at all from the time the disclosure is issued. However, the credit or charge for the specific interest rate chosen may change before the interest rate is locked. As a result, if Block 2 changes, it will affect the calculation in Block A, "Your Adjusted Origination Charges." After the interest rate is locked there is a zero tolerance for change,

unless the requirements of a “Changed Circumstance” exist.

If the line between originator compensation and the credit or charge for the interest rate chosen were blurred, it is likely the figure in Block A would also be held to a \$0 tolerance, leaving originators subject to market conditions while the interest rate was not locked.

So, while the mystery of how to document YSP on the GFE beginning in January has hopefully been solved, the saga of originator compensation continues. The Federal Reserve Board’s proposed amendments to the Truth in Lending Act (TILA) contain restrictions on how loan originators may legally be compensated and how that figure is determined. For instance, the proposed rule changes state that originator’s compensation may not be based on the “Terms and Conditions” of the loan, leaving many industry participants wondering what the charge would then be based on.

The current pace of regulatory and compliance change is frenetic and odds are things will continue like this for at least the next year and probably longer. Turn to the sources you know and trust for assistance in guiding through these complex issues and tumultuous times. We at Calyx will continue to be an advocate for the mortgage industry and

are committed to doing our part to bring clarity and stability when it’s needed most.

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