

Clarifying Our Roles

Brokers and bankers should work together to educate consumers and better the industry's image

By **Tom Heath**, owner, Rio Nuevo Financial LLC

MORTGAGE BROKERS, BANKS and lenders are in business to help consumers get financing to purchase or refinance their homes. In many cases, though, the roles can be blurred in consumers' eyes.

Defining the roles of bankers versus brokers is important to helping consumers make better choices, however. Bankers and brokers must work in concert to ensure the mortgage industry's vitality and to restore the public faith in our purpose.

This past May, the Mortgage Bankers Association (MBA) issued a report titled "Mortgage Bankers and Mortgage Brokers: Distinct Businesses Warranting Distinct Regulation" ([PDF: tinyurl.com/6yl3fe](http://tinyurl.com/6yl3fe)) to help policymakers clarify the difference between bankers and brokers. In many ways, the MBA paper is well-intentioned but misguided.

There are a number of issues discussed in the MBA paper that must be made clear within the industry and for consumers.

Pay structures

One issue deserving clarification is the broker-commission process. A major argument in the MBA report is that consumers misunderstand the broker commission process and are therefore susceptible to broker "steering."

As a broker, I agree that customers must have a clear picture of their mortgage transaction. It is important to help them understand yield-spread premiums (YSPs) and par rates that banks offer to brokers. Many do not realize, however, that the par rate that banks offer brokers often is lower than the rate the bank would offer through its retail branches.

Bankers, on the other hand, earn fees in originating, underwriting and servicing loans

and then selling loans on the secondary market, in addition to cross-selling items. The income the bankers receive on the secondary market can vary based on market conditions, but the higher interest rates they charge to borrowers typically bring better returns from the investors.

"The mortgage industry already has disclosures and mechanisms in place to help consumers make good financial decisions. The problem is that many consumers don't know the right questions to ask."

Unlike brokers, who must disclose their YSP, banks typically do not disclose how much of the offered rate comprises the servicing premium or for how long they expect to hold the loan or servicing rights before selling it on the secondary market.

Risk exposure

Although bankers are financially tied to a loan through its termination and have higher earning potential than brokers, brokers also are at risk.

Brokers often work with their clients for several months to get them into a situation where they can obtain financing. But brokers are not guaranteed income from this work. Customers are not financially or legally bound to the brokers.

Because of their agreements with lenders, which stipulate that brokers bear risk if a loan

they originate is found to have fraud or is paid off within the first six months, brokers could be responsible for reimbursing the lender for their fees in such cases.

And because brokers typically are small businesses, as the MBA paper points out, having to repay their fees could tax their operating budget. Buying back a loan could put these brokers out of business — in other words, maximum exposure.

Underwriting

In the May report, the MBA states that it agrees with the sentiment that brokers are more inclined to steer customers toward bad loans to earn high commissions and that bankers are more likely to practice sound lending practices.

Because bankers underwrite the loans, including evaluating borrowers' creditworthiness and property values, as the MBA paper points out, it would seem that regardless of the source — broker or banker — the system would work to protect the borrowers.

There now are massive delinquencies because some brokers did steer the customers toward bad loans — that bankers accepted. Brokers and bankers alike acted out of greed and shortsightedness.

Regulations

Bankers and brokers both face varying regulatory concerns. There are the U.S. Department of Housing and Urban Development's Real Estate Settlement Procedures Act reform, the Federal Reserve Board's proposed changes to the Truth in Lending Act and Congress' Federal Housing Administration overhaul.

This additional regulation for brokers, but not necessarily for bankers, is leading toward confusion within the industry without providing clarity for borrowers.

Many, including the authors of the MBA paper, suggest that brokers should have a required net worth. Because brokers typically are small businesses with little capital, however, a financial benchmark to remain in business would discriminate against smaller companies.

Continued ...



Tom Heath is an owner of Rio Nuevo Financial LLC in Tucson, Ariz. He serves on the board of directors of the state and local mortgage lenders' associations and is a member of the Arizona Association of Mortgage Brokers. Before starting his own company, Heath was branch manager for a national lender. He has experience in residential and commercial lending. For more information, please visit www.rionuevofinancial.com or e-mail tom@rionuevofinancial.com.

REPRINTED FROM *SCOTSMAN GUIDE* RESIDENTIAL EDITION AND SCOTSMANGUIDE.COM, AUGUST 2008

All rights reserved. Third-party reproduction for redistribution is prohibited without contractual consent from Scotsman Publishing Inc.

Clarifying Our Roles

... Continued

Rather than an industrywide financial requirement, bankers should evaluate the relationship with individual brokers based on merit.

Fiduciary duty

Nationwide, many are calling for the creation of an agency relationship with the borrower, which MBA also comes out in favor of in the May report. The first step in doing so is to define what is in clients' best interests. Many also would argue that a lower rate on a mortgage equals a better loan; this oversimplifies the lending industry, however.

ARMs often have the lowest starting interest rate, but they are not always the best loan for the customers who cannot deal with fluctuating payments. Fixed-rate loans may not be the best option for customers who want to pay low closing costs and don't mind high payments.



The mortgage industry already has disclosures and mechanisms in place to help consumers make good financial decisions. The problem is that many consumers don't know the right questions to ask, and the mortgage industry has done a poor job of holding originators accountable.

Licensing originators, regardless of who they work for, is a necessary step in creating a better environment for consumers. Originators and principals for brokers and bankers should be required to complete education, to undergo background investigations and to subscribe to a database that will track them from company to company.

We cannot hide our fees or profits, but we do our customers a disservice if we focus their attention solely on originators' profits. Rather, as an industry, we must commit to educating consumers and to helping them make better choices. **!!**

On the Web

Comment on This Piece

Want to comment on this article?
Visit scotsmanguide.com/3053.