



## Yield Spread Premium (“YSP”)

*Sustaining a Competitive Mortgage Marketplace & Offering Consumers Choice*

### **“Myths vs. Facts”**

**Myth:** YSP “came into play” around the mid-1990s.

**Fact:** YSP has existed from the time loan origination services expanded out of the S&Ls and the banking industry moved away from keeping loans in portfolio. Called different things over the years, YSP came to the forefront in 1992 because of a HUD ruling under RESPA. This ruling required *only* mortgage broker transactions (those that do not fund and close loans in their name or those that table-fund) to disclose YSP on the good faith estimate (“GFE”) and again on the HUD-1.

Today, an overwhelming number of loans are sold onto the secondary market and securitized immediately after origination. As a result, this ruling has created an artificial distinction between the YSP earned by those that “originate” transactions and the service release premium (“SRP”), or gain-on-sale, which is earned by those that “originate and fund” transactions and then sell them. Because of this artificial line, today there is intense focus on the YSP but little understanding or discussion of the SRP or gain on sale. This is despite the fact that prior to the 1992 HUD ruling all three were considered one in the same—indirect compensation paid to the originator by either the lender or the investor in return for services performed and the value of the loan. The lines drawn between these forms of compensation are based on “industry jargon,” not function.

**Myth:** Only mortgage brokers get paid YSP.

**Fact:** Every originator that does not keep loans in portfolio is paid compensation; it’s just called something different for each distribution channel. YSP = SRP = Gain on Sale. YSP is a payment by a wholesaler<sup>1</sup> to a retailer<sup>2</sup> in a broker transaction in return for operating costs absorbed, services performed, closing costs financed, if applicable, and/or the value of the loan. SRP, or gain on sale, is what the lender, banker, or wholesaler receives as payment from the investor/secondary market—again, for costs absorbed, services performed, the financing of any closing costs, and/or the value of the loan. In today’s market, the real difference that exists between SRP, gain on sale and YSP is that only YSP is disclosed. SRP and gain on sale is not disclosed anywhere, anytime—this is back-end compensation that remains undetected and therefore, has escaped scrutiny.

**Myth:** YSP is a “bonus” payment.

**Fact:** YSP is how mortgage originators get paid for the loan origination services they perform when a consumer does not want to pay any, or only some, fees upfront. YSP is also a legitimate and legal way for borrowers to forgo paying their closing costs upfront and instead, finance those costs through the interest rate. YSP finances these fees and costs through the rate and so a consumer is paying a higher interest rate. When the consumer chooses not to pay any origination fees or closing costs upfront they are receiving what is known as a no-cost and/or no-fee loan. These loans are offered widely by both broker and retail lender channels and made available because the YSP and SRP compensation structure exists.

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<sup>1</sup> Lenders who have certain loan origination functions performed for them by mortgage brokers.

<sup>2</sup> Lenders who perform all of the loan origination functions in-house.

Thus, the YSP is beneficial for many consumers who are ready to own a home but have to overcome the hurdle of significant closing costs, or for customers that choose to realize the savings of keeping their cash and financing their costs through their loan rate. Choosing to finance closing and origination costs through the rate allows borrowers to purchase and start building wealth through their home without requiring significant outlay of cash at the onset of the loan.

**Myth:** YSP encourages steering and unjustified increases in the loan rate.

**Fact:** Brokers operate in a competitive marketplace and must compete on service, product and price. To be competitive, brokers can not simply increase their interest rate on a loan product in the face of all this competition. The internet, newspapers, TV ads and sheer number of loan originators in the marketplace makes it difficult, if not impossible, for *any* originator to charge higher fees or rates than the market supports and still remain in business.

In addition, there are a number of variables that go into qualifying a borrower for a particular loan product. Qualification of borrowers, especially of non-prime borrowers, can be tight. Therefore, it is not so easy to increase the rate on a loan without negatively impacting loan-to-value and debt-to-income, among other underwriting factors, and triggering a potential disqualification for a loan.

**Myth:** Broker customers pay more on their loans because of YSP.

**Fact:** Broker customers pay less than they would if they obtained the mortgage through any other source, including retail. Brokers receive what is known as a wholesale price on any particular loan product. This price is unavailable directly to the consumer. The wholesale price is increased to retail to take into account origination costs as well operating costs (*i.e.*, administrative plus brick and mortar costs associated with conducting business in a particular locality) to reach the actual interest rate that the customer can obtain. Mortgage brokers are primarily small business professionals. Small business entities usually have smaller overhead and administrative costs than their larger retail counterparts. Even with their origination and operating costs included in the rate, mortgage broker customers tend to receive a more competitive interest rate and loan program as compared to borrowers of these other larger channels. This is why mortgage brokers have originated the majority of mortgages in the U.S.

**Myth:** Banning YSP will eliminate steering and protect consumers from abusive practices.

**Fact:** Regardless of what it is called, banning YSP will:

- Destroy the small business broker industry. YSP is how brokers are most frequently paid for their services on many loan products. No one can work for free for very long, if at all.
- Eliminate choice and increase costs to consumers significantly. Without the small business broker there will be fewer market participants, resulting in less competition and less choice, which will cause upward pressure on price. In short, all the broker business will be pushed to competitors, placing those entities in a market position to charge even more to the consumer.
- Legislatively pick winners and losers. With brokers unable to earn YSP, they will be prevented from assisting those consumers that are unable or choose not to come to the table with anything less than a 20% down payment and full closing costs and origination fees. Consumers looking for a no or low-cost or fee loan will be forced to turn to other competitors.
- Create a market distortion pushing brokers to get a wholesale line of credit, thereby enabling mortgage brokers to earn a SRP rather than YSP, similar to their industry counterparts.

**Myth:** YSP is not in the interest rate; YSP does not allow shopping.

**Fact:** YSP is not an additional charge. It is part of the interest rate and included in the annual percentage rate (“APR”) calculation required to be disclosed under the Truth in Lending Act (“TIL”). APR is the primary shopping tool used by consumers today. YSP is disclosed and is included in the APR. SRP and gain on sale is NOT disclosed, but it is included in the APR.