

Opening Statement of Chairman Paul S. Sarbanes (D-MD)

Hearing on "Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums."

9:30 a.m., Tuesday, January 8, 2002 - Dirksen 538

This morning the Committee will hold its third hearing on the subject of predatory lending. Our previous two hearings on this topic focused largely on the predatory loans and practices which resulted in stripping hard-earned equity away from many low income home owners. These include folding high points and fees, as well as products such as credit insurance, into the loan. We also looked at how unscrupulous lenders and mortgage brokers target low income, elderly, and uneducated borrowers as likely marks for predatory loans.

Today's hearing will focus more on the role of the broker in the lending process, specifically the use and misuse of yield spread premiums.

Let me start by addressing how yield spreads are used in the marketplace. Typically, a mortgage broker will offer to shop for a mortgage on behalf of a consumer. In many cases, that broker will promise to get the borrower a good deal, meaning low rates and fees. Borrowers pay the broker a fee for this service, either out of their savings or with the proceeds of the loan. Unbeknownst to them, however, that broker may also be paid a yield spread premium if he can get the borrower to sign up for a loan at a higher rate than the borrower qualifies for. The higher the mortgage rate, the higher the payment. We will hear about of such cases this morning.

Yield spread premiums can be a legitimate tool in helping a home buyer or home owner offset all or some of the closing costs associated with buying or refinancing a home. When used properly, the broker discloses his total fee to the consumer. The consumer may then choose to pay that fee, and, perhaps other closing costs as well, by accepting a higher interest rate and having the lender pay the fee to the broker. In such cases where the borrower makes an informed choice the payment helps families overcome a barrier to homeownership- - the lack of funds for closing costs.

However, it appears that in practice, perhaps in widespread practice, yield spread premiums are not used to offset closing costs or broker fees. Instead, these premiums are used to pad the profits of mortgage brokers, without regard to any services they may provide to borrowers. Let me quote from a report issued by the Financial Institutions Center at the Wharton School of Business at the University of Pennsylvania. Professor Emeritus Jack Guttentag, discussing the problem of "rebate pricing" that is, payments by lenders to brokers of yield spread premiums, writes:

In most cases ... rebates can be pocketed by the broker, unless the broker commits to credit them to the borrower, which very few do. Rebate pricing [i.e. YSPs] has been

growing in importance, and one of the reasons is that it helps mortgage brokers conceal their profit on a transaction.

Moreover, this does not just affect subprime borrowers, as do most of the other egregious practices we heard about in our previous hearings. This misuse of yield spread premiums affects prime borrowers, FHA borrowers, VA borrowers; but, because of the lack of openness and competition in the subprime market, it hits subprime borrowers hardest of all. Even for those with the best credit, the current use of yield spread premiums can cost thousands of dollars in increased financing costs.

Yield spread premiums, when they are misused in this way, fall directly into the category of the kind of referral fees or kickbacks that were so prevalent in the settlement business prior to the passage of RESPA. After years of hearings and reports, the Congress passed the Real Estate Settlement Procedures Act (RESPA) in 1974 specifically to outlaw side payments of this kind because they increase the costs of homeownership for so many Americans. Indeed, the plain language of the law, the regulations, the 1998 Congressional instructions to HUD to formulate a policy on the issue, and the 1999 HUD policy statement- particularly when taking the legislative history into account- all make it clear that RESPA was intended to prohibit all payments that are not demonstrably and specifically for actual services provided. That is to say, each fee collected by the broker should be for a corresponding service actually provided.

Because the majority of home loans are now originated through brokers, lenders have less and less direct access to borrowers. This means they must compete for the broker's attention to gain access to the ultimate consumer - the borrower. This competition means that, too often, lenders must pay yield spread premiums to the brokers simply for the referral of business. As all of us know, this is prohibited under the law precisely because it raises the costs of homeownership to the consumers.

Regrettably, HUD's recent "clarification" of its 1999 policy statement on the issue of Yield spread premiums will open the door to new and ongoing abuses of low and moderate income home buyers and owners. Despite the Secretary's statement at his confirmation hearing that he finds predatory lending "abhorrent," I fear that the new policy statement will facilitate the predatory and racially discriminatory practice of steering homeowners to higher interest rate loans without their knowledge, and, importantly, without any effective means of redress.

Secretary Martinez has made increasing minority homeownership a primary goal of his Administration. However, a study done by Howell Jackson of Harvard Law School (who will testify on the 2nd panel) shows that, while the current use of Yield spread premiums imposes extra costs on all homebuyers, the burden falls especially hard on minorities. In other words, yield spread premiums, when they are used in this abusive fashion, put the dream of homeownership further out of reach for minority Americans. Those who still manage to achieve this dream are forced to pay thousands of dollars in increased interest costs over the life of their loans. Many find themselves in more precarious financial positions than they should or could be, thereby putting them more at greater risk of

falling prey to the kind of repeated refinancings that we have seen lead to equity stripping or even the loss of the home.

I recognize that it is unusual to have a hearing while the Congress is in recess. HUD has indicated, both in testimony before this Committee in December, and in the Federal Register, that it intends to publish a proposed regulation on this matter by the end of this month. These issues are so important that I wanted to make sure that there would be a public airing of the issues for the consideration of the Department while their deliberations were still ongoing.