



LAW OFFICES OF BURTON L. RAIMI, P.A.

8499 South Tamiami Trail • Suite 266 • Sarasota, Florida 34238 • (941) 927-1603 • (941) 927-1703 (fax)

Bank Regulatory Law

Yield Spread Premium To Pay or Not to Pay

Over the past few months more than thirty class action lawsuits have been filed against home mortgage lenders in the United States challenging the legality of what has commonly come to be known as "yield spread premium" lawsuits. These lawsuits have the potential of affecting every mortgage lender and every mortgage broker in the United States.

There is no clear definition of a yield spread premium. Depending upon which source is referenced, it is defined as an incremental increase in the interest rate for a home mortgage loan brought to a lender by a mortgage broker, or a portion of such an incremental increase which is paid to a mortgage broker for having brought the loan to the lender. However it is defined, the yield spread premium is being challenged as an unlawful payment under the Real Estate Settlement Procedures Act ("RESPA"). Section 8 of RESPA prohibits any person from giving

"any fee, kickback, or thing of value pursuant to any agreement or understanding ... that business involves the performance of real estate settlement service involving a federally related mortgage loan shall be referred to any mortgage broker or mortgage lender."

In the class action lawsuits the plaintiffs are typically alleging that mortgage brokers directed the lenders to charge a higher than normal interest rate on their mortgage and, in turn, pay a portion of the interest to the mortgage broker for the referral of the loan.

Section 8 of RESPA also specifically permits the payment of fees for the performance of services by a mortgage broker or mortgage lender.

The question of whether yield spread premiums are lawful payments for services, or unlawful payments under the various statutes and regulations governing real estate closings, is an extremely confusing one. It is particularly confusing because the HUD regulations and instructions for real estate closings specifically address the existence of yield spread premiums and other payments made to mortgage brokers. Thus, for example, in 24 CFR part 3500, where the HUD regulations provide illustrations of the disclosure requirements of RESPA, it states:

Also, any other fee or payment received by the mortgage broker from either the lender or the borrower at the time of the initial funding transaction, including a servicing release premium or yield spread premium, is to be disclosed to the borrower. Estimate and listed in the 800 series of the HUD-1 Settlement Statement. [Emphasis added]

While HUD has thus recognized the existence of payments such as the yield spread premium, and where they are to be disclosed, it is the position of the various class action plaintiffs that this statute

make such premiums "legal" under the statute.

The mortgage banking community, on the other hand, takes the position that the brokers have provided a valuable service to the borrower for which they should be paid and paying for that service by an increased interest rate is the easiest method for the borrower to absorb this expense rather than paying for it in cash as a closed-end mortgage. To date, a federal district court in Alabama^[2] has determined that a lender and mortgage broker violated the RESPA provisions by paying a yield spread premium, as the payment was for services actually rendered. An important fact in that case was that even though mortgage brokers were paid a fee by the lender, the interest rates through mortgage brokers carried interest rates that were exactly the same as the interest rates in the geographic area who did not use the services of mortgage brokers.

As the controversy continues to swirl and new cases are filed, the banking community as well as the borrower community is left in a quandary. In Florida, for example, a judge denied a motion for summary judgment by the lender saying that whether a mortgage broker performed a valuable service for which it could be paid was a factual question for a jury to decide. However, the judge also indicated that it would be difficult to prove a separate charge had already been made for every conceivable service in the transaction.^[3] Numerous class action suits have been settled with cash payments made to the borrowers.

Various associations, including the Mortgage Bankers Association, have met regularly with officials from the Department of Housing and Urban Development requesting that the regulations be clarified to make explicit that the yield spread premium is lawful. To date the Department of Housing and Urban Development has not done so. In response to this issue, a group of four influential congressmen have written to the Department of Housing and Urban Development that:

we do not believe that a consumer receives any legitimate service when a mortgage broker who is not the borrower's agent steers that individual to a higher priced loan than the one the consumer could obtain elsewhere. A mortgage broker can earn a profit from the difference. This situation should not be tolerated under RESPA.

This statement was signed by Henry B. Gonzalez, Bruce P. Vento, John J. LaFalce and Joseph P. Moakley. The allegations in the lawsuits, do not deal with the very basic question of whether the mortgage broker provided a valuable service for which he should be paid.

In an effort to clarify this issue, HUD officials drafted a policy statement which has been forwarded to the Office of Management and Budget for review. However, as reported by those who have seen this new preliminary bureaucratic pronouncements, it does little to clarify the confusion caused by the allegations made in the lawsuits. It states only that payments by lenders to mortgage brokers would not be a "per se violation" of the Real Estate Settlement Procedures Act. The proposed policy statement does not define what type of payments are prohibited; the parameters for making a payment to a mortgage broker; nor does it define a mortgage broker's services for which a payment may be made. Some see this non-position by the Department of Housing and Urban Development as simply an effort to defer the matter until Congress itself can or is willing to act. In view of the way with bureaucracies, it is unlikely, in view of the letter written by the four Congressmen, that a policy statement will be issued soon.

Under the current state of the law and the current propensity of borrowers to file class action lawsuits, borrowers who deal with mortgage brokers are asking how they can protect themselves. The answer, unfortunately, is that lenders cannot protect themselves except perhaps by making mortgage loans to persons referred to them on exactly the same terms as mortgage loans are made to others, and even this is not a guarantee. It does not appear that mortgage brokers can be compensated for their services. The question still remains: Is it lawful for a mortgage broker to receive compensation from an increase in the interest rate on a loan or the referral of an above market rate loan. Fair compensation paid to the broker in cash by the borrower is the issue.

probably lawful, as would be compensation paid by the lender from the mortgage lender's resou increased loan rate. Of course not every interest rate differential will amount to a yield spread pi differentials may still be based upon different credit risks, different types of mortgage loans, diffi and different manners of paying closing costs by a borrower. Nonetheless, until there are more c form of concise statutes and regulations or favorable court decisions, the new class action suits i proceed cautiously when using the services of mortgage brokers.[4]

Recently, U.S. Congressman Robert L. Erlich, Jr. (R-MD) introduced a bill to freeze class action la payment of such premiums. The bill, the "RESPA Class Action Relief Act of 1997 (H.R. 1283), if p prevent courts from certifying any new class action lawsuits based upon the payment of so calle As of mid-April, forty- one other congressmen had signed on as co-sponsors of the bill including Representatives Foley and Weldon. If passed into law, the moratorium would last until the end c give the Department of Housing and Urban Development additional time to issue rules in this are Erlich's bill is passed, it is only a temporary measure. It will still be necessary for either HUD or C to clarify the issues raised by the payment of yield spread premiums. Thus, final resolution is stil years, away.

[1] This confusion was recently dra District Court judge in Arlington, Virginia, first denied a motion for summary judgment by Crests yield spread premiums violated the provisions of RESPA and the regulations promulgated by the and Urban Development because they are not compensation for services actually performed. Lat ruling, stating that he was not making a determination as to whether yield spread premiums viol regulations and further indicating that his denial of the motion for summary judgment could be i Fourth Circuit Court of Appeals in Richmond, Virginia, thus pushing the decision onto a higher cc

[2] Culpepper v. Inland Mortgage Corp., CV 96-H-917-S (DC No.Dist.AL).

[3] Martinez v. Weyerhauser Mortgage Co., Case No. 94-1610 (DC So.Dist FL).

[4] As a final note on the class action lawsuits, a successful plaintiff in one class action lawsuit ir has turned around and sued his class action attorney because his recovery in the lawsuit was les he paid. It is too bad that cases such as these do not receive more publicity.

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