Mortgage brokers file suit against Federal Reserve

BY ANNE BEST BENNETTE

Following the Federal Reserve Board’s ruling to prohibit mortgage brokers from receiving a commission based on interest rates of loans, the National Association of Mortgage Brokers filed a request for emergency relief to prevent enforcement of the ruling. In response to a volatile real estate market and a pool of insecure borrowers, the Federal Reserve sought to further regulate lenders. In what appears to be an action intended to instill confidence in future bor- rowers, regulators sought to prohibit com- mission-based payments to loan officers. The new regulations provide that mortgage brokerage companies are both prohibited from charging yield-spread premiums and also forbidden from paying their individual employees or loan officer commissions based on transactions in which the con- sumer pays the origination fee.1

A yield-spread premium occurs when a borrower accepts a higher interest on a loan in lay of paying upfront costs at closing. The loan officer is then indirectly compen- sated for the borrower’s elections that higher interest rate. For example, rather than electing a 4 percent interest rate on a $200,000 loan and paying 2 percent of the principal at closing, the borrower could elect a 4.5 percent interest rate and bring only 1 percent of the principal is charged as an ‘origination fee’ at closing. Because the loan officer would lose that one percent, if the borrower elects the higher interest rate, the plan officer would be indirectly compensated.

Though this is an elementary explana- tion of how such closing costs are calcula- ted, as many factors will affect the final costs (i.e. credit score, available discounts, appraisal value, etc.), it elucidates the con- cern.

The Federal Reserve argues that such premiums and commissions provide a per- verse incentive for loan officers to either induce borrowers to borrow more money than is truly necessary, or to elect a higher interest rate with the outcome that the loan officer receives greater compensation. The board cites the Home Ownership and Equi- ty Protection Act (HOEPA) as its authority to act, which allows the board to regulate or prohibit acts or practices found to be unfair, deceptive or to evade the provisions under the act. Citing the reasons aforesaid, the board cites regulations under its pur- view. The board is proposing a flat fee for loan officers to ensure the decisions made are in the borrowers’ best interest. The National Association of Mortgage Brokers has quite a different view on the matter. According to NAMB, the yield- spread premium exists as a viable option to borrowers who either do not want to pay upfront costs at closing or simply cannot afford to do so. Additionally, such premi- ums must be disclosed on the Good Faith Estimate furnished to the borrower within the three days of the initial application. By the NAMB’s calculations, this is an option that exists at the election of the borrower and is not concealed.

Additionally, the NAMB argues, such regulation will virtually end the business of the small mortgage broker. According to the NAMB, more than 50 percent of mortgage brokers are big banks who can make up for such legislation in other departments. The regulation provides that mortgage broker- age companies are the only one mentioned, so the rule will not apply to lenders or credit- ors. Smaller businesses would not be able to compete. Accordingly, the NAMB argues, loan officers for these smaller brokerage houses will leave for bigger banks and creditors wherein the rule will not apply.

The U.S. Court of Appeals for the District of Columbia has yet to rule on NAMB’s request for emergency relief.

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