FED Announces Rule Change for Home Mortgages

August 18, 2010 - On Monday, the FED announced a rule changes for home mortgages. Lenders will no longer be able to pay mortgage brokers based on Yield-Spread Premium (YSP). This was a method used by many brokers to place borrowers into higher priced loans than they actually qualified for. Because the banks making the loans made more money over the life of a loan, they compensated mortgage brokers based on the higher payment amounts that they received.

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The practice of paying mortgage brokers based on YSP was widespread prior to the financial crisis, and there were calls to ban the practice long ago when it could have done some good. Unfortunately, the impact of the new FED rule will be more to prevent reintroduction of YSP payments sometime in the future. It is unlikely to have much of any impact on current lending activities because banks have significantly tightened their lending standards.

The net effect of YSP payments was that millions of people who received loans through mortgage brokers were actually steered into paying higher interest rates than they deserved. By adding an extra Â¼ percentage point to the rate of the loan, the broker could receive hundreds, or even thousands of dollars more in commission, depending on the size of the loan.

While many good and well established loan brokers conducted themselves with high ethical standards, other brokers actively pushed consumers into high priced loans without regard to the cost to the borrower. Customers who qualified for the best rate on a 30 year fixed loan could be put in a higher rate for more commission. If the broker could convince the borrower to take an Option ARM loan - one of the riskiest types of mortgages - the broker might make even more money. Subprime borrowers were at even greater risk of being victimized through YSP payments.

The end result of the practice was not just that many consumers paid more for their mortgage than they needed to, many were steered into risky loans and eventually needlessly lost their homes as a result.

Under the new rules, brokers can be paid based on the size of the loan, not based on the interest rate. Direct lenders are also restricted under the rules. They must put their clients into the best loan possible for their needs and can't knowingly steer their clients into higher priced loans without any legitimate reason.

byJim Malmberg

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