CT FAIR HOUSING CENTER

STATEMENT OF ANDREW PIZOR
IN SUPPORT OF S.B. 423

My name is Andrew Pizor. I am a staff attorney with the Connecticut Fair Housing Center. Thank you for the opportunity to speak in support of S.B. 423, which is designed to protect Connecticut homeowners from predatory mortgage loans. In addition to my support for S.B. 423, I also wish to state that another bill before the Committee today, H.B. 5577, also includes many similar provisions and would also do a great deal to protect borrowers from abusive practices that are unfortunately legal under existing law. Due to the similarities between the bills, my testimony will focus on one of the differences between the two bills – that is regulation of Yield Spread Premiums.

Yield spread premiums are a form of mortgage broker compensation paid by lenders. The size of the payment is largely based on the interest rate charged on a borrower's loan. The higher the interest rate, the larger the yield spread premium payment. Brokers can also earn higher YSPs for certain types of loans and when the amount of money borrowed exceeds a certain threshold. A more traditional method of broker compensation is when the borrower pays the broker directly based on a percentage of the loan principal. Yield spread premiums, however, are much more common in residential mortgages because they are more profitable to the brokers.

S.B. 423 would include YSPs in the existing 5% cap on prepaid finance charges allowed in home mortgages. H.B. 5577 only calls for disclosing YSPs, which is generally already done in most loans. The Governor's anti-predatory lending bill, S.B. 21, is silent on YSPs. Currently Minnesota, Illinois, North Carolina, Maine, New Jersey, Georgia, Massachusetts, and New York all regulate YSPs – mostly with different forms of caps.

YSPs should be capped because they are essentially kickbacks from the lender to the broker for getting homeowners into more expensive loans. While the industry defends YSPs by saying borrowers recoup the cost of YSPs through lower direct payments to brokers, research disproves that argument. Instead, a study recently published in the Stanford University Journal of Law, Business & Finance by a Harvard Law School professor shows that YSPs are often abused to over-charge unsophisticated consumers, including indications that minorities are especially at risk.[1]

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[1] Howell Jackson, Kickbacks or Compensation: The Case of Yield Spread Premiums, Stanford J. of Law, Bus. & Finance (Spr. 2007) (all facts cited in my testimony are from this article unless otherwise noted).

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It is often difficult for borrowers to protect themselves from unreasonable YSPs. The amount of the YSP is frequently unknown until the closing where it is usually disclosed as being paid by the lender. Most borrowers don't even know what a YSP is and, because it is paid by the lender, it is difficult for the average borrower to understand that the YSP ultimately comes out of their wallet in the form of higher interest rates. A 2002 survey by Fannie Mae[2] showed that over a third of all borrowers (and half of minority borrowers) incorrectly believed their broker was legally required to help them get the best interest rate. From my personal experience as a practicing attorney, I have found that the vast majority of borrowers believe brokers are acting in the borrower's best interests. Instead, any broker who is paid a YSP is actually working against the borrower's best interest by getting the borrower a more expensive loan.

The previously mentioned Stanford study examined between two and three thousand mortgages made between 1996 and 2001 and found the value of YSPs to vary widely among loans. That was in contrast to direct payments, which were more consistent in value. The author found this to be one indication that YSPs are manipulated to take advantage of less sophisticated borrowers. Comparing loans having direct broker compensation to those with YSPs revealed that brokers usually get paid more when they are paid by YSP. The estimated difference between direct payments and YSPs ranged from $600 to $1200 per loan.

Instead of recouping YSPs in the form of lowering other closing costs, the study found borrowers get less than thirty-five cents of value for every dollar of yield spread premium. Put another way, "for every additional dollar that a mortgage broker receives in yield spread premiums, that broker's total compensation appears to increase by somewhere between sixty-five and eighty cents." If the industry's argument regarding YSPs was true, every additional dollar of YSP would be matched by a dollar decrease in other closing costs paid to the broker. Analysis of actual lending practices show this is not the case.

Yield Spread Premiums are too often used to over-charge borrowers. They work as an incentive for brokers to act against the borrower's best interests. Mere disclosure of YSPs will not help borrowers protect themselves due to opaque and complicated pricing methods and lack of negotiating power. I encourage you to include a cap on YSPs in any bill that you enact.

Thank you for your time.

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[2] THE GROWING DEMAND FOR HOUSING: 2002 FANNIE MAE NAT'L HOUS. SURVEY, available at http://www.fanniemae.com/global/pdf/media/survey/survey2002.pdf.