Bonuses to Loan Brokers Scrutinized

Lenders often reward those who arrange high-interest mortgages. Many borrowers don't know they qualify for a lower rate, officials say.

By Jonathan Peterson, Times Staff Writer
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WASHINGTON — A little-known reward for brokers who arrange home loans at high interest rates is drawing scrutiny from law enforcement authorities, who say these bonuses can cost unwitting homeowners thousands of dollars over time.

Lenders pay the bonuses to independent brokers who sign up borrowers for mortgages at higher interest rates than they qualify for. With these brokers now writing an estimated 60% of home loans in the U.S., regulators are concerned that many people are being steered into higher-rate loans without being aware of the higher costs.

"With the growing role of mortgage brokers, my office and attorneys general around the country have focused increased attention on these lending arrangements," California Atty. Gen. Bill Lockyer said in a statement to The Times. "We will be monitoring the market to ensure abuses do not occur."

The bonus — typically worth thousands of dollars — is included in most loans written by independent brokers, some industry experts say, and may be especially prevalent in costlier mortgages that brokers arrange for borrowers with weak credit.

In some cases, customers knowingly accept the higher rates. Homeowners who plan to sell or refinance in a year or two, for example, can often save money by taking a higher-interest loan and lowering their upfront closing costs.

But homeowners who settle on a higher rate and plan on staying put can spend thousands of additional dollars over time. Consumer advocates and regulators say this trade-off is often not understood by borrowers. They also caution that brokers may not always make clear that they are rewarded by the lender for loans with higher interest rates.

Kimberly Marumoto said she used a broker to get a mortgage for her Hermosa Beach home and learned later — from her accountant — that she could have qualified for a lower interest rate.

"It's almost like if you went to the store, and the store didn't tell you you could actually get this item for 20% off," said Marumoto, who sells bedding and table linens. "This whole home loan

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Lockyer is part of a nationwide task force of prosecutors that in January announced a $325-million settlement by Orange-based Ameriquest Mortgage Co. for alleged deceptive lending practices. Under that agreement, Ameriquest's loan agents cannot profit from bumping customers into loans at higher rates than they qualify for.

A leader of the task force said that the practices of independent brokers — who now write an estimated 60% of home loans — is an emerging focus, although no cases are imminent. Up to now, investigators have concentrated on retail lenders, such as Ameriquest, that deal with customers directly.

"We want to look at it because it may constitute a deceptive practice," said Iowa Atty. Gen. Tom Miller, who led the Ameriquest case. "Consumers are paying more than the fair market price of their loan."

The payments to brokers are known in the industry as yield spread premiums. The terms vary by company but generally work the same way.

Say a consumer qualifies for a $400,000 loan at a 6.75% annual interest rate and an upfront fee of 1 percentage point, or $4,000. If that same borrower agrees to take the loan at 7%, a lender might reward the broker with a bonus of half a percentage point, or $2,000.

The $2,000 is the yield spread premium. The "spread" reflects the difference between the lower interest rate that the borrower could qualify for and the higher interest rate that he or she actually paid. The "premium" is the reward paid to the broker.

Although buying a home is a typical family's biggest financial commitment, "here's a major component of it that folks are clueless about," said Michael D. Calhoun, general counsel of the Center for Responsible Lending. "This obscurity and confusion has been a huge boon to those brokers who want to overreach."

The National Assn. of Mortgage Brokers does not keep statistics on the prevalence of such payments. But a Harvard study concluded that they were paid in 85% to 90% of broker-arranged loans and averaged $1,850 in the late 1990s. With the escalation in housing prices and the size of mortgages, those average payments are probably higher today.

A 2002 analysis by the U.S. Department of Housing and Urban Development has suggested that the payments amount to about half of brokers' income, with the rest coming from other commissions and fees.

Brokers fiercely defend the incentives. Higher interest rates may enable borrowers to finance closing costs and pay less upfront, they point out, in return for accepting higher monthly payments. In those cases, federal officials and courts have said the payments are legal compensation to brokers, who have the ability to guide consumers through many loan choices.

The premiums "are not inherently bad or evil," said Tom Pool, an assistant commissioner and spokesman with the California Department of Real Estate. "They're in response to a need of the market."

Brokers also take exception to consumer advocates' complaint that they often guide naive