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Yield-Spread Premiums: Who's Working For the Borrower? HUD's Erroneous Regulation and Its Bar on Plaintiffs

Taiesha L. Cantwell*

INTRODUCTION

Beatrice Hiers was approved for a Federal Housing Administration (FHA) mortgage of \$159,750.¹ Although Countrywide offered her a seven and a half percent fixed-rate mortgage, she opted to go with Homebuyers Mortgage Company, for what she thought was a seven percent fixed-rate mortgage.² At closing, she was told that the mortgage was adjustable-rate.³ The compensation paid to the mortgage broker totaled \$10,004.45.⁴ Ms. Hiers paid \$5,282.87 in out-of-pocket costs; \$4,538.87 of the total compensation was in the form of a yield-spread premium.⁵ No one disclosed the yield-spread premium to Ms. Hiers.⁶ Astonishingly, Ms. Hiers actually qualified for the same loan with a lower interest rate and without the broker's yield-spread

* B.A. 1998, Cornell University. J.D. expected 2004, University of Minnesota Law School. Professor Ann M. Burkhardt and all the JLI Staff, especially Krisann Kleibacker, were invaluable. Thank you to Beverly Cantwell and Maya Clarke. And, a very special thank you to Aaron McBroom. Mr. McBroom and I hope to become home-owners one day.

1. *HUD Policy Statement on Yield-Spread Premiums Suffers Another District Court Snub in 'Culpepper' Class Action*, INSIDE MORTGAGE FINANCE, July 2, 1999, at 3.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.* See discussion, *infra*, Part I.A (explaining the mortgage broker compensation system and yield-spread premiums). A yield-spread premium occurs when the borrower is charged a higher interest rate than what the lender is offering. See *id.* The excess is given to the mortgage broker as a form of indirect compensation. See *id.*

6. *Senate Banking Committee Hearing on Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums* (Jan. 8, 2002) (statement of Ms. Beatrice Hiers), at http://banking.senate.gov/02_01hrg/010802/hiers.htm [hereinafter *Hiers*] (“[H]ad I known that Homebuyers had secured for me a mortgage with an above par interest rate, I would have secured other financing.”).

premium.⁷ Sadly, Beatrice Hiers is the type of borrower who becomes weighed-down by a yield-spread premium: minority and female.⁸

Congress has passed legislation designed to protect borrowers like Beatrice Hiers from paying “kickbacks and unearned fees.”⁹ This Note contends that the rules promulgated by the Department of Housing and Urban Development (HUD) with respect to yield-spread premiums¹⁰ and the Real Estate Settlement Procedures Act¹¹ run contrary to congressional purpose and intended result. The statute’s language explicitly makes referral fees illegal, but allows fees for services actually rendered.¹² Given this dichotomy,

7. *Id.* (“Irwin’s [the lending company] rate sheet, in fact, shows that I qualified for the same loan at about a 5.5% interest rate with no Yield Spread Premium to the broker.”).

8. See *Senate Banking Committee Hearing on Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums* (Jan. 8, 2002) (statement of David Donaldson), at http://banking.senate.gov/02_01hrg/010802/dnldson.htm [hereinafter *Donaldson*]. David Donaldson is the attorney for the plaintiffs in the *Culpepper* cases, discussed *infra* Part C.2 (analyzing the *Culpepper* cases’ challenge of the legality of yield-spread premiums). Donaldson referred to a test by the Urban Institute as proof that African-Americans and Hispanics “tend to pay higher YSP’s [yield-spread premiums] than whites and that women pay more than men.” *Id.* (citing THE URBAN INSTITUTE, WHAT WE KNOW ABOUT MORTGAGE LENDING DISCRIMINATION IN AMERICA 34-35 (1999), available at www.hud.gov/library/bookshelf18/pressrel/newsconf/menu.html). Donaldson also stated that “[a]fter spending five years of looking at numerous borrowers’ closing documents it is clear to me that borrowers who are black, female or Hispanic pay higher total broker ‘compensation’ than white males.” *Id.*

9. See Real Estate Settlement Procedures Act, 12 U.S.C. § 2607 (2002) (prohibiting kickbacks and unearned fees in the context of real estate settlement procedures).

10. See Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10,080 (Mar. 1, 1999) (codified at 24 C.F.R. pt. 3500) [hereinafter HUD Policy Statement I]. See Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed. Reg. 53,052 (Oct. 18, 2001) (codified at 24 C.F.R. pt. 3500) [hereinafter HUD Policy Statement II].

11. 12 U.S.C. § 2607.

12. The statute reads:

No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

Id. at § 2607(a). The qualification to the general prohibition on kickbacks and unearned fees reads:

Nothing in this section shall be construed as prohibiting (1) the payment of a fee ... (C) by a lender to its duly appointed agent for services actually performed in the making of a loan, (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.

the hard issue for both HUD and the courts has been how to determine the legality of yield-spread premiums given this dichotomy.¹³ The legality of yield-spread premiums is an especially onerous issue because most borrowers are simply not aware that they are paying a higher interest rate only so that their mortgage broker can get paid more.¹⁴

Part I of this Note will detail the HUD rulemakings, as well as court rulings, surrounding yield-spread premiums.¹⁵ Studies have shown that yield-spread premiums disproportionately impact minority borrowers and, importantly, are part of the debate on predatory lending.¹⁶ Part II of this Note will explain the illogic of HUD's "total compensation" test and why class litigation should not be barred.¹⁷ This "total compensation" test results in an "individual look" to plaintiff suits that effectively creates a bar to potential plaintiffs.¹⁸ The current test for the legality of yield-spread premiums as promulgated by HUD is part of the problem of abusive loan practices.¹⁹ Further, this Note suggests licensing arrangements for the mortgage broker that will create a suitability requirement and a fiduciary relationship with the borrower.²⁰ In Part III, this Note explains that mortgage brokers should not go uncompensated for services performed.²¹ Rather, the yield-spread premium should be properly attributable by the borrower as payment to the mortgage broker for origination and servicing fees, not as part of the risk assessment inherent in the loan interest rate.²²

I. BACKGROUND

A. *The Mortgage Broker Compensation System*

At least half of all residential mortgages are originated by

Id. at § 2607(c).

13. See discussion, *infra*, Part I.C-D (detailing HUD's various rulemakings, differing court interpretations, and the HUD Proposed Rule).

14. See *infra* note 39 (detailing testimony of two borrowers who were unaware they were paying yield-spread premiums).

15. See *infra* notes 23-145 and accompanying text.

16. See *infra* notes 45-72 and accompanying text.

17. See *infra* notes 146-184 and accompanying text.

18. See *infra* notes 97-110 and 201-204 and accompanying text.

19. See *infra* notes 45-72 and accompanying text.

20. See *infra* notes 133-145 and 201-217 and accompanying text.

21. See *infra* notes 218-219 and accompanying text.

22. See *infra* notes 218-219 and accompanying text

mortgage brokers.²³ In a complex transaction, the borrower usually deals with a mortgage broker, who in turn obtains the loan from a lender.²⁴ The mortgage broker can be a valuable part of the home-buying process by providing services and bringing the lender and borrower together.²⁵ The common method of mortgage broker compensation has sparked fierce litigation.²⁶

The broker can be compensated directly or indirectly. Direct fees are those fees paid out-of-pocket by the borrower, such as a processing fee or application fee, or fees that are added to the principal amount of the loan.²⁷ Indirect compensation is fees paid on the borrower's behalf to the broker based on the interest rate of the loan.²⁸ Yield-spread premiums are a form of indirect compensation and occur when the mortgage broker is paid a portion of the borrower's interest rate on the loan.²⁹

Typically, a lender releases what is known as a rate sheet,³⁰

23. See, e.g., Neal Gendler, *In the Courts: Mortgage brokers face challenge from 'yield-spread premium' lawsuits*, STAR TRIBUNE (Minneapolis), Feb. 15, 1997, at D1. See also *Bjustrom v. Trust One Mortgage*, 178 F. Supp. 2d 1183, 1193 (W.D. Wash. 2001) (noting that "mortgage brokers occupy approximately fifty percent of the market"); *Simplifying and Improving the Process of Obtaining Mortgages To Reduce Settlement Costs to Consumers*, 67 Fed. Reg. 49,134, 49,140 (July 29, 2002) (to be codified at 24 C.F.R. pt. 3500) (noting that mortgage brokers "originate more than sixty percent of the nation's mortgages") [hereinafter HUD Proposed Rule]; HUD Policy Statement I, *supra* note 10, at 10,080 (noting that mortgage brokers originate more than half of new home mortgages).

24. A mortgage broker is most commonly used to refer to a person who is not employed by a lender and "acts as an intermediary" in a mortgage loan. HUD Proposed Rule, *supra* note 23, at 49,134 n.2. A lender is the "real source of funds," while the mortgage broker simply facilitates the borrower's access to the funds from the lender. *Id.*

25. Typical mortgage broker services include ordering credit reports and required documents, filling out paperwork, and participating in loan closing. See HUD Policy Statement I, *supra* note 10, at 10,081. Additionally, mortgage brokers counsel borrowers on loan products, collect application information, and gather information to complete the mortgage loan. *Id.* They also provide office space and facilities to carry out retail functions. *Id.* See also HUD Proposed Rule, *supra* note 23, at 49,140 (explaining that "[d]ifferences in credit ratings, employment status, levels of debt, assets, and experience frequently translate into varying degrees of effort required to originate a loan").

26. HUD estimates that over 150 lawsuits have been brought alleging the illegality of indirect compensation to mortgage brokers under RESPA. HUD Policy Statement I, *supra* note 10, at 10,083.

27. *Id.* at 10,081.

28. *Id.*

29. *Id.*

30. See *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324, 1326 (11th Cir. 2001) (defining a "rate sheet" as an item distributed by the lender to the mortgage broker each business day, listing the par rate and above-par rates). The sheet references a formula that provides the broker with a yield-spread premium for the difference between the par rate and above-par rate and the amount of the loan. *Id.* The work

which delineates the par rate for loans offered through that lender.³¹ The broker's compensation is the excess of the par rate and the "above par" loan given by the broker, commonly referred to as the yield-spread premium.³² This means that the borrower is charged a higher interest rate than what the lender is offering, and the excess is given as indirect compensation to the mortgage broker.³³

The Real Estate Settlement Procedures Act (RESPA) was passed to cure abusive practices that resulted in "unnecessarily high settlement charges," and to provide the consumer with more timely and accurate information about the "nature and costs of the settlement process."³⁴ Specifically, Congress noted that the purpose of RESPA was to effect changes resulting in "more effective advance disclosure" of settlement costs and to eliminate "kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services."³⁵

HUD maintains that indirect fees, such as yield-spread premiums, enable consumers who are unable to pay direct, or up-front, fees to obtain home loans.³⁶ This is partly correct: for those consumers who do not have the money for up-front fees or whose loan-to-value ratio disallows the option of financing the fee into the principal of the loan,³⁷ indirect payment is an attractive option for attaining homeownership.³⁸ Nevertheless, this argument

by the broker in originating the loan is not taken into account on the rate sheets. *Id.*

31. A "par rate" is the interest rate at which there is no payment made to the lender by the borrower and at which no payment from the borrower is made to the lender. See, e.g., HUD Proposed Rule, *supra* note 23, at 49,134 n.3.

32. HUD Policy Statement I, *supra* note 10, at 10,081.

33. *Id.*

34. 12 U.S.C. § 2601 (2002) (stating the congressional findings and purpose for the Real Estate Settlement Procedures Act). 12 U.S.C. § 2601(b) expressly states that the purpose of the legislation is to "effect certain changes in the settlement process for residential real estate that will result ... (2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services." *Id.*

35. 12 U.S.C. § 2601(b)(1)-(2).

36. HUD Policy Statement II, *supra* note 10, at 53,054.

37. See *Glover v. Standard Fed. Bank*, 283 F.3d 953, 957 (8th Cir. 2002) (discussing how lenders impose a loan-to-value ratio for each loan). A loan-to-value ratio simply measures the amount of the principal with the value that it is borrowed against; in the case of a mortgage, it would be the value of the home. *Id.* Therefore, a borrower may not be able to add fees to the amount of the loan if the principal amount significantly exceeds the value of the collateral. *Id.*

38. In fact, indirect fees by way of yield-spread premiums become the *only* viable option to pay mortgage broker fees where the loan-to-value ration is exceeded and the borrower is not able to pay up-front fees. *Id.*

assumes that services are actually being provided in exchange for the yield-spread premium. More often than not, a mortgage broker is both paid directly and indirectly, with the yield-spread premium going undisclosed to the borrower.³⁹ This merely increases the cost of homeownership.⁴⁰ Where a yield-spread premium is paid to the broker using only a rate sheet provided by the lender,⁴¹ it is highly unlikely that any services are provided in exchange for that premium.⁴² Since RESPA prohibits kickbacks and unearned fees,⁴³ it would seem that yield-spread premiums formulated from a mere rate-sheet violate RESPA.⁴⁴

B. Yield-Spread Premiums as a Form of Predatory Lending

"In conclusion, the \$1620 yield spread premium on our loan was nothing more than a bonus paid by the lender to the broker for securing a bad deal for my husband and me, and referring a better deal to the lender."⁴⁵

Predatory lending is a problem that is almost incapable of

39. See, e.g., *Senate Banking Committee Hearing on Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums* (Jan. 8, 2002) (statement of Ms. Susan M. Johnson), at http://banking.senate.gov/02_01hr/010802/johnson.htm [hereinafter *Johnson*] ("The \$1620 yield spread premium was not disclosed, discussed or agreed to before the closing ... [m]y husband and I were never informed that our loan had an above-par interest rate because of the premium payment from AMN AMRO [the lender] to the broker."). See *Senate Banking Committee Hearing on Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums* (Jan. 8, 2002) (statement of Ms. Rita Herrod), at http://banking.senate.gov/02_01hr/010802/herrod.htm [hereinafter *Herrod*] (explaining that Ms. Herrod had no idea that her interest rate could have been 8.85%, rather than almost ten percent, were it not for the mortgage broker's "secret kickback of over \$3300").

40. See *supra* note 39.

41. See, e.g., *infra* notes 82-96 and accompanying text (describing the *Culpepper* cases).

42. This is because the rate paid to the mortgage broker is pre-determined by the lender. See *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324, 1326 (11th Cir. 2001) (explaining that each business day, the lender "distributes a rate sheet to its brokers"). Allowing the mortgage broker to essentially determine his or her own fee cuts the borrower out of the fee-arrangement process, making it much more likely that the fee is only tenuously related to the services rendered. After all, the lender cannot police the services rendered by the broker. See generally HUD Proposed Rule, *supra* note 23, at 49,140-41 (noting that differently situated borrowers require different levels of service, the fee should be determined by reference to specific services rendered, not the ultimate amount of the loan).

43. 12 U.S.C. § 2607(a) (2001).

44. Further, some scholars contend that yield-spread premiums are "against the letter and spirit of federal laws designed to prohibit kickbacks and referral fees in mortgage transactions." See Cassandra Jones Havard, *Invisible Markets Netting Visible Results: When Sub-Prime Lending Becomes Predatory*, 26 OKLA. CITY U. L. REV. 1057, 1078 (2001).

45. *Johnson*, *supra* note 39.

definition.⁴⁶ While many agree that it is wrong, most cannot agree on what it is.⁴⁷ At the lowest common denominator, it is a system of lending practices that prey on populations such as minorities.⁴⁸ Comparing the “borrower’s cost” to the “creditor’s take” is a useful analytical tool to search out predatory lending.⁴⁹ Perhaps more specifically, predatory lending can be classified into five general schemes:

- 1) seriously disproportionate net harm to borrowers,
- 2) harmful rent seeking,
- 3) fraud or deceptive practices,
- 4) lack of transparency that is not actionable as fraud, and
- 5) requirements that borrowers waive meaningful legal redress.⁵⁰

Mirroring the debate on predatory lending in general, yield-spread premiums are both touted as a way to increase

46. See Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1259 n.4 (2002) (discussing how the former chairman of the Senate Banking Committee, Phil Gramm, lamented that the problem of predatory lending could not be addressed if no one could decide what it is).

47. *Id.*

48. For a look at subprime lending and its disparate impact on minorities see *Unequal Burden: Income and Racial Disparities in Subprime Lending in America*, HUD, at overview (April 2000), available at www.hug.gov/library/bookshelf18/pressrel/subprime.html. The report finds that subprime loans are three times more likely in low-income neighborhoods than high-income neighborhoods, five times more likely in black neighborhoods than in white neighborhoods, and, incredibly, twice as likely in high-income black neighborhoods than in low-income white neighborhoods. *Id.* To see how subprime lending is fertile ground for predatory lending, see *Curbing Predatory Home Mortgage Lending*, HUD-Treasury Task Force on Predatory Lending, at 21-24, 69 (June 2000), available at www.huduser.org/publications/pdf/treasrpt.pdf (discussing and defining the problem of predatory lending, within the context of subprime lending, and its effect on minority, female, elderly, and low-income borrowers). For a look at the specific practice of predatory home mortgage lending, see URBAN INSTITUTE, *supra* note 8, at 11-13, which found that “minorities were less likely to receive information about loan products, received less time and information from loan officers, and were quoted higher interest rates in most of the cities where tests were conducted.” Importantly, “racial disparities in loan denial rates cannot be ‘explained away’ by differences in creditworthiness or by technical factors affecting the analyses.” *Id.* Finally, even pre-application inquiries by minority borrowers were susceptible to discrimination. *Id.*

49. See Kathleen E. Keest, *Whither Now? Truth in Lending In Transition – Again*, 49 CONSUMER FIN. L.Q. REP. 360, 363 (1995) (where one author likened predatory lending to a “distorted price tag”). Keest gives the example of the grocery shopper who buys a loaf of bread marked \$1.80, but when brought up to the cashier the price is subject to another forty cents in order to “pay the delivery man.” *Id.* Thus, the total cost is \$2.20, not \$1.80 as the price tag disclosed. *Id.* This is an oversimplification of the problem of predatory lending, but couching the problem in terms of the borrower’s cost is a useful analytical tool. See *id.*

50. Engel & McCoy, *supra* note 46, at 1260.

homeownership among the poor and decried as a deceptive practice that harms the consumer.⁵¹ Professor Howell E. Jackson of Harvard Law School investigated the use of yield-spread premiums and concluded that “[they] are rarely optional and rarely needed.”⁵² In particular, Professor Jackson found that yield-spread premiums were just a tool to increase broker compensation, while costing borrowers thousands of dollars, especially African-American and Hispanic borrowers.⁵³ Finally, yield-spread premiums arguably cause harmful rent-seeking by mortgage brokers.⁵⁴ Harmful rent-seeking occurs because economic resources are diverted into loan products that could be obtained at a lower cost.⁵⁵ This “steering” is considered an unsuitable method that increases predatory lending;⁵⁶ mortgage brokers are able to “steer” borrowers into loans that are disadvantageous due to the use of a yield-spread premium.⁵⁷

Perhaps most disturbing is that yield-spread premiums create artificial market segmentation.⁵⁸ This occurs when lenders,

51. See Lisa Morgan, *Yield Spread Premiums for Mortgage Brokers: Culpepper v. Irwin Mortgage Corp. and the 2001 HUD Policy Statement*, 6 N.C. BANKING INST. 571, 590-91 (Apr. 2002). Morgan notes that this debate is perhaps most clearly delineated between mortgage brokers and consumer advocates. *Id.* At hearings conducted by the Senate Banking Committee in January 2002, the president of the National Association of Mortgage Brokers and the chairman-elect of the Mortgage Bankers Associations both heralded the yield-spread premium as a tool advancing home ownership. *See id.* See also *Donaldson*, *supra* note 8 (stating the yield-spread premiums disproportionately harm minority and female borrowers).

52. See *Senate Banking Committee Hearing on Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums* (Jan. 8, 2002) (testimony of Prof. Howell E. Jackson), at http://banking.senate.gov/02_01hrg/010802/jackson.htm [hereinafter *Jackson*].

53. *See id.*

54. “The practice of steering prime borrowers to high-cost lenders is an example of pricing that is designed to extract harmful rents.” *See Engel & McCoy*, *supra* note 46, at 1266. Inaccurate price signals can encourage harmful rent-seeking that results in a loss of economic resources. *See generally id.* at 1265-67. Economic resources are poured into prices designed to extract harmful rents from consumers, instead of prices that are competitive. *Id.* *See also supra* note 7 and accompanying text (explaining that Ms. Hiers could have qualified for a lower interest-rate loan).

55. *See* discussion, *supra* notes 1-7 (explaining that Ms. Hiers actually qualified for a lower-interest loan). The yield-spread premium attached to Beatrice Hiers’ loan serves as a prime example of harmful rent-seeking. *Id.* The entire amount of her yield-spread premium could have been diverted to more efficient economic uses.

56. *See Engel & McCoy*, *supra* note 46, at 1371-72 app.

57. *Id.*

58. *See Havard*, *supra* note 44, at 1075 (“Market segmentation is another term for lenders’ ability to select borrowers based on criteria other than credit factors.”); *Engel & McCoy*, *supra* note 46, at 1271, 1281-83 (discussing market segmentation as a tool of predatory lending).

or brokers, identify distinct customer groups for certain products.⁵⁹ Thus, it is possible that a customer in one area is offered a credit card at a lower interest rate than another customer, merely because of geographic groupings that the lender uses.⁶⁰ Often, these geographic groupings are racially based.⁶¹ Incredibly, a member of a minority group received “a credit card offer with higher interest rates and lower credit limits than a white member of [the] same interracial household.”⁶²

Indeed, yield-spread premiums have a disproportionate impact among African-Americans and Hispanics.⁶³ In *Johnson v. Equicredit Corporation of America*,⁶⁴ the plaintiff-borrower claimed that Equicredit Corporation, a subsidiary of Bank of America, was discriminating against minority borrowers by utilizing yield-spread premiums.⁶⁵ Johnson claimed that similarly situated Caucasian borrowers were given loans by Bank of America, rather than its subsidiary Equicredit, and were not charged a yield-spread premium, whereas minority borrowers were serviced by Equicredit and forced to pay yield-spread premiums.⁶⁶ This fact pattern illustrates Professor Jackson’s conclusion that minority groups are particularly affected by the

59. See Timothy C. Lambert, *Fair Marketing: Challenging Pre-Application Lending Practices*, 87 GEO. L.J. 2181, 2190 (1999) (noting that financial institutions divide their markets into groups according to geographic or demographic areas, including religion, social class, age, and race); Havard, *supra* note 44, at 1070 (“Lenders rely on economic and social codes that borrowers do not understand or even realize fully.”).

60. Lambert, *supra* note 59, at 2190 n.46 (Often, “middle-class neighborhoods receive credit offers with low ‘teaser’ rates regardless of their credit history, while residents in poor communities receive less attractive offers for collateralized credit, *irrespective of their credit history or income*”) (emphasis added).

61. See Press Release, Department of Justice, Justice Department Obtains Unprecedented Settlement from D.C. Area Bank for Allegedly Failing to Service Predominantly Black Areas (Aug. 22, 1994), *available at* www.usdoj.gov/opa/pr/Pre_96/August94/484.txt.html. The Chevy Chase Federal Savings Bank and its wholly owned subsidiary, B.F. Saul Mortgage Company, settled a suit brought by the Justice Department based on the refusal of those companies to market services in minority neighborhoods. *Id.* The market segmentation went so far as to even exclude a county that had the “nation’s lowest disparity in income levels between black and white residents.” *Id.* Virtually all branches and mortgage offices were located in “majority white areas – delineated by census tracts.” *Id.*

62. Lambert, *supra* note 59, at 2190 n.49.

63. See Jackson, *supra* note 53, at 2 (explaining that the “less educated and the less sophisticated about financial matters” fall prey to yield-spread premiums and that the cost of mortgage broker services is much higher for African-American and Hispanic borrowers than for other borrowers).

64. No. 01-C5197, 2002 WL 448991, at *1 (N.D. Ill. Mar. 22, 2002).

65. *Id.* at *5.

66. *Id.* at *6.

cost of yield-spread premiums.⁶⁷

Professor Cassandra Jones Havard compares Ralph Ellison's *Invisible Man*⁶⁸ to the plight of those who are preyed upon by sub-prime lenders.⁶⁹ Havard views such consumers as part of an invisible market, where flawed market assumptions go uncorrected, ultimately to the consumer's detriment.⁷⁰ The average borrower believes that a mortgage broker will search out the best loan for him or her.⁷¹ Correcting the flawed assumptions requires, in part, the limiting of loan fees such as yield-spread premiums.⁷²

C. HUD's Interpretation of The Real Estate Settlement Procedures Act is Erroneous

1. HUD "Policy Statement I" Illogically Adopts the "Total Compensation" Test

In response to abundant litigation regarding the legality of yield-spread premiums,⁷³ HUD promulgated a policy statement that sought to dispel confusion among the courts.⁷⁴ However,

67. See Lambert, *supra* note 63, at 3-4.

68. RALPH ELLISON, *INVISIBLE MAN* (Vintage International 1995) (1952).

69. See generally Havard, *supra* note 44. In Ellison's *Invisible Man*, the protagonist, or the Invisible Man, though awarded a college scholarship, is eventually expelled when he brings a white college trustee to the "wrong side of town." *Id.* at 1063. The Invisible Man is eventually hired by the Brotherhood, "an integrated organization that supposedly addresses issues of social equality." *Id.* at 1069. However, the Invisible Man learns that the true goal of Brotherhood is to spark race riots. *Id.* at 1074. Ultimately, the Invisible Man's flawed assumptions about the purposes of the organization cause him great harm because he recognizes his lack of power in changing it. *Id.* Like the Invisible Man, many borrowers misunderstand the broker's position and believe their broker is working as an agent for them. See HUD Proposed Rule, *supra* note 23, at 49,141 ("[T]he fact is that many brokers are perceived by borrowers as shopping on their behalf for the best loan to meet the borrower's needs."). These flawed assumptions rarely get corrected and the borrower suffers economic harm as a result. See *id.* (noting that the false assumption deters the borrower from finding a loan on better terms).

70. Havard, *supra* note 44, at 1062. Like the Invisible Man, low-income and minority borrowers are duped by lenders and brokers who do not fully disclose information. See, e.g., *supra* notes 6-7 and accompanying text. A borrower, like Beatrice Hiers, falls prey to invisible markets that serve to put her into unsuitable and high-cost loans. See, e.g., *supra* notes 2-8 and accompanying text.

71. Havard, *supra* note 44, at 1077.

72. *Id.* at 1076-78.

73. See *supra* note 26 (noting HUD's estimate of over 150 lawsuits brought alleging the illegality of yield-spread premiums).

74. HUD Policy Statement I, *supra* note 10, at 10,084. Courts took different approaches to the legality of yield-spread premiums before HUD's first ruling in March 1999. *Id.* Some courts required a case-by-case analysis, others certified a class, and still others held that the analysis of yield-spread premiums must be

HUD's Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers⁷⁵ did little to dispel the controversy.⁷⁶ HUD Policy Statement I clarified that yield-spread premiums are not illegal per se, but required a two-part test to assess their legality.⁷⁷ The first step in the analysis requires an inquiry into whether goods or facilities were furnished or services were performed for the compensation paid.⁷⁸ The second step requires an inquiry into whether the payments were reasonably related to value of goods or services furnished or services performed.⁷⁹ This "reasonably related" test calls for a look at "total compensation," which in turn would be compared to prices in "similar transactions and in similar markets" to assess its reasonableness.⁸⁰ The crux of the inquiry is to determine if brokers are being compensated for mere referrals of business or unearned fees, both of which are prohibited by statute.⁸¹

2. The *Culpepper* Cases Correctly Allow Class Certification of the Legality of Yield-Spread Premiums

The *Culpepper*⁸² line of cases came in the aftermath of HUD's

subject to a rule of reason. *Id.* See also *supra* note 26 and accompanying text (discussing the volume of litigation in this matter).

75. HUD Policy Statement I, *supra* note 10, at 10,084.

76. See HUD Policy Statement II, *supra* note 10, at 53,052 (noting that the rule was being promulgated to dispel confusion since the issuance of HUD Policy Statement I).

77. HUD Policy Statement I, *supra* note 10, at 10,084. It is also important to note that the language in HUD Policy Statement I stated that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." *Id.* (emphasis added). The "classes of transactions" language indicates that perhaps class action litigation was not seen as prohibited in HUD Policy Statement I, even though class action litigation was prohibited in a later policy statement by the agency. See HUD Policy Statement II, *supra* note 10, at 53,054 (noting that the two-part test must be applied to the specific factual circumstances of each transaction).

78. HUD Policy Statement I, *supra* note 10, at 10,084.

79. *Id.*

80. *Id.*

81. See *id.* at 10,085 (providing examples of broker services for which compensation is justified).

82. The District Court for the Northern District of Alabama originally found that the yield-spread premium was a payment for goods or services. *Culpepper v. Inland Mortgage Corp.*, 953 F. Supp. 367, 372 (N.D. Ala. 1997) (*Culpepper I*). The Eleventh Circuit then reversed the grant of summary judgment and found that a jury could find in the borrowers' favor. See *Culpepper v. Inland Mortgage Corp.*, 132 F.3d 692, 697-98 (11th Cir. 1998) (*Culpepper II*), *reh'g denied*, 144 F.3d 717, 718-19 (11th Cir. 1998) (finding that the yield-spread premium was not compensation for services). Finally, the Eleventh Circuit allowed class certification of the issue. *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324, 1332 (11th Cir.

Policy Statement I. In December of 1995, the Culpeppers secured a thirty-year home loan at 7.5%, 1.675% of which went to their mortgage broker as a yield-spread premium.⁸³ Premiere Mortgage Company, the Culpeppers' mortgage broker, did not tell the Culpeppers that they could have obtained a loan at a rate of 7.25%.⁸⁴ The yield-spread premium on the lower-interest loan would have only been 0.125%, or \$97.20.⁸⁵ The yield-spread premium on the higher-interest rate garnered a 1.675% yield-spread premium, or \$1,263.61, for Premier.⁸⁶ This was paid in addition to a 1% origination fee of \$760.50 to Premier.⁸⁷ Thus, the Culpeppers ended up paying \$2,024.11 to the mortgage broker, rather than \$857.70 that the lower interest rate would have provided to the broker.⁸⁸

In the most current disposition of the case, the Eleventh Circuit reasoned that under the test promulgated by HUD Policy Statement I, a class can be certified to litigate the legality of yield-spread premiums.⁸⁹ The court noted that where a yield-spread premium was not negotiated loan-by-loan,⁹⁰ but rather was paid only in accordance with "terms and conditions common to all the loans," class certification was appropriate.⁹¹ Importantly, the court interpreted the test given by the HUD Policy Statement I as not precluding class action.⁹²

The defendants in *Culpepper III* urged a reading of the first prong of HUD's test that would make some referral fees legal so long as they could be seen as reasonable service fees.⁹³ The court

2001) (*Culpepper III*).

83. *Culpepper II*, 132 F.3d at 694.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Culpepper I*, 953 F. Supp. at 370.

88. See *Culpepper II*, 132 F.3d at 694. \$857.70 is derived by adding the origination fee to the yield-spread premium of \$97.20 on the lower-interest loan the Culpeppers could have received. *Id.*

89. *Culpepper v. Inland Mortgage Corp.*, 253 F.3d 1324, 1332 (11th Cir. 2001) (*Culpepper III*) ("Given the test for liability that we interpret the HUD Statement and *Culpepper I* to impose, in these circumstances the district court acted within its discretion in determining that common questions of law and fact predominate and that class certification is thus appropriate.")

90. *Id.* at 1332. The lender gave Premiere a rate sheet that only allows for calculation of how many loans are given above, below, or at par. *Id.* at 1326. This "rate sheet" method does not take into account any work done by the broker for the borrower. *Id.*

91. *Id.* at 1332.

92. *Id.*

93. *Id.* at 1330.

instead adopted the plaintiff's interpretation: HUD's first inquiry into goods or services for compensation paid required an inquiry into whether the yield-spread premium was paid in exchange for those goods or services.⁹⁴ In short, the Eleventh Circuit held that the yield-spread premium must be in exchange for those services and not merely for a referral.⁹⁵ Thus, the *Culpepper III* court did not even reach the second "reasonableness" prong of the analysis under HUD Policy Statement I.⁹⁶

3. HUD Policy Statement II Erroneously Disallows Class Action Litigation Surrounding the Legality of Yield-Spread Premiums

Under a new executive administration, and in response to the *Culpepper III* interpretation of the HUD test and concomitant grant of class certification, HUD promulgated another policy statement in October, 2001.⁹⁷ HUD Policy Statement II clarified that the first inquiry into the performance of compensable goods and services, and the legality of yield-spread premiums in particular, is not amenable to a mere inquiry into the existence of a rate sheet.⁹⁸ In addition, HUD noted that each transaction must be looked at individually.⁹⁹

The second prong of the HUD inquiry, reasonableness of the broker fees, requires an examination to ascertain if the mortgage broker's total compensation is reasonably related to the "total set of goods or facilities actually furnished or services performed."¹⁰⁰ Although HUD noted that delivery of a higher interest rate loan is not a compensable service,¹⁰¹ HUD Policy Statement II effectively precludes class action and narrowly limits the illegality of yield-

94. *Id.* at 1331.

95. *Id.*

96. *Id.*

97. HUD Policy Statement II, *supra* note 10, at 53,052-54.

98. *Id.* at 53,055 ("Whether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD's test applies to the transaction involved."). The Eleventh Circuit in *Culpepper III* used the rate sheet to show presumptive illegality when the broker merely referenced the sheet rather than each borrower's specific situation or the services necessary to service the borrower. See *supra* notes 90-91 and accompanying text.

99. HUD Policy Statement II, *supra* note 10, at 53,054. This individual look includes "examining all of the goods or facilities provided or services performed by the broker in the transaction, whether the goods, facilities or services are paid for by the borrower, the lender, or partly by both." *Id.* at 53,055.

100. *Id.*

101. *Id.*

spread premiums.¹⁰² As a result, subsequent court decisions have relied on Policy Statement II to deny class certification.¹⁰³ Functionally, it is difficult for an individual plaintiff to have a claim, since only excessive total compensation can be found to be unearned fees or kickbacks.¹⁰⁴

D. Later Courts Have Been Critical of HUD Policy Statement II

Following HUD Policy Statement II, most courts have refused to certify class litigation surrounding the legality of yield-spread premiums.¹⁰⁵ Some judges have, however, criticized the reasoning behind HUD's articulation of the rule surrounding yield-spread premiums.¹⁰⁶ Beginning with *Culpepper III*, which allowed class certification to determine the legality of yield-spread premiums,¹⁰⁷ courts have criticized the post-hoc rationalization of

102. See *id.* (requiring scrutiny of individual transactions only and, even then, merely requiring "reasonableness" in the total compensation where services provided were neither non-existent, nominal, nor duplicative). HUD Policy Statement II specifically states that a yield-spread premium cannot be presumed to be a referral fee. *Id.*

103. See, e.g., *Glover v. Standard Fed. Bank*, 283 F.3d 953, 966 (8th Cir. 2002) (rejecting a class certification because the HUD Policy Statement indicates that loan-specific analysis is required); *Schuetz v. Banc One Mortgage Corp.*, 292 F.3d 1004, 1014 (9th Cir. 2002) (deferring to HUD Policy Statement II in not granting class certification because individual issues predominated).

104. HUD Policy Statement II, *supra* note 10, at 53,053 (explaining that total compensation must not be in excess of the reasonable value of goods or services provided). See also *Donaldson*, *supra* note 8, at 5 (arguing that "it is impossible to assess the reasonableness of one borrower's payments in a vacuum").

105. E.g., *Schuetz*, 292 F.3d at 1014; *Glover*, 283 F.3d at 966; *Costa v. SIB Mortgage Corp.*, 210 F.R.D. 84, 91 (S.D.N.Y. 2002); *Cedeno v. Fieldstone Mortgage Co.*, No. 01-C5110, 2002 WL 1592759, at *5 (N.D. Ill. July 19, 2002); *Vargas v. Universal Mortgage Corp.*, No. 01-C0087, 2001 WL 1545874, at *2-3 (N.D. Ill. Nov. 29, 2001).

106. *Schuetz*, 292 F.3d at 1014-17 (Kleinfeld, J., dissenting) (finding that HUD's Policy Statements are incorrect as to yield-spread premiums and should not be given deference); *Costa*, 210 F.R.D. at 88 (noting that the test "suffers from various shortcomings," including the opportunity for "easy post-hoc rationalization") (citations omitted); *Dominguez v. Alliance Mortgage Co.*, 226 F. Supp. 2d 907, 913-14 (N.D. Ill. 2002) (criticizing the test's omission of a look at congressional intent and its tolerance for "post hoc explanation of fees"); *Vargas*, 2001 WL 1545874, at *3 (criticizing the test's allowance of post-hoc rationalization of a fee "so long as it is not wildly excessive or explicitly termed a 'referral fee'"); *Bjustrom v. Trust One Mortgage*, 178 F. Supp. 2d 1183, 1195 (W.D. Wash. 2001) (expressing skepticism for the test's ability to adequately protect consumers and noting that a test "where HUD looks to see if consumers are actually receiving *something* for potentially higher interest rates would be more effective" (emphasis in original)).

107. *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324, 1332 (11th Cir. 2001) (*Culpepper III*).

fees that the HUD "total compensation" test allows.¹⁰⁸ By only inquiring into the reasonableness of total compensation, courts have recognized that this allows a mortgage broker to charge a yield-spread premium that may really be a prohibited referral fee.¹⁰⁹ Finally, HUD rulemakings requiring individual litigation of claims with little monetary value create a disincentive to plaintiffs because of the cost of litigation.¹¹⁰

E. HUD's New Proposed Disclosures Will Curb Litigation, but Still Will Allow Reliance on the Erroneous "Total Compensation" Test

Most recently, HUD has proposed a rule that affords new disclosure and transparency for the yield-spread premium.¹¹¹ The rule does not repeal the "total compensation" test, but rather proposes the transparent disclosure of a yield-spread premium.¹¹² In some instances, RESPA's prohibition on unearned fees will not even be applied.¹¹³

HUD's proposed rule closed for comment on October 28, 2002.¹¹⁴ If promulgated in its present form, it will require yield-spread premiums to be disclosed as a lender payment to the borrower on the Good Faith Estimate (GFE) form¹¹⁵ and the HUD 1/1A Settlement Statement.¹¹⁶ Presently, the yield-spread premium is not required to be disclosed on the GFE form.¹¹⁷ Instead, it is only disclosed at settlement on the Settlement Statement.¹¹⁸ This new type of disclosure will benefit the borrower because the GFE form is required to be sent to the borrower before settlement.¹¹⁹ Thus, HUD anticipates that the borrower's new

108. See *supra* note 106.

109. See *supra* note 106.

110. *Bjustrom v. Trust One Mortgage*, 178 F. Supp. 2d 1183, 1195 (W.D. Wash. 2001). See also *infra* notes 201-204 and accompanying text.

111. HUD Proposed Rule, *supra* note 23, at 49,146-49.

112. See *id.*

113. *Id.* at 49,152-55 (detailing an instance of "safe harbor" for packagers of mortgage broker services). See also *infra* notes 121-125 and accompanying text (describing HUD's "safe harbor" provisions).

114. HUD Proposed Rule, *supra* note 23, at 49,134.

115. *Id.* at 49,136. The GFE is a form given to the borrower to estimate the total cost of the loan to the borrower. *Id.* at 49,148.

116. *Id.* at 49,147. Previously, the yield-spread premium was reported as "Paid Outside of Closing" in a column that is attributed as lender payments to the broker. *Id.* Therefore, the yield-spread premium is not reported as a fee in the borrower column under current regulations. See *id.*

117. *Id.*

118. *Id.*

119. *Id.* at 49,148. The current requirements for a Good Faith Estimate do not

knowledge gained at an earlier date will promote shopping and increase competition in the mortgage broker industry.¹²⁰

In addition, HUD's proposed rule would allow for a new type of "packaging" in the home mortgage system.¹²¹ Any loan originator who provides a guaranteed interest rate and fees to the borrower for a period of thirty days would be exempt from RESPA's prohibition on unearned fees.¹²² Specifically, this "safe harbor" would only apply to persons inside the package, such as lenders, brokers, and other settlement service providers.¹²³ Unearned fees between people inside the package and people outside the package would still be policed by HUD.¹²⁴ In addition, if a packager violates the borrower's guarantee, the "safe harbor" would be inapplicable.¹²⁵

HUD believes the new disclosure requirements and packaging option will inject competition and increase borrower shopping opportunities for mortgage broker services.¹²⁶ In addition, HUD believes that the proposed rule will decrease litigation surrounding yield-spread premiums and reduce instances of predatory lending.¹²⁷ However, HUD's promulgation of Policy Statement II perhaps sounded the death knell for litigation surrounding the legality of yield-spread premiums, especially class litigation.¹²⁸

include information on all costs to the borrower. *Id.* In addition, a borrower has often already paid significant fees in order to receive a Good Faith Estimate. *Id.* The new GFE regulations require more complete disclosure of fees, as well as only requiring basic information from the borrower so as to limit the expenditure of fees before issuance of the GFE. *Id.* at 49,149.

120. *Id.* at 49,149.

121. *Id.* at 49,152. This package can be provided to the consumer in lieu of the GFE. *Id.* at 49,154.

122. *Id.* at 49,153. In particular, the package must be offered within three days of the borrower's application and must include, without any fee, the following:

- (1) a guaranteed price for the loan origination and virtually all other lender required settlement services ...
- (2) a mortgage loan with an interest rate guarantee ... and
- (3) a Guaranteed Mortgage Package Agreement (GMPA) ... [that] would remain open as an offer for a minimum of 30 days from when the document is delivered or mailed to the borrower.

Id.

123. *Id.* at 49,152. HUD reasons that without the "safe harbor," persons inside the package offering services will be unable to retain profits for fear of violating the prohibition against unearned fees. *Id.* at 49,154. HUD has determined that the benefit to borrowers through a new "packaging" scheme outweigh the benefits of prohibiting unearned fees in this particular instance. *Id.*

124. *Id.*

125. *Id.*

126. *Id.* at 49,134.

127. *Id.* at 49,147.

128. The Chairman of the Mortgage Banker's Association, Mr. Courson, stated:

If any hope of challenging yield-spread premiums was alive after the "total compensation" test, HUD's proposed rule effectively quashes it because the broker will not be subjected to scrutiny if within the safe harbor.¹²⁹ Since the broker is exempted from compliance with RESPA's prohibition on unearned fees if the broker comes within the safe harbor, the borrower has no claim when charged a yield-spread premium in exchange for no services rendered.¹³⁰ Moreover, the borrower must go from mortgage broker to mortgage broker in order to search out the lowest yield-spread premium to be charged. Most importantly, HUD's former attempts at disclosures have not caused increased shopping by consumers.¹³¹ HUD's proposed rule shifts the emphasis from unearned fees to lowest cost.¹³² However, one must ask whether this new emphasis merely begs the question: That is, are yield-spread premiums being used unnecessarily as a tool to increase mortgage broker compensation? The new disclosure requirements do not solve this dilemma and do not create a mortgage broker who will work for the borrower.

F. A Suitability Requirement Forces Someone to Work for the Borrower

In agency law, the agent owes fiduciary duties to the principal.¹³³ Specifically, the agent must deal fairly with the principal and act for the benefit of the principal in all matters.¹³⁴

"What we were able to do, with HUD, through this YSP clarification, is to get those lawsuits stopped. That's a very big deal." Tommy Fernandez, *Is MBA Finally Ready to Silence Naysayers?*, 167 AM. BANKER, Oct. 21, 2002, available at 2002 WL 26547662.

129. HUD Proposed Rule, *supra* note 23, at 49,152.

130. *Id.* at 49,154 (explaining that only entities outside the package will be subject to Section 8 [RESPA scrutiny barring unearned fees and referral fees], thus exempting from scrutiny those entities inside the package).

131. *Id.* at 49,147 (noting HUD's Special Information Booklet given to consumers to explain the homebuying process to them). Note that the Settlement Cost Booklet must be revised because it incorrectly suggests that yield-spread premiums are not costs to borrowers. *Id.* at 49,147 n.37.

132. *Id.* at 49,145 (maintaining that "costs [to the borrower] would be lowered").

133. RESTATEMENT (SECOND) OF AGENCY § 13 (1958). "Agency is the fiduciary relationship that arises when one person (a "principal") manifests assent to another person (an "agent") that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." RESTATEMENT (THIRD) OF AGENCY § 1.01 (Tentative Draft No. 2, 2001).

134. RESTATEMENT (SECOND) OF AGENCY § 13 cmt. a (1958). Note that the lawyer-client relationship is one of agency. See MODEL RULES OF PROF'L CONDUCT R. 1.3, 1.4, 1.6 - .10 (detailing duties of diligence, communication, and confidentiality owed to the client by the lawyer, as well as prohibiting conflicts of

HUD's proposed rule eliminates the possibility of creating an agency relationship between a mortgage broker and a borrower.¹³⁵ Instead, a suitability requirement¹³⁶ for mortgage brokers and the formation of a self-regulatory organization¹³⁷ would best serve the needs of the borrower.¹³⁸

Analogously, the securities industry has determined that mandatory disclosures do not provide enough protection for individual investors.¹³⁹ A suitability requirement is also imposed to protect the investor.¹⁴⁰ For instance, most investors do not understand the sophisticated information that is contained on certain SEC disclosure documents such as the prospectus.¹⁴¹ Therefore, the complexity of information necessary to make an informed decision is taken into account when imposing a suitability requirement.¹⁴² The complexity of necessary information serves to create a relationship of trust with the service-provider.¹⁴³ Additionally, the party in the best position to

interest between lawyer and client). Therefore, a lawyer working for a corporate client must disclose to an employee of the client-corporation that the lawyer does not represent the employee should the employee's interests clash with those of the employer. *See id.* R. 1.13(d).

135. *See* HUD Proposed Rule, *supra* note 23, at 49,147. The proposed rule would require that the Good Faith Estimate (GFE) describe the services of the broker including a disclaimer that the broker does not "shop for ... the lowest price or best terms available in the market." *Id.* at 49,146-47. The GFE will inform the borrower that he or she should shop around for the best offer. *Id.* The "language seeks to disabuse borrowers of the notion that brokers or other loan originators are their agents, and therefore are automatically shopping for them, a notion that can prevent their own shopping." *Id.*

136. "Suitability" would require that the broker is aware of an individual client's financial situation and risk assessment. Engel & McCoy, *supra* note 46, at 1318. More importantly, it puts the onus on the broker to prove an "adequate and reasonable basis" for any recommendation. *Id.* at 1324.

137. Self-regulatory organizations, such as the stock exchanges and the National Association of Securities Dealers, register with the Securities and Exchange Commission (SEC). *Id.* at 1321. The organizations adopt rules that are enforced by the SEC. *Id.* at 1321-22. Internal controls by the organizations ensure compliance to avoid SEC prosecution. *Id.* at 1328-29. These internal controls serve, in part, as best practices that protect the interests of the investor.

138. *Id.* at 1336 ("Disclosure has proven useless, and financial literacy is hopelessly costly and unlikely to succeed."). *See* HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 117 (June 2000), available at www.huduser.org/publications/pdf/treasrpt.pdf (discussing the need to track mortgage brokers at the federal level for high loan default and claim rates).

139. Engel & McCoy, *supra* note 46, at 1334-35.

140. *Id.* *See also* Janet E. Kerr, *Suitability Standards: A New Look at Economic Theory and Current SEC Disclosure Policy*, 16 PAC. L.J. 805, 830-31 (Apr. 1985).

141. Engel & McCoy, *supra* note 46, at 1335.

142. *Id.*

143. *Id.*

avoid harm at the lowest cost “should bear the cost of avoiding the harm.”¹⁴⁴ Certainly Ms. Hiers should not have to bear the cost of avoiding harm when her mortgage broker is in a unique position of trust and expertise in relation to her.¹⁴⁵ Examining the research, it becomes clear that HUD has inadequately addressed the state of yield-spread premiums thus far.

II. ANALYSIS

A. HUD's Total Compensation Test is Unfaithful to the Text of RESPA

RESPA prohibits any kickback or referral fee.¹⁴⁶ HUD's test for determining if yield-spread premiums are illegal, as promulgated by Policy Statement II, is not faithful to the text of the RESPA; merely outlawing yield-spread premiums if the total compensation is unreasonable will still allow kickbacks.¹⁴⁷ For example, Beatrice Hiers's mortgage broker would still receive over \$10,000 in compensation, even though Ms. Hiers had no idea she could have qualified for a loan on better terms.¹⁴⁸ By only requiring an analysis of “total compensation,” HUD's test implicitly allows kickbacks because it does not require the matching of fees with services rendered.¹⁴⁹ Since kickbacks are expressly prohibited under RESPA, kickbacks should be per se illegal, regardless of the excessiveness or reasonableness of the total compensation package. If Congress wanted to permit referral fees

144. *Id.* at 1335.

145. See *Hiers*, *supra* note 6 (“Because I was inexperienced with real estate transactions, I engaged the services of Homebuyers Mortgage Company ... Because of my experiences with mortgage brokers and Yield Spread Premiums, I will never go to a mortgage broker again.”).

146. 12 U.S.C. § 2607(a) (2001) (“No person shall give and no person shall accept any ... kickback.”).

147. See *supra* note 106 and accompanying text (citing several courts criticizing HUD's test because it allows for post-hoc rationalization for fees that are not wildly excessive but nonetheless still unearned).

148. See *Donaldson*, *supra* note 8 (noting that the payment of over \$10,000 to Ms. Hiers's broker would be defined as “reasonable”). See also *Hiers*, *supra* note 6 (stating she could have received a better loan and never knew about the yield-spread premium she was being charged).

149. See *Schuetz v. Banc One Mortgage Corp.*, 292 F.3d 1004, 1014-17 (9th Cir. 2002) (Kleinfeld, J., dissenting). Judge Kleinfeld noted that Congress did not permit kickbacks if they seem to work out economically for increased homeownership, but rather all kickbacks are prohibited. *Id.* at 1015. Since the relationship between yield-spread premiums and mortgage broker compensation was too “fortuitous,” Kleinfeld would find the yield-spread premium not “within RESPA's explicit exceptions” to prohibited referral fees. *Id.* at 1016.

conditioned on the entire compensation scheme being subject to a reasonableness requirement, then Congress would not have expressly prohibited any fee or kickback not in exchange for goods actually furnished or services actually performed.¹⁵⁰

In addition, a common-sense reading of RESPA's exceptions to the prohibition against kickback and unearned fees also cuts against HUD's "total compensation" test.¹⁵¹ RESPA excepts prohibition of the payment of a fee for "facilities actually furnished or for services actually performed."¹⁵² The plain meaning of this exception would seem to limit the exception to instances where a broker is paid for facilities or services. Yet, if a "total compensation" test is utilized, the exception becomes conflated to include fees that are reasonable, regardless of whether or not the fees were paid for "facilities actually furnished or for services actually performed."¹⁵³

For example, in *Dominguez v. Alliance Mortgage Company*¹⁵⁴, the plaintiff-borrower paid up-front fees of \$1,878.93, but the defendant-mortgage broker also received indirect compensation from a yield-spread premium in the amount of \$1,901.40.¹⁵⁵ The mortgage broker was not required to show services and goods furnished for the yield-spread premium.¹⁵⁶ Instead, the court found the total compensation to be reasonable and thus found the yield-spread premium not prohibited by RESPA.¹⁵⁷ The court never determined what was provided to the plaintiff-borrower in exchange for the yield-spread premium, because the court assumed the legality of the yield-spread premium once total compensation was deemed to be reasonable and not excessive.¹⁵⁸ A faithful reading of RESPA's prohibition against kickbacks and unearned fees would recognize that all unearned fees should be prohibited, not only those that are excessive.

*B. Yield-Spread Premiums Should Be Illegal If Paid
Without Exchange of Services or Goods*

Policy Statement II misstates the core concern. HUD's

150. 12 U.S.C. § 2607(a).

151. *Id.* The statute uses the word "any," which implies a total prohibition on kickbacks, not a prohibition on *excessive* kickbacks. See *id.*

152. *Id.* § 2607(c).

153. *Id.*

154. 226 F. Supp. 2d 907 (N.D. Ill. 2002).

155. *Id.* at 909.

156. *Id.* at 914.

157. *Id.*

158. *Id.*

rulings do not solve the problem of unearned fees or kickbacks that are prohibited by RESPA.¹⁵⁹ A yield-spread premium, no matter what amount, is excessive if not in exchange for goods or services received.¹⁶⁰ HUD's "total compensation" test does not effectively search out illegal yield-spread premiums. By only recognizing the illegality of yield-spread premiums when total compensation is excessive,¹⁶¹ HUD implicitly allows yield-spread premiums to be paid by borrowers where no goods or services are received in exchange, thereby violating RESPA's prohibition on kickbacks.¹⁶² For example, a borrower who pays an origination fee of one percent of principal and also pays other fees and costs up-front to the broker, will not be protected from paying a yield-spread premium.¹⁶³ This is exactly the situation in most cases challenging the legality of yield-spread premiums.¹⁶⁴

The true inquiry should be whether goods or services are performed in exchange for the yield-spread premium, not whether the total compensation is reasonable.¹⁶⁵ Indeed, HUD's look at similar transactions in similar markets as a gauge for reasonableness merely states the problem.¹⁶⁶ Market comparison will yield skewed results because all brokers may be using yield-spread premiums.¹⁶⁷ Further, broker-only comparisons do little to

159. See *supra* note 12. Neither RESPA's prohibition on kickbacks and unearned fees nor the exception for payment for goods or services mentions anything about reasonableness or excessiveness. *Id.*

160. HUD Policy Statement II, *supra* note 10, at 53,055.

161. See *id.*

162. See 12 U.S.C. § 2607(a) (2002) (prohibiting kickbacks and unearned fees).

163. See, e.g., *Costa v. SIB Mortgage Corp.*, 210 F.R.D. 84, 85 (S.D.N.Y. 2002); *Dominguez*, 226 F. Supp. 2d at 907; *Cedeno v. Fieldstone Mortgage Co.*, No. 01 C 5110, 2002 WL 1592759, at *1 (N.D. Ill. 2002); *Krzalic v. Am. Home Mortgage Corp.*, No. 01 C 9107, 2002 WL 924618, at *1 (N.D. Ill. 2002); *Bjstrom v. Trust One Mortgage*, 178 F. Supp. 2d 1183, 1186 (W.D. Wash. 2001). Each case illustrates an instance where a plaintiff-borrower already paid significant closing costs and was still charged a yield-spread premium.

164. See *supra* note 163. See also *supra* note 105 and accompanying text (citing courts who, relying on HUD Policy Statement II, have refused to certify class action litigation).

165. See *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324, 1329-31 (11th Cir. 2001) (*Culpepper III*) (explaining that a true test for yield-spread premiums' legality would require compensation paid in the form of a yield-spread premium to be in exchange for goods or services).

166. See HUD Policy Statement II, *supra* note 10, at 53,054 (noting that "total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets").

167. See *Glover v. Standard Fed. Bank*, 283 F.3d 953, 965 (8th Cir. 2002) (noting plaintiff-borrower's argument that HUD's reasonableness valuation is self-serving because it creates "a system that drowns any reasonableness standard in a sea of broker-only comparisons"). The court rejected this argument by plaintiff,

stave the problem of yield-spread premiums being paid by borrowers without any delivery of goods or performance of services in exchange. Since reasonableness is tied to other mortgage-brokers, it is hard to argue that kickbacks are actually being policed by a market comparison to search out excessiveness. In any event, kickbacks are illegal regardless of how the rate fares in comparison to the market.¹⁶⁸

In addition, the court would not have to "price" regulate under an alternative system of matching services and goods with payment of yield-spread premiums.¹⁶⁹ The courts would merely be required to target the goods or services provided in exchange for the yield-spread premium. This would require no regulation of the market. In fact, the "total compensation" test requires an analysis of the market for reasonableness,¹⁷⁰ while the matching test would require only a pairing of goods or services and compensation paid in exchange.

1. Class Action Litigation Regarding the Legality of Yield-Spread Premiums Should Not Be Barred

A permissible construction of RESPA does not preclude class action litigation surrounding kickbacks. HUD Policy Statement II's preclusion of class action litigation regarding the legality of yield-spread premiums is erroneous.¹⁷¹ Indeed, the court in *Culpepper III* was correct in granting a motion of class certification.¹⁷² In holding that a jury could find that the yield-spread premiums at issue were illegal referral fees, the Eleventh Circuit recognized that "the standardized terms under which [the plaintiff] pays yield-spread premiums can by themselves prove that yield-spread premiums are fees for referrals."¹⁷³ By first

countering that courts are able to gauge reasonableness. *Id.*

168. See *supra* note 12 (quoting RESPA's language that prohibits unearned fees and kickbacks without reference to market comparisons).

169. Price regulation connotes the court's scrutiny of mortgage broker fees as "reasonable." Engel & McCoy, *supra* note 46, at 1343 ("Without more, a broad reasonableness standard ... would pose the danger of deteriorating into general price regulation."). A system of matching services with price would generally not require a look at the "reasonableness" of the compensation. See *id.*

170. See *supra* note 166.

171. See *Culpepper v. Irwin Mortgage Co.*, 253 F.3d 1324, 1332 (11th Cir. 2001) (*Culpepper III*) (finding that common questions of law and fact can predominate when the terms and conditions for payment of a yield spread premium are the same for all borrowers because the payment was based on a "rate sheet").

172. *Id.* at 1332 (granting class certification where the terms and conditions of payments of yield-spread premiums were determined by a rate sheet for all borrowers, without individual analysis of their financial situation).

173. *Id.*

inquiring whether any services or goods were provided in exchange for the yield-spread premium itself, the court correctly observed that there was no need for a loan-by-loan look at each borrower's specific transaction.¹⁷⁴ This method of inquiry more closely parallels the structure of the loan when a rate-sheet is utilized. Reasoning that the system in place from broker to lender was a simple rate-sheet and that there was no individual analysis by the broker into the specifics of the borrower's financials, the Eleventh Circuit noted that the mortgage broker was really being compensated for referrals.¹⁷⁵ The court allowed class certification of the legality of the yield-spread premiums because all members of the class had similar issues of law and fact.¹⁷⁶

This decision was correct because Congress did not eliminate a class action as a remedy in the RESPA statute.¹⁷⁷ RESPA's allowance of attorney's fees and treble damages in individual cases merely demonstrates the seriousness of a violation.¹⁷⁸ The statute does not in any way negate the existence of class action as a viable method of challenging the legality of yield-spread premiums as prohibited kickbacks. Indeed, judicial economy calls for class litigation as a potential litigation tool in these cases.¹⁷⁹ As HUD itself has stated, hundreds of cases have been filed alleging violations of RESPA by the use of yield-spread premiums.¹⁸⁰ Where rate-sheets are used, as in the *Culpepper* cases, common issues of law and fact predominate and as such, class certification is appropriate.¹⁸¹

174. *Id.*

175. *Id.* at 1331-32.

176. *Id.* at 1332.

177. 12 U.S.C. § 2607(d) (2001) (stating penalties for violation but not prohibiting class action).

178. *Id.*

179. See Fed. R. Civ. P. 23(b)(3) (2002) (allowing for class action where common questions of law and fact predominate and noting that class action is "superior to other available methods for the fair and efficient adjudication of the controversy").

180. See *supra* note 26 (noting HUD's estimate of over 150 lawsuits brought).

181. See *supra* notes 90-91 and accompanying text (discussing class action as appropriate where a rate sheet, which does not reference the specific situation of the borrower, is used to determine mortgage broker fees). According to the Federal Rules of Civil Procedure, the four requirements for class action include: (1) a class so numerous that joinder is impracticable; (2) common questions of law and fact; (3) "claims or defenses of the representative parties are typical of the claims or defenses of the class"; and (4) the interests of the class are fairly and adequately protected by the representative parties. Fed. R. Civ. P. 23(a)(1)-(4). The *Culpepper III* court recognized that all of these elements were met in a situation where all borrowers had used the same mortgage broker and lender, and each borrower was charged a yield-spread premium based on a rate sheet. *Culpepper III*, 253 F.3d at 1332. Further, the court noted that the defendant-lender offered no proof of

2. Yield-Spread Premiums From the Use of Rate Sheets Should Be Presumptively Illegal

RESPA's prohibition of unearned fees should extend to a prohibition on interest rates that are configured only by means of a rate-sheet.¹⁸² Where a mortgage broker does not delve into the borrower's individual situation, but instead relies on the use of a rate sheet provided by the lender to determine the interest rate, the transaction has the appearance of an illegal kickback.¹⁸³ The appearance of a kickback should become a presumption in favor of the borrower during the course of litigation.

A mortgage broker's work is lessened when, armed with a rate sheet, the broker simply mechanically lumps a borrower into a loan category. This sort of mechanical categorization does not call for any discretion on the broker's part. Thus, there is a lesser amount of service being provided to the borrower. HUD does the borrower a disservice by maintaining that the rote procedure afforded by use of a rate-sheet should not be analyzed when searching out unearned kickbacks.¹⁸⁴ To the contrary, the use of a rate-sheet will go far in bringing a mortgage broker's true discretion to light.

If shown that borrowers were systematically given the same rates and that these rates were determined by rate-sheets, the burden should shift to the defendant-broker to prove the nonexistence of unearned kickbacks. In essence, the defendant-broker should be required to show that services were rendered and that the borrower's loan terms were not determined by mechanical use of a rate-sheet. The alternative is a system where a borrower visits a mortgage broker, only to be charged more for a less advantageous loan. One can see the tragic comedy of a broker who does nothing more than provide the borrower with forms that are not understood and a higher interest rate for the borrower's trouble.

individual work done for each borrower. *Id.*

182. See *supra* notes 90-91 and accompanying text (discussing the *Culpepper* line of cases); see also *infra* Part I.A (explaining that a rate sheet is a compilation of interest rates charged by the lender, including the par rate, or rate at which the mortgage broker receives no compensation).

183. See *supra* note 182.

184. HUD Policy Statement II, *supra* note 10, at 53,055.

C. HUD's Test for Yield-Spread Premiums Will Have a Disparate Impact on Minority Borrowers and Will Not Increase Home Ownership

Yield-spread premiums adversely affect minority groups.¹⁸⁵ Given that yield-spread premiums are a method of lowering up-front costs during the home-buying process,¹⁸⁶ because the borrower's financial situation prohibits direct fees,¹⁸⁷ it is easy to see how the poor would be disparately impacted. Direct fees are not possible where the borrower cannot afford such payments, or where the loan-to-value ratio prohibits the roll-up of fees into the principal of the loan.¹⁸⁸ Professor Howell E. Jackson concluded that his "best estimate is that borrowers, on average, enjoy 25 cents of benefit for each dollar of yield spread premiums [O]n the order of seventy five percent . . . serve only to increase the compensation of mortgage brokers."¹⁸⁹

In addition, Professor Jackson found that the "average additional charge" for African-Americans is \$474 per loan and \$580 per loan for Hispanics.¹⁹⁰ Overall, his study "suggests that industry practices allow for certain racial groups to be charged on the order of \$500 to \$600 more per transaction in mortgage broker compensation."¹⁹¹ Bolstering this hypothesis, an Urban Institute Study found that minorities are less likely than other borrowers to receive all the information about a loan product and are often

185. See *supra* notes 64-66 and accompanying text (discussing the *Johnson* case where similarly situated Caucasian borrowers were given more advantageous loans, without yield-spread premiums, while non-white borrowers were weighed-down with yield-spread premiums and served by a different subsidiary of the company). See also discussion *supra* Part I.B (discussing yield-spread premiums as a form of predatory lending). See generally G. Carol Brani, *Civil Rights and Mortgage Lending Discrimination: Establishing a Prima Facie Case Under The Disparate Treatment Theory*, 5 RACE & ETHNIC ANC. L.J. 42, 44-45 (1999); Richard D. Marsico, *Shedding Some Light on Lending: The Effect of Expanded Disclosure Laws on Home Mortgage Marketing, Lending and Discrimination in the New York Metropolitan Area*, 27 FORDHAM URB. L.J. 481, 528-29 (1999).

186. HUD Policy Statement II, *supra* note 10, at 53,054 (indicating "that up front costs could be lowered by yield-spread premiums").

187. *Id.* (indicating that yield-spread premiums can be used by "those without the available cash").

188. *Id.* ("For those without the available cash, who are at the maximum loan-to-value ratio . . . there is a third option. This third option is a yield spread premium.").

189. *Jackson*, *supra* note 53.

190. *Id.*

191. Howell E. Jackson & Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums* 128 (Jan. 28 2002) (unpublished draft), available at www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf.

quoted higher interest rates.¹⁹²

D. The New Transparency in the Proposed Rule Will Still Not Search Out Illegal Referral Fees

1. The Proposed Rule Implicitly Legalizes Yield-Spread Premiums

HUD's new proposed rule goes even further in presumptively legalizing yield-spread premiums. While increasing disclosure, the proposed rule also legalizes unearned fees and kickbacks for those who fall within its safe-harbor exceptions.¹⁹³ Transparency is a step in the right direction,¹⁹⁴ but allowing unearned fees in specific instances¹⁹⁵ will not lower the cost of home ownership. Indeed, the proposed rule only ensures that the borrower learns of the yield-spread premium, not that the yield-spread premium is earned or even that the broker attempt to get the best loan for the borrower.¹⁹⁶

2. Implicitly Legalizing Yield-Spread Premiums Will Not Curb Abusive Practices

The proposed rule will still lead to the same situation as seen in *Culpepper*, where the plaintiffs were not aware that they even qualified for a lower interest rate.¹⁹⁷ As such, relying on a rate sheet to determine yield-spread premiums is an abusive practice that is not curbed by HUD's newest proposed rule. A suitability requirement would adequately protect borrowers in the situation of the *Culpeppers*,¹⁹⁸ as would promulgation of a rule that tied

192. HUD News Release, No. 99-191, *New Reports Document Discrimination Against Minorities by Mortgage Lending Institutions* (Sept. 15, 1999), available at www.hud.gov/library/bookshelf18/pressrel/pr99-191.html ("The testing found that overall, minorities were less likely to receive information about loan products, received less time and information from loan officers, and were quoted higher interest rates in most of the cities where tests were conducted.").

193. See discussion *supra* Part I.E (describing the "safe harbor" provided to mortgage brokers and lenders who offer lending "packages" to borrowers).

194. See *supra* notes 115-119 and accompanying text (discussing the disclosures in HUD Proposed Rule).

195. See *supra* note 122 and accompanying text (detailing the "safe harbor" in HUD Proposed Rule that would allow exemption from Section 8 [RESPA's prohibition on unearned fees and referral fees] scrutiny).

196. See *supra* note 135 and accompanying text (noting HUD Proposed Rule would disavow any notion that the broker is the borrower's agent).

197. See discussion *supra* Part I.C.2 (explaining that the *Culpeppers* paid a yield-spread premium based on a rate sheet and not an individual look at their financial situation).

198. See *supra* notes 82-96 (discussing the factual situation of the *Culpeppers*).

yield-spread premiums to specific services.¹⁹⁹ Because brokers will not be “lobbying” for the borrower, but rather for their fees, borrowers will effectively be unaided from paying unearned fees and higher interest rates. This is especially the case where brokers and lenders are given “safe harbor” from the RESPA prohibitions on kickbacks and unearned fees.²⁰⁰

E. A Suitability Requirement Will Curb The Use Of Illegal Referral Fees And Aid Minority, Female, and Unsophisticated Borrowers

Since class-action litigation is effectively barred by HUD Policy Statement II,²⁰¹ plaintiff-borrowers must rely on individual plaintiffs’ attorneys to take on a case. Proponents of the bar on class certification note that RESPA’s allowance for attorney’s fees and costs will ensure that borrowers’ interests are appropriately represented in the legal sphere.²⁰² However, litigation of an individual claim worth only a few thousand dollars is unlikely to appeal to any plaintiffs’ attorney.²⁰³ In addition, HUD’s proposed rule and its disclosures will not aid the borrower.²⁰⁴

In conjunction with professional rules and standards, a suitability requirement should be imposed upon the mortgage broker. Like the securities industry, the home buying process is replete with complex forms and information not easily comprehended by the average homebuyer.²⁰⁵ This complex information often makes the borrower rely on the mortgage broker as “de-coder.”²⁰⁶

199. See *supra* note 94 and accompanying text (noting that the *Culpepper III* court required tying the fees to the services).

200. See discussion *supra* Part I.E (discussing the new “safe harbor” provisions of HUD Proposed Rule).

201. See *supra* note 99 and accompanying text (noting that HUD Policy Statement II requires each transaction to be looked at individually). See also discussion *supra* Part I.C.3 (discussing the erroneous barring of class action by HUD Policy Statement II).

202. See, e.g., *Glover v. Standard Fed. Bank*, 283 F.3d 953, 966 (8th Cir. 2002) (using the statute’s provision of attorneys fees and costs as a reason to reverse a grant of class certification by the district court).

203. See *Bjustrom v. Trust One Mortgage*, 178 F. Supp. 2d 1183, 1195 (W.D. Wash. 2001) (noting the effective closing off of class action litigation and even litigation by individuals due to HUD Policy Statement II).

204. See discussion *supra* Part II.D (explaining that the HUD Proposed Rule will not effectively aid the borrower).

205. See *supra* notes 115-118 and accompanying text (noting that forms include GFE and HUD-1 statements).

206. See *supra* note 135 and accompanying text (noting that the HUD Proposed Rule admits that borrowers generally think brokers are their agents).

A suitability requirement and the promulgation of self-regulating organizations for licensed mortgage brokers would protect the borrower and place the cost of avoiding harm on those in the best position to avoid the harm at the lowest cost. Because disclosure will not adequately protect the borrower in a complex industry,²⁰⁷ a system with standards for suitability, best practices,²⁰⁸ licensing requirements, and penalties is the best method for protecting the borrower and curbing unearned kickbacks. All of these changes would go far in ensuring mortgage broker compliance.²⁰⁹ Much like the securities industry, mortgage brokers should be required to register with a national organization that would police the enforcement of suitability requirements and standards of conduct.²¹⁰ Because mortgage brokers possess the necessary information regarding home loans, they are in the best position to avoid the harm caused by asymmetrical information and harmful rent-seeking.²¹¹ In conjunction with a cause of action for a breach of a duty of suitability, the self-regulation of brokers would go far in ensuring that borrowers are adequately protected.²¹² As in agency law, the broker would owe fiduciary duties to the principal-borrower.²¹³ These fiduciary duties would police the relationship of trust that occurs when a borrower relies on a mortgage broker to decode the complex information necessary in order to purchase a home.²¹⁴

Ensuring that someone is on the borrower's side is the only truly effective means of curbing unearned fees. This is specifically the case with yield-spread premiums because indirect

207. See discussion *supra* Part I.F (analogizing the security industry's requirements of disclosure and suitability).

208. Engel & McCoy, *supra* note 46, at 1329 (discussing the internal controls utilized by securities dealers in order to comply with the disclosure and suitability requirements). Best practices, or the most efficient ways to ensure compliance, would be developed by the industry. *Id.* at 1338.

209. *Id.* at 1338-39 (explaining that a self-regulatory organization and suitability requirements for mortgage brokers would generate best practices and compel industry compliance).

210. *Id.* Recently, the National Association of Insurance Commissioners has recommended suitability requirements for life insurance and annuity products. *Id.* at 1333.

211. See discussion *supra* Part I.B (describing deceptive practices, lack of transparency, and harmful rent-seeking as common predictors of predatory lending).

212. Engel & McCoy, *supra* note 46, at 1338-39.

213. See discussion *supra* Part I.F. See also *supra* notes 133-134 and accompanying text (detailing the duties owed by agent to principal under agency law).

214. See *supra* note 205 and accompanying text (compiling all of the forms and disclosures necessary to purchase a home).

compensation is so hard for the borrower to even know about. Disclosure alone will not work in the mortgage broker industry, just as it was not enough in the securities industry.²¹⁵ And, like the securities industry, suitability requirements are required to truly protect the borrower.²¹⁶ Finally, the borrower who is disparately impacted by illegal referral fees will reap the most benefits because those people most disadvantaged by the system will now have someone acting as their agent. History has shown that this disparately impacted borrower will be female or minority.²¹⁷

CONCLUSION

Beatrice Hiers' yield-spread premium paid to her broker, resulting in over \$10,000 of loan origination fees for a \$159,750 FHA mortgage, would have been "reasonable"²¹⁸ and therefore legal under the "total compensation" test.²¹⁹ Conversely, under the rule that the *Culpepper* court supports, Ms. Hiers' yield-spread premium would have been illegal.²²⁰

Transparency will aid the borrower in recognizing yield-spread premiums paid with no return of goods given or services performed. However, transparency does not cure the illogical and unfaithful "total compensation" test promulgated by HUD. In addition, transparency may not cure the situation of kickbacks, where mortgage brokers are compensated by yield-spread premiums merely for referring the loan to the lender. Specifically, the situation where a mortgage broker simply uses a rate-sheet distributed by the lender to determine interest rates and is compensated by a loan given above-par is not cured by transparency. Rather, the "total compensation" test still allows for post-hoc rationalization of the yield-spread premium. If the yield-spread premiums are paid because the mortgage broker is referring business to the lender, and that relationship is

215. See discussion *supra* Part I.F (explaining why a suitability requirement was necessary in the securities industry because it forced investors to work for the borrower). See also *supra* notes 138-139 and accompanying text (discussing why disclosure is not enough and why the securities industry moved toward a suitability requirement).

216. See *supra* note 215 and accompanying text.

217. See *supra* note 48 and accompanying text (discussing the disparate impact of predatory lending).

218. See *Donaldson*, *supra* note 8.

219. See HUD Policy Statement II, *supra* note 10, at 53,055 (detailing the "reasonableness" requirement of the "total compensation" test).

220. See discussion *supra* Part II.C.2 (explaining why yield-spread premiums from the use of a rate sheet should carry a presumption of illegality).

characterized by mere use of a rate-sheet of interest payments and does not reference the borrower's particular financial situation, even a transparent yield-spread premium may be a kickback or unearned fee.

Mortgage brokers provide a valuable service to borrowers. Sifting through complex information, explaining the homebuying process to the borrower and then guiding the borrower through the myriad of paperwork to the ultimate goal of home ownership is important work. Suitability and licensing requirements would provide legitimacy for mortgage brokers in the eyes of the public. Changes like this would also go a long way toward curing the disparate impact currently suffered by female and minority borrowers. Finally, by focusing on the borrower's financial situation and imposing a suitability requirement on mortgage brokers, the prevention of unearned yield-spread premiums can be realized.