

MONEY

CAN I EVER RETIRE? + OTHER URGENT QUESTIONS P.114

DECEMBER 2008

MAKE YOUR MONEY SAFE! ...AND STILL BE READY FOR THE REBOUND

25 SMART WAYS TO GET AHEAD IN 2009 P.82

PLUS P.65 WHAT BUFFETT SAYS TO DO NOW

Mop up mortgages

• **YOU LAWMAKERS DON'T** need us to tell you that there's work to do on mortgages. Right now you're focused on containing the financial damage, helping banks deal with their toxic mortgage-backed assets and trying to stanch the rate of foreclosures. But you should also take a close look at how the mortgage business works at the ground level. It's not pretty.

Here's the basic problem: Too many of the people we deal with when buying a home have no incentive to refrain from chiseling us. It was bad enough that banks were willing to write those crazy no-income-doc, teaser-rate loans that borrowers couldn't repay. But mortgage brokers, whose advice many people relied on, were actually rewarded for steering borrowers into costlier mortgages.

To shop for a loan, brokers charge home buyers a fee and receive a payment called the yield spread premium (YSP) from the lender they recommend. Generally, the higher the rate on the loan, the bigger the YSP the broker receives. That's hardly a boon for the home buyer. In a 2002 study of 2,000 mortgages, Harvard law professor Howell Jackson found that borrowers paid more when a YSP was involved—\$1,046 extra. YSPs, wrote Jackson, “serve primarily to increase compensation to mortgage brokers.”

Then there are closing costs. According to Bankrate.com, which conducts an annual survey, in 2008 they ranged from \$2,650 in North Carolina to \$4,015 in New York. Some of these fees are simply junk: copying, mailing and other items that should be included in the cost of doing business. Others are services provided by third parties selected by the lender.

Home buyers get little help in shopping for low closing costs. The government requires lenders to provide buyers with a good-faith estimate, but law professor Christopher Peterson of the University of Utah calls it “a joke.” Why? Lenders pay no penalty even if the numbers are a far

JUST HOW LOUDLY DOES MONEY TALK?



“Regulation” isn't such a dirty word in Washington anymore. But K Street—that's D.C. shorthand for the corporate lobbyists—still has plenty of muscle. Members of the key congressional committees take in lots of donations from the financial sector.

House Financial Services Committee

TOTAL DONATIONS FROM FINANCIAL AND REAL ESTATE INDUSTRIES

\$21,776,767

Senate Banking, Housing and Urban Affairs Committee

TOTAL DONATIONS FROM FINANCIAL AND REAL ESTATE INDUSTRIES

\$33,649,154

NOTE: Donations from PACs and industry employees for the 2008 election cycle. SOURCE: Center for Responsive Politics.

cry from those on the final closing documents. By that time it's a bit late for the buyer to negotiate.

HOW TO FIX IT

•• In July, Congress passed legislation requiring mortgage brokers to become licensed and take courses, including ethics. That's long overdue. Now it's time to dump the YSP. Michael Donovan, a Philadelphia consumer lawyer and former SEC trial attorney, argues that the YSP may already be prohibited under federal closing laws, which bar kickbacks. If it isn't, it should be.

The Department of Housing and Urban Development has proposed new regulations for closings—for the third time in eight years. The new rules would require lenders' final closing costs to be firm; third-party services could not be 10% higher than those in the good-faith estimate. Alternatively, and more convenient for the buyer, new regs would allow the lender to offer one all-inclusive price for closing services. Reform may not be in the cards, however. Already, 224 House members have urged HUD to withdraw these proposals for fear they'll endanger small lenders.

Get a tougher watchdog

• **FINALLY, WE NEED** a government outfit that looks out for us consumers. It's fine to come up with new laws making this or that kind of loan illegal, but lawmakers aren't always going to be able to keep pace with the financial industry's, er, innovations. We need one strong agency that makes this a full-time job. Call it the Financial Products Safety Commission, as Harvard law professor Elizabeth Warren suggests. It would approve or disapprove products for sale, set education and licensing requirements for financial professionals who deal with the public, and create uniform disclosures for financial products. Most important, it would have strong enforcement powers—to issue warnings and recalls and to file suits to block hazardous products.

Compared with this year's \$1 trillion bailout, these problems may seem like the smallest of potatoes. But they're big to us. And if you deal with them now, maybe you'll prevent the next crisis. **\$**

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