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ARTICLES

FEDERALISM AND PREDATORY LENDING: UNMASKING THE DEREGULATORY AGENDA

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I. INTRODUCTION

Predatory home mortgage lending is one of our nation's most pressing social problems. The media have widely documented predatory lending and vigorously editorialized in favor of reform.¹ Predictably, consumer advocates

1. See, e.g., *An Epidemic of Defaults*, BALT. SUN, July 16, 2002, at 12A ("[G]overnment regulators have an obligation to exercise diligence in preventing swindlers from taking advantage of consumers . . ."); Editorial, *Curb Lending Predators*, DENV. POST, Mar. 10, 2002, at E6 ("Predatory lenders often target the elderly, minorities and those in low-income neighborhoods, charging astronomical interest rates – even for those with good credit."); Robert K. Heady, *Greedy Lenders Continue to Pitch Their Predatory Loans*, HARRISBURG PATRIOT, Apr. 24, 2002, at D2 ("Predatory loans . . . have been exploding across America since the 1990s, fueled by greedy lenders who, with their fast pitches, particularly exploit women, the elderly, the less-creditworthy and low-income neighborhoods."); Mary Kane, *Subprime Mortgage Loans Raise Concerns: High Rates, Fees Leave Little Equity, Lots of Risk*, NEW ORLEANS TIMES-PICAYUNE, Apr. 9, 2000, at F1 ("In a record economy . . . it might seem odd for anyone to worry about home ownership problems. But the growth of subprime lending—high rate, high-fee loans—along with loans that require no down payments or allow for huge debts, is raising concern."); Mary Meehan, *Loan Wolves: Kentuckians Lose Homes to Predatory Lending*, LEXINGTON HERALD-LEADER, Apr. 10, 2002, at C1 ("Targeted at borrowers who often don't have access to more-mainstream financial institutions, [predatory lending is] a growing problem in Kentucky and across the country."); Editorial, *Predatory Lending a Shameful Practice that Must be Ended*, THE STATE (Columbia, S.C.), Feb. 24, 2002, at D2 ("[J]ust because someone is a credit risk does not mean they should be taken advantage of."); Terence Samuel, *Support Grows for Controls on "Predatory Lending,"* ST. LOUIS POST-DISPATCH, Apr. 16, 2000, at A12 ("[C]oncern is growing in many quarters that as that sub-prime lending market booms, many people, particularly the elderly and the poor, are being savaged by unscrupulous operators who prey on their ignorance, inexperience or desperation."); CBS Evening News: *Predatory Lenders Driving Foreclosures*, (CBS

have been enraged about predatory mortgage lending for years. But less expected, responsible leaders in the home mortgage lending industry, including originators, trade association leaders, as well as both the secondary market giants Fannie Mae and Freddie Mac, have all admirably come to acknowledge a grave problem.² Scholars from a wide range of academic backgrounds, ranging from business to geography, have also turned their attention to the consequences and causes of predatory mortgage lending.³ Legal scholarship in particular has documented predatory lending and has raised a variety of proposals for reform.⁴

television broadcast, July 18, 2002), available at 2002 WL 6517143 (statement of Cynthia Bowers, CBS News Correspondent) (“[I]n Chicago alone over the last decade, the number of foreclosures has jumped from about 100 a year to nearly 5,000.”).

2. See, e.g., Bill Emerson, *The Predatory Lending Maze*, 62 MORTGAGE BANKING, Sept. 2002, at 101, 101 (“True predatory lenders are those who give the borrowers certain disclosures at application, only to significantly switch the numbers around at the time of closing without a logical explanation. Or they offer costly subprime loans to borrowers who clearly qualify for less costly conventional loans.”); John M. Robbins, Jr., *Integrity*, 62 MORTGAGE BANKING, Apr. 2002, at 17, 17 (“As mortgage bankers, we know that integrity, trust and honesty are simply the rules of conduct by which we should all live Any business that values and ultimately seeks to earn the trust and respect of its customers cannot permit predatory lending practices or the payment of hidden fees. As an industry, we must tackle the tough issues so that more people are not placed on the path to foreclosure each year for the sake of larger commissions and greater profitability.”).

3. See, e.g., GREGORY ELLIEHAUSEN & MICHAEL STATEN, REGULATION OF SUBPRIME MORTGAGE PRODUCTS: AN ANALYSIS OF NORTH CAROLINA’S PREDATORY LENDING LAW 2 (Geo. U. Credit Res. Center Working Paper No. 66, 2002) (arguing that a regulatory remedy to predatory lending may unintentionally harm many of its potential beneficiaries); Steven R. Holloway, *Exploring the Neighborhood Contingency of Race Discrimination in Mortgage Lending in Columbus, Ohio*, 88 ANNALS OF ASS’N OF AM. GEOGRAPHERS 252, 253 (1998) (arguing that race-based and place-based discrimination, though distinct, remain fundamentally intertwined); Jane S. Pollard, *Banking on the Margins: A Geography of Financial Exclusion in Los Angeles*, 28 ENV’T AND PLAN. 1209, 1209 (1996) (examining the relationship between “the eroding competitive position of the banking industry and an unfolding geography of financial exclusion affecting one low-income community in Los Angeles”); Michael Reibel, *Geographic Variation in Mortgage Discrimination: Evidence from Los Angeles*, 21 URB. GEOGRAPHY 45, 45 (2000) (stating that “the joint contingency of applicant race/ethnicity and neighborhood race/ethnic context plays a significant role in determining mortgage application outcomes”); Keith Ernst et al., *North Carolina’s Subprime Home Loan Market After Predatory Lending Reform: A Report from the Center for Responsible Lending* iv (Aug. 13, 2002) (concluding that “reductions in predatory lending are estimated to have generated considerable savings to consumers while preserving continued access to credit under fair terms”), available at <http://www.responsiblelending.org>; Eric Stein, *Quantifying the Economic Cost of Predatory Lending: A Report from the Coalition for Responsible Lending* 2 (Oct. 30, 2001) (concluding that the cost of predatory lending is \$9.1 billion each year in terms of lost homeowner equity, back-end penalties, and excess interest), available at <http://www.responsiblelending.org>.

4. My book provides an introduction to predatory lending policy and law. CHRISTOPHER L. PETERSON, *TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH-COST CREDIT MARKET* (Christopher P. Banks ed., 2004). See also Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 640 (2002) (claiming that the holder in due course is no longer necessary in commercial loans); Daniel S. Ehrenberg, *If the Loan Doesn’t Fit, Don’t Take It: Applying the Suitability Doctrine to the Mortgage Industry to Eliminate Predatory Lending*, 10 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 117, 129-30 (2001) (advocating the suitability doctrine as a solution to predatory lending); Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1337-57 (2002) (promoting a three-prong approach to reform, including an SRO

Something in the residential mortgage market and the laws that govern it has

requirement, new cause of action for breach of duty of suitability and agency enforcement); Anna Beth Ferguson, *Predatory Lending: Practices, Remedies and Lack of Adequate Protection for Ohio Consumers*, 48 CLEV. ST. L. REV. 607, 636 (2000) (encouraging the adoption of wide-ranging regulations, similar to measures taken in North Carolina and New York, to combat predatory lending); Julia Patterson Forrester, *Constructing a New Theoretical Framework for Home Improvement Financing*, 75 OR. L. REV. 1095, 1138 (1996) (concluding that promissory notes and power of sale foreclosure must be prohibited in contractor-connected home improvements loans to protect vulnerable homeowners); Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 456 (1994) (noting that a more open credit market, together with prohibitions against certain unconscionable credit terms, would make fair credit available and provide adequate protection to homeowners); Deborah Goldstein, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 HARV. C.R.-C.L. L. REV. 225, 255 (2000) (suggesting that current laws should be improved to require that disclosed information be clear and that lenders educate consumers regarding financial transactions and choices); Donna S. Harkness, *Predatory Lending Prevention Project: Prescribing a Cure for the Home Equity Loss Ailing the Elderly*, 10 B.U. PUB. INT. L.J. 1, 45 (2000) (suggesting that expansion of mandatory housing counseling into the area of home equity, non-purchase lending for borrowers over 60 would be the most effective reform); Cassandra Jones Havard, *Invisible Markets Netting Visible Results: When Sub-Prime Lending Becomes Predatory*, 26 OKLA. CITY U. L. REV. 1057, 1080 (2001) (arguing that sound policy requires scrutinizing how lenders measure risk and use it to segment the market); Cecil J. Hunt, II, *In the Racial Crosshairs: Reconsidering Racially Targeted Predatory Lending Under a New Theory of Economic Hate Crime*, 35 U. TOL. L. REV. 211, 313 (2003) (concluding that current legislative remedial approach is inadequate and that true reform will occur only by understanding the core problem of reverse redlining and racialized predatory lending); Donita Judge, *Predatory Lending: Legalized Theft of Home Equity*, 5 RUTGERS RACE & L. REV. 293, 320-21 (2003) (stating that Congress should increase funding for programs that promote consumer awareness); Michelle W. Lewis, *Perspectives on Predatory Lending: The Philadelphia Experience*, 12 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 491, 513-15 (2003) (suggesting that consumer education and the development of responsible mortgage products help reduce the number of predatory mortgage victims); Frank Lopez, *Using the Fair Housing Act to Combat Predatory Lending*, 6 GEO. J. ON POVERTY L. & POL'Y 73, 108-09 (1999) (arguing that the FHA is the most viable means to remedy discriminatory lending practices); Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 575 (2000) (calling for the regulation of mortgage loan rates in the subprime home equity market); Anne-Marie Motto, *Skirting the Law: How Predatory Mortgage Lenders are Destroying the American Dream*, 18 GA. ST. U. L. REV. 859, 900 (2002) (concluding that current federal predatory lending laws are ineffective and proposing a comprehensive effort to enact a new federal predatory lending law and encourage responsible lending); Margot Saunders, *The Increase in Predatory Lending and Appropriate Remedial Actions*, 6 N.C. BANKING INST. 111, 142-43 (2002) (noting that, in addition to amending current predatory lending legislation, tax reforms to encourage preserving home equity and federal protection in foreclosure proceedings are necessary); Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 266 (2002) (asserting that consumer protection legislation should not be based on a false notion that documentary disclosure provides adequate protection); Abraham B. Putney, Comment, *Rules, Standards, and Suitability: Finding the Correct Approach to Predatory Lending*, 71 FORDHAM L. REV. 2101, 2139 (2003) (suggesting that preference should be given to objective rules rather than subjective standards); Michael J. Pyle, Comment, *A "Flip" Look at Predatory Lending: Will the Fed's Revised Regulation Z End Abusive Refinancing Practices?*, 112 YALE L.J. 1919, 1926 (2003) (arguing that antiflipping provisions are only effective if they are combined with a policy of policing for abuses). Also, in a thoughtful piece, Professor Baher Azmy has recently discussed the state legislative response to predatory lending. Baher Azmy, *Squaring the Predatory Lending Circle*, 57 FLA. L. REV. (forthcoming July 2005) (arguing against federal preemption).

gone seriously amiss.

Recognizing the necessity of intervention in this market, all levels of government have actively participated in a continuing national debate over the best way to address predatory lending. As of January 2004, twenty-five state governments have adopted legislation or regulations specifically addressing predatory home mortgage lending, or at least purporting to do so.⁵ Close to a dozen major cities across the country have passed ordinances attempting to prevent predatory home mortgage lending within their jurisdictions.⁶ Furthermore, no less than *eleven* different federal agencies—including the Board of Governors of the Federal Reserve, the Department of Housing and Urban Development, the Federal Trade Commission, the Office of the Comptroller of the Currency, the Federal Housing Finance Board, the Office of Thrift Supervision, the National Credit Union Administration, the Office of Federal Housing Enterprise Oversight, the Federal Deposit Insurance Corporation, the Government Accountability Office (“GAO”),⁷ and the Department of Justice—are publicly on record acknowledging that predatory mortgage lending poses a significant social problem for low and moderate income Americans.⁸ Even the

5. U.S. GEN. ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING at 2, GAO-04-412T (Feb. 24, 2004) [hereinafter GAO, CONSUMER PROTECTION].

6. See *infra* notes 464-72 and accompanying text (summarizing city ordinances attempting to prevent predatory home mortgage lending).

7. Congress recently changed the GAO’s official name to the Government Accountability Office to better reflect its mission. GAO Human Capital Reform Act of 2004, Pub. L. 108-271, 118 Stat. 811, 817 (2004); David M. Walker, *GAO Answers the Question: What’s in a Name?*, ROLL CALL, July 19, 2004, at 1.

8. Transcript of the *Federal Reserve Board Public Hearing on Home Equity Lending*, at 8 (Sept. 7, 2000) (statement of Governor Edward M. Gramlich) (“The basic goal of the hearings, and for every agency that has any kind of authority for predatory lending, is to try to, in effect, clean up the subprime market, to make sure that the good subprime lending proceeds and the abuses are stopped.”), available at <http://federalreserve.gov/Events/PublicHearings/20000907/20000907.htm>; *Predatory Lending Practices in the Subprime Industry: Hearing Before the House Comm. on Banking and Financial Services*, 106th Cong. 44 (2000) (statement of David Medine, Associate Director for Financial Practices, FTC Bureau of Consumer Protection) (“[T]he Commission supports the expansion of HOEPA protections to enhance consumer protections against predatory lending.”); *Predatory Lending Practices: Hearing before the House Comm. on Banking and Financial Services*, 106th Cong. 39 (2000) (statement of Donna Tanoue, Chairman, FDIC) (“[T]he FDIC is concerned that insured institutions, like other institutional investors, may be involved in the predatory loan market in an indirect fashion.”); GAO, CONSUMER PROTECTION, *supra* note 5, at 14 (“[T]he secondary market [for home mortgages] may also inadvertently facilitate predatory lending by providing a source of funds for unscrupulous originators, allowing them to quickly sell off loans with predatory terms.”); FREDDIE MAC, AUTOMATED UNDERWRITING: MAKING MORTGAGE LENDING SIMPLER AND FAIRER FOR AMERICA’S FAMILIES, at Ch. 5 n.6 (1996) (citing *Half of Subprime Loans Categorized as ‘A’ Quality*, INSIDE B&C LENDING, June 10, 1996), available at <http://www.freddie.mac.com/corporate/reports/moseley/moseidx.htm> (last visited Apr. 5, 2005); Press Release NR 2000-21, Office of the Comptroller of the Currency, Comptroller Hawke Urges Increased Action, Education to Combat Predatory Lending (Apr. 5, 2000) (“To heighten our examiners’ awareness of the fact that a predatory lending environment presents a high level of risk for discrimination, we will be issuing an advisory to examiners that instructs them to be on the alert for patterns of predatory lending so that we can follow up appropriately through the examination

FBI has weighed in, decrying near “epidemic” levels of fraud “running rampant in the nation’s mortgage industry.”⁹

This Article considers the debate over predatory lending in light of the American federalist tradition. As any introduction to American civics makes clear, the U.S. Constitution intentionally pits citizens’ loyalties to state and national governments against each other in the hope of providing one more fulcrum upon which the balance of power can shift against those who seek its abuse.¹⁰ Because of their commitment to a system of divided and limited loyalties, the Framers were profoundly uneasy with the supremacy clause of the Constitution, which provides that where federal and state law conflict, federal law must prevail.¹¹ For the Framers, the Constitution limited federal action to

process.”), available at <http://www.occ.treas.gov/ftp/release/2000%2D21.txt>; Press Release, Board of Governors of the Federal Reserve System et al., Federal Agencies Publish Consumer Brochure on Predatory Lending (Oct. 7, 2003) (“[C]ertain lenders—often called “predatory lenders”—target homeowners with low incomes or credit problems, including the elderly, by deceiving them about loan terms or giving them loans they cannot afford to repay.”), available at <http://www.fhfb.gov/PressRoom/press/PR03-37.htm>; Ellen Seidman, Director, Office of Thrift Supervision, Strategies for Combating Predatory Lending in Our Neighborhoods, Remarks before the Neighborhood Reinvestment Training Institute, Washington, D.C. (Feb. 23, 2000) (“Predatory lenders operate in cities and rural areas across the country. Their activities threaten to harm not only individual borrowers, but also whole communities, the financial services industry, and our society in general.”), available at <http://www.ots.treas.gov/docs/8/87073.pdf>; John Ashcroft, Attorney General, Remarks Commemorating the 33rd Anniversary of the Fair Housing Act (Apr. 11, 2001) (“We will not tolerate predatory lending practices, which too often target minorities and the elderly. Predatory lending practices can result in people being robbed of equity in their homes, or even losing their homes altogether.”), available at http://www.usdoj.gov/crt/housing/ashcroft_april01.htm; U.S. Dep’t of Housing & Urban Dev., Homes & Communities Webpage, Predatory Lending, at <http://www.hud.gov/offices/hsg/pred/predlend.cfm> (last visited Apr. 5, 2005) (“Predatory mortgage lending practices strip borrowers of home equity and threaten families with foreclosure, destabilizing the very communities that are beginning to enjoy the fruits of our nation’s economic success.”).

9. Curt Anderson, *Mortgage Fraud Surges Since 2001*, *FBI Reports*, L.A. TIMES, Sept. 19, 2004, at A26.

10. Madison explained the fundamental role of the state-federal power dichotomy in preserving the balance of power:

In the compound republic of America, the power surrendered by the people is first divided between two distinct governments, and then the portion allotted to each subdivided among distinct and separate departments. Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself.

THE FEDERALIST NO. 51, at 248 (James Madison), in THE FEDERALIST PAPERS READER AND HISTORICAL DOCUMENTS OF OUR AMERICAN HERITAGE 131, 134 (Frederick Quinn ed., 1997).

11. U.S. CONST. art. VI, cl. 2 (“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”). Walter Mead explains the framers’ trepidations in this respect:

Even when the war had required the states to pull together, the emotional fervor with which each state guarded its own independence and sovereignty had several times threatened the attempt at independence for all of them. Those who, at the time of the Philadelphia Convention, were still defending state autonomy in the name of the existing Articles of Confederation perceived the framers, at least the vast Federalist majority of them, as

issues for which national action was particularly suited, such as foreign policy, conflict between the states, and interstate commerce.¹² However, as government has grown, state and federal responsibility have often come to overlap. Rather than spheres of influence uniquely associated with the federal government or with the state governments, our law has evolved to embrace many areas of concurrent responsibility or “mixed-federalism,” where the actions and rules of both levels of government entwine.¹³ At the margin, the respective control of federal and state government is a complex, dynamic, and, at times, delicate equipoise.

The regulation of residential mortgage lending in general, and predatory lending in particular, has historically been just such a mixed-federal issue.¹⁴ Accordingly, financial industry leaders, consumer advocates, and government officials around the country are currently grappling with the overlapping federal and state responsibilities presented by predatory lending regulation.¹⁵

“consolidationists”—that is, advocates of a unitary, or centralized, government. However, with the exception of Alexander Hamilton, these Federalists themselves were too much convinced of the merits of state government to be willing to divest their states of extensive and significant power in the new governing scheme.

WALTER B. MEAD, *THE UNITED STATES CONSTITUTION: PERSONALITIES, PRINCIPLES, AND ISSUES* 90 (1987).

12. See U.S. CONST. art. I, § 8, art. III, § 2, amend. X (defining federal congressional and judicial power). Madison explained:

The powers delegated by the proposed Constitution to the federal government are few and defined. Those which are to remain in the State governments are numerous and indefinite. The former will be exercised principally on external objects, as war, peace, negotiation, and foreign commerce The powers reserved to the several States will extend to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the State.

THE FEDERALIST NO. 45 (James Madison).

13. One commentator famously compared interlaced state and federal powers to a blended “marble cake.” MORTON GRODZINS, *THE AMERICAN SYSTEM* 60-88 (Daniel J. Elazar ed., 1966). In attempting to helpfully characterize this form of government some have used labels such as “co-operative federalism,” “centralized federalism,” and even “picket fence federalism.” See Thomas R. Dye, *Liberty, Markets, and Federalism*, in *FEDERALIST GOVERNMENT IN PRINCIPLE AND PRACTICE* 1, 4-5 (Donald P. Racheter & Richard E. Wagner eds., 2001) (summarizing these and other descriptive theories). For purposes of this Article, the term “mixed-federal” will suffice to describe those areas of law and policy where the federal and the state governments have come to accept shared responsibility. For at least a generation, “mixed problems” have become the norm because legal issues “repeatedly fail to come wrapped up in neat packages marked ‘all-federal’ or ‘all-state.’” Henry M. Hart, Jr., *The Relations Between State and Federal Law*, in *FEDERALISM: MATURE AND EMERGENT* 177, 183-84 (Arthur W. Macmahon ed., 1955).

14. Joseph A. Smith, Jr., *Federal and State Regulation of Financial Services: Competition and the Search for Comity*, 57 CONSUMER FIN. L.Q. REP. 131, 131 (2003). There are, of course, innumerable other examples of difficult mixed-federal legal issues. See, e.g., Note, *Double Prosecution by State and Federal Governments: Another Exercise in Federalism*, 80 HARV. L. REV. 1538, 1538 (1967) (discussing dual federal and state criminal prosecution); Eugenia F. Toma, *Education: The Path from Centralization to Privatization*, in *FEDERALIST GOVERNMENT IN PRINCIPLE AND PRACTICE* 193 (Donald P. Racheter & Richard E. Wagner eds., 2001) (discussing the federal-state relationship in education policy).

15. The balance between federal and state power over predatory lending policy is likely to

Commenting on this process, one influential state banking commissioner publicly decried the “tension, if not conflict” that has come to characterize federal and state relations over predatory lending.¹⁶ United States Senator Paul Sarbanes (Democrat, Maryland) goes further, suggesting that recent federal efforts to preempt state law have “led to such a unanimous and strong outcry from state officials as to suggest that fundamental damage has been done to the federal-state relationship.”¹⁷ For these leaders, and one might expect for this Article, the natural question at hand has been whether and to what extent state or federal government should be responsible for making policy with respect to predatory lending. Is predatory lending most akin to family law, criminal law, and small purely local commercial ventures, and therefore, most appropriately addressed by the states? Or, does predatory lending more closely resemble foreign policy or interstate commerce and, accordingly, merit federal oversight? Or, finally, is this a mixed-federal question deserving of shared responsibility? While these are important and weighty concerns, they are *not* the subject of this Article.¹⁸ Here, I take no position on the level of government from which predatory lending policy should emanate.¹⁹ Rather, this Article explores the extent to which the debate over federal and state power has cloaked a different and less euphoniously philosophical agenda. To wit, this Article argues that today’s advocates of exclusive federal power over predatory lending policy care less for the niceties of balance of power, nor even for the benefits of uniform regulation, than they do for the covert protection of a powerful industry that profits, either directly or indirectly, from predatory lending. This Article is less about a debate over federalism *per se*, than it is about how our notions of federalism are used to mask a substantively anti-consumer policy agenda. It is an attempt to clarify the predatory lending debate, stripping it of one form of disingenuous political posturing. The thesis of my argument is that current efforts to preempt state law have little or nothing to do with federalism in general or uniformity in particular, but are, in fact, simply efforts to deregulate.

In advancing this argument, I begin with what has become a standard description of the predatory mortgage lending problem, including both an exposition of predatory loan contract terms and practices, as well as the

become closely related to the longstanding competitive regulation model in the mixed-federalist dual banking system. See Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 STAN. L. REV. 1, 35 (1977) (explaining that the dual banking system creates a “dynamic and interactive regulatory structure [where] a change in the content or effect of regulation in one sector releases a series of forces” as banks reassess their business plans).

16. Smith, *supra* note 14, at 131 (“There is currently tension if not conflict, between the federal government and at least some states involving the assertion by states of jurisdiction over the mortgage banking and brokerage subsidiaries of national banks and over the applicability to national banks and their subsidiaries of state laws that address predatory lending.”).

17. Brian Collins, *States Oppose OCC Exemption*, ORIGINATION NEWS, May 3, 2004, at 1.

18. See generally Azmy, *supra* note 4 (arguing against federal preemption); Edmund Mierzwinski, *Preemption of State Consumer Laws: Federal Interference is a Market Failure*, 6 GOV’T L. & POL’Y J. 6 (2004) (same).

19. Professor Azmy’s forthcoming article forcefully argues in favor of state-level decision-making on predatory lending reform. Azmy, *supra* note 4.

secondary capital markets which fund predatory lenders. Next, in Part III, I provide a detailed exposition of current law and policy related to predatory lending. In addition to this description, Part III will also make two points: first, our predatory lending policies have achieved only limited success; and second, these policies are fundamentally mixed-federalist, each having been deployed by both federal and state government. Part IV summarizes a recent burst of relatively innovative state predatory lending statutes meant to correct the limitations of the traditional body of law surveyed in Part III. In turn, Part V analyzes the incentives and possible consequences of recent federal banking regulators' efforts to preempt state predatory lending laws. This Section suggests that while federal regulators claim their preemption decisions were made to promote uniform national regulation, their efforts may have more to do with rolling back progressive new state consumer protections. Part VI looks at how Congress is poised to enter this debate, potentially reshaping a centuries-old federal-state balance of power with respect to real estate finance. Taking a current leading Congressional proposal as an example, this Section ultimately distills lessons for consumer advocates and federalists.

II. THE PROBLEM OF PREDATORY HOME MORTGAGE LENDING

A. *Context: The Prime and Subprime Home Mortgage Markets*

A brief background description of predatory lending is best begun by noting what is *not* predatory lending. Initially, it should go without saying that the traditional home purchase mortgage market, most typically made up of "prime loans," is the financial backbone of the American middle class. Lenders typically grade borrowers' credit histories ranging from "A" credit through "B," "C," and "D" credit.²⁰ Prime loans are generally those extended to customers with "A" credit histories.²¹ The government-sponsored enterprises ("GSE") Fannie Mae and Freddie Mac purchase most prime mortgage loans from lenders who originate the loans.²² These two companies either hold conventional prime loans themselves or bundle and resell them as securities to Wall Street investors.²³

Although recently Fannie Mae and Freddie Mac have begun purchasing some "A-" loans, in general, both have strict underwriting standards and pay similar prices for all the loans they purchase.²⁴ Both GSE's have moved to automated underwriting that uses a relatively complex financial model to predict

20. Anand K. Bhattacharya et al., *Overview of the Mortgage Market*, in THE HANDBOOK OF MORTGAGE-BACKED SECURITIES 3, 22 (Frank J. Fabozzi ed., 5th ed. 2001).

21. *Id.*

22. Together, Fannie Mae and Freddie Mac purchase just over seventy percent of all fixed-rate mortgages extended to middle-income families. JERRY W. MARKHAM, 3 A FINANCIAL HISTORY OF THE UNITED STATES 347 (2002).

23. William R. Emmons et al., *The Housing Giants in Plain View*, REGIONAL ECONOMIST, July 1, 2004, at 4.

24. Bhattacharya et al., *supra* note 20, at 22.

the likelihood of default.²⁵ The GSE's have also required that prime loan originators use standardized contract and disclosure forms.²⁶ Conditioning access to the GSE's seemingly endless well of capital upon standardized underwriting and origination practices, as well as relatively vigorous front-end competition, stabilizes the prices prime market originators charge.

In contrast, industry insiders call subprime lending the "wild-west" of the real estate secured credit market.²⁷ The subprime market is usually thought to service borrowers with "A-," "B," "C," and sometimes even "D" credit histories.²⁸ Thus, an influential subprime lending industry trade journal styles itself "Inside B&C Lending." This is something of a misnomer however, because subprime lenders are happy to lend at subprime prices to borrowers with "A" credit histories. A Freddie Mac study of 15,000 consumer credit histories found that between ten to fifty percent of subprime borrowers actually qualified for prime loans.²⁹ Another poll of the fifty most active subprime lenders found that *half* of all subprime borrowers actually had "A" credit histories.³⁰ Disturbingly, millions of Americans have overpaid on the most important investment of their lives, which suggests a deep breakdown in the comparative shopping behavior thought to drive efficient market outcomes.³¹

As we shall see, the back-end securitization structure of the subprime market also tolerates these disturbing origination practices.³² Unlike prime

25. FREDDIE MAC, AUTOMATED UNDERWRITING: MAKING MORTGAGE LENDING SIMPLER AND FAIRER FOR AMERICA'S FAMILIES, at Ch. 1 (1996), available at <http://www.freddiemac.com/corporate/reports/moseley/moseidx.htm> (last visited Apr. 5, 2005).

26. See Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 971 (1997) (describing Fannie Mae and Freddie Mac's promulgation of standard forms).

27. Karen Hube, *In the Wild West of Subprime Lending, Borrowers Have to Dodge Many Bullets*, WALL ST. J., Mar. 18, 1998, at C1; Micheal D. Larson, *It's Buyer Beware When You're Shopping for a Subprime Loan*, at <http://www.bankrate.com/inm/news/mtg/20000420.asp> (last visited Apr. 5, 2005). See also Neil J. Morse, *Coping with a Wild Market*, 62 MORTGAGE BANKING, Jan. 2002, at 107, 107-08 (discussing new players and volatility in the subprime lending market).

28. The subprime lending market is also sometimes referred to as the "nonconforming market" since subprime borrowers are thought to have credit histories, income-to-debt ratios, loan-to-value ratios, and other risk markers that do not meet standard GSE underwriting criteria. JOHN C. WEICHER, THE HOME EQUITY LENDING INDUSTRY: REFINANCING MORTGAGES FOR BORROWERS WITH IMPAIRED CREDIT 12-13 (1997).

29. FREDDIE MAC, AUTOMATED UNDERWRITING, *supra* note 25, at Ch. 5 n.5; Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 559 (2000); Hube, *supra* note 27, at C1. Cf. Amilda Dymi, *Report Takes a Look at the Bright Side of B&C Lending*, 13 ORIGINATION NEWS, July 1, 2004, at 38 (discussing subprime lender trade association funded study criticizing Freddie Mac's survey).

30. FREDDIE MAC, AUTOMATED UNDERWRITING, *supra* note 25, at Ch. 5 n.6 (citing *Half of Subprime Loans Categorized as 'A' Quality*, INSIDE B&C LENDING, June 10, 1996).

31. Press Release, Fannie Mae, Fannie Mae Chairman and CEO Franklin D. Raines Calls for Mortgage Consumer Bill of Rights; Cites New Company Initiatives to Advance Home Buyer Protections (Jan. 14, 2000) (quoting CEO of Fannie Mae) ("Millions of families are steered to higher-cost mortgages when they could qualify for more affordable, conventional financing . . ."), available at <http://www.fanniemae.com/newsreleases/2000/0608.jhtml>.

32. Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in*

lenders, subprime lenders resell their loans to many different buyers and use many different investment structures.³³ As an industry insider explains, “[t]hat means subprime originators have much more leeway when it comes to setting rates and underwriting standards. As a result, rates, fees and program guidelines vary drastically depending on which broker or lender a consumer visits.”³⁴

All this being said, subprime lending is certainly not predatory lending.³⁵ Many subprime loans are actually originated by lenders that have traditionally focused on prime lending.³⁶ In the 1990s, some banks felt compelled to offer nonconforming loan packages to hold market share against mortgage loan companies.³⁷ The great majority of subprime loans refinance previous debts, rather than providing funds to purchase a home. Nevertheless, subprime lending allows those with troubled credit history to tap accumulated home equity savings to bridge income gaps, repair a home or car, fund education or entrepreneurship, or even pay medical bills. These “cash-out” refinances have annually pumped an estimated 100 billion dollars into the U.S. economy, helping it retain buoyancy despite slow economic growth.³⁸ Moreover, there is certainly some truth to the standard argument that greater risk and higher closing, servicing, and default costs justify higher subprime prices.³⁹ It is no coincidence that the nation’s home ownership rate has risen to its highest level ever along side the growth in

Due Course Doctrine, 35 CREIGHTON L. REV. 503, 548 (2002) (“Securitization has also benefited investors by allowing them to purchase an interest in the high interest rate loans that have been associated with predatory lending, while avoiding much of the risk of defaults and delinquencies that is associated with those loans.”).

33. See Evan M. Gilreath, *The Entrance of Banks into Subprime Lending: First Union and The Money Store*, 3 N.C. BANKING INST. 149, 152-53 (1999) (detailing practices of subprime lenders).

34. Larson, *supra* note 27. See also WEICHER, *supra* note 28, at 13 (“In sharp contrast to the prime mortgage market, there are no generally accepted underwriting guidelines for subprime home equity lenders. Individual firms set their own guidelines. They typically take the same factors into consideration but set different criteria to qualify for a given credit grade. Hence, one firm’s B loans may look like another’s C loans. Underwriting appears to be an art rather than a science. For this reason, subprime loans cannot be treated as a standard commodity, again in contrast to loans in the prime market.”); Morse, *supra* note 27, at 107-08 (outlining variations in program guidelines between different lenders).

35. See Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1259-61 (2002) (noting distinction between “legitimate” subprime loans and predatory lending).

36. See Gilreath, *supra* note 33, at 161 (citing examples of traditional lenders catering to the subprime market).

37. A Joint Treasury and HUD report explained that “[b]anks and thrifts themselves accounted for approximately 13 percent of all subprime mortgage originations in 1998; together with their affiliates, they accounted for a little more than one out of four subprime originations in 1998.” U.S. DEP’T OF THE TREASURY & U.S. DEP’T OF HOUS. & URBAN DEV., CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT 104 (2000), available at <http://www.treas.gov/press/releases/reports/treasrpt.pdf>.

38. David Ignatius, *Perils of an Empty Piggy Bank*, WASH. POST, Sept. 24, 2004, at A25 (“[T]he American Enterprise Institute estimates in a Sept. 22 report that cash-out refinancings pumped \$100 billion annually into household disposable incomes in 2002 and 2003.”).

39. WEICHER, *supra* note 28, at 67, 69-70, 80.

subprime mortgage lending.⁴⁰ Still, it is also no coincidence that home foreclosures have more than *tripled* over roughly this same period.⁴¹ Different commentators have struggled to characterize the resulting market structure that has produced these seemingly paradoxical results.⁴² The reality, of course, is a complex spectrum of loan quality, which usually, but certainly not always, corresponds to borrower risk. While virtually everyone agrees that most subprime lenders are legitimate businesses providing necessary services, the problem for policymakers is that an unmarked and unguarded border separates the market territory of legitimate subprime lending from predators on the fringe.

B. Finding the "Predatory" in Predatory Lending

A working definition of predatory lending has been the subject of more debate than it deserves, owing partly to the reluctance of key policymakers to admit that a problem exists.⁴³ Still, the most common description of predatory home mortgage lending references a list or catalogue of abusive contract terms and practices. This standard contemporary list includes packing of credit insurance, balloon payments, padded fees, rapid refinancing, broker kickbacks disguised as yield spread premiums, high pressure marketing, and of course, high rates.⁴⁴ Some in turn attempt to generalize this long list into a shorter list of

40. MARGOT SAUNDERS & ALYS COHEN, *FEDERAL REGULATION OF CONSUMER CREDIT: THE CAUSE OR THE CURE FOR PREDATORY LENDING?* 11 (Harvard University Joint Ctr. for Hous. Studies, Working Paper No. BABC 04-21, 2004) (citing Mortgage Bankers Ass'n Nat'l Delinquency Survey (third quarter 2003)).

41. *Id.*

42. See Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 605 (2000) (characterizing the market as two tiered); Engel & McCoy, *supra* note 35, at 1278 (suggesting home mortgage lending is better thought of as three markets: prime, legitimate subprime, and predatory); AMY CREWS CUTTS & ROBERT VAN ORDER, *ON THE ECONOMICS OF SUBPRIME LENDING* 22 (Freddie Mac Working Paper Series, Working Paper No. No. 04-01, 2004) (arguing there are at least four distinct market tiers).

43. See, e.g., Tom Bengtson, *Battling the Predators*, NW. FIN. REV., Feb. 15, 2002, at 16 ("Call predatory lending the pornography of the financial services industry. Everyone seems to know it when they see it but no one seems to be able to come up with a good definition for it."); Michele Heller & Robert Garver, *Gramm Takes Stand Against Predator Bills*, AM. BANKER, Aug. 24, 2000, at 1 (reporting Senator Gramm's assertion that the problem of predatory lending cannot be addressed because it has not been defined); Patricia E. Obara, *Predatory Lending*, 118 BANKING L.J. 541, 541 (2001) ("Notwithstanding the lack of an accepted definition of 'predatory lending,' the desire to 'do something' to stop abuses in the lending industry has led to a plethora of state bills . . ."); *Report of the Staff to Chairman Gramm, Committee on Banking, Housing and Urban Affairs - Predatory Lending Practices: Staff Analysis of Regulators Responses*, Aug. 23, 2000, reprinted in 54 CONSUMER FIN. L.Q. REP. 228, 229 (2000) ("[R]egulators do not have and did not provide a definition of 'predatory lending.'"); Richard Boisky, Editorial, *In Reality, "Predatory Lending" Isn't Easy to Define*, NEWS & OBSERVER (Raleigh, N.C.) Oct. 24, 2000, at A10 (noting difficulty in establishing a universal definition of predatory lending).

44. ELIZABETH RENUART, NATIONAL CONSUMER LAW CENTER, *STOP PREDATORY LENDING: A GUIDE FOR LEGAL ADVOCATES* 29-32 (2002) [hereinafter RENUART, NCLC, *STOP PREDATORY LENDING GUIDE*]; Mansfield, *supra* note 29, at 532-61; Patricia Sturdevant & William J. Brennan, Jr., *A Catalogue of Predatory Lending Practices*, 5 CONSUMER ADVOC. 4 (1999).

factors.⁴⁵ Others have defined predatory lending as a mismatch between loan provisions and borrowers' financial needs.⁴⁶ Still others define predatory lending along the lines of vulnerable groups – namely abusive lending that targets vulnerable ethnic, socioeconomic, or generational groups.⁴⁷ Each of these descriptions is certainly valuable and all hit close to the mark. In my view, they also seem to overlook what is most essentially wrong with the commercial practice. Predatory lending at its heart is nothing more than misappropriation of income or equity by financial subterfuge. Predatory lenders take more from borrowers than they are rightly entitled to.⁴⁸ What is difficult to define is not predatory lending, but rather, the ethically acceptable commercial practices that demarcate entitlement.

Nevertheless, the standard list of the contemporary predatory home finance practices is a useful vehicle for introducing the problem. A short introduction to indicia, or warning signs, of predatory loans that present themselves at different stages in a mortgage loan transaction follows. It is important to remember that these are indicia, rather than criteria. This is to say, a loan may be fairly considered a predatory loan not only where all of these factors are present, but more likely where some or even one are present. Furthermore, because this is an abbreviated list of indicia, a loan can be predatory where none of the following factors are present. The value of this short list is demonstrative, rather than definitive.

45. See James H. Carr & Lopa Kolluri, *Predatory Lending: An Overview*, in FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 31, 32-35 (Fannie Mae Foundation 2001) (defining predatory loans as having one or more of three features: targeted marketing to vulnerable groups, unjustifiable loan terms, and outright fraud); Engel & McCoy, *supra* note 35, at 1260 (defining predatory loans as having one or more of five features: structured to harm borrowers, harmful rent seeking, fraud or deceptive practices, lack of transparency not actionable as fraud, and loans requiring borrowers to waive meaningful redress); Deborah Goldstein, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 HARV. C.R.-C.L. L. REV. 225, 255 (2000) (defining predatory lending as “a combination of unfair loan terms and pressure tactics that limit the information and choices available to borrowers and target consumers because of particular vulnerabilities.”).

46. Daniel S. Ehrenberg, *If the Loan Doesn't Fit, Don't Take It: Applying the Suitability Doctrine to the Mortgage Industry to Eliminate Predatory Lending*, 10 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 117, 119 (2001) (“Another way of looking at the issue of predatory lending is to realize that predatory lending involves a mismatch between the needs and capacities of the borrower on the one hand and the making of and final shape of the loan product by the lender on the other. In essence, the loan does not fit the borrower . . .”).

47. See Cecil J. Hunt, II, *In the Racial Crosshairs: Reconsidering Racially Targeted Predatory Lending Under a New Theory of Economic Hate Crime*, 35 U. TOL. L. REV. 211, 215 (2003) (describing predatory lending as different than other forms of non-racialized financial exploitation); Frank Lopez, Note, *Using the Fair Housing Act to Combat Predatory Lending*, 6 GEO. J. ON POVERTY L. & POL'Y 73, 74 (1999) (explaining predatory lending in terms of disparate treatment of low-income minorities).

48. At least one student note appears to agree. See Anna Beth Ferguson, Note, *Predatory Lending: Practices, Remedies and Lack of Adequate Protection for Ohio Consumers*, 48 CLEV. ST. L. REV. 607, 609 (2000) (“Predatory lending could be viewed as the practice of deceptive mortgage lending where a lender charges fees and interest that are greater than the risk presented by the borrower.”).

1. Sales and Marketing

Predatory practices begin at the marketing stage of a loan. Many commentators have pointed to the targeting of ethnic minority neighborhoods for aggressive solicitations as a principle warning sign of predatory lending.⁴⁹ Often called “reverse redlining,” solicitations may employ a concerted campaign of television and radio ads, telemarketing, direct mail, and door-to-door sales.⁵⁰ Some lenders use public records to obtain lien, purchase, and foreclosure information and then repeatedly contact borrowers with loan offers.⁵¹ Predatory lending campaigns occur not only in the inner-city, but also in depressed rural areas, especially including Native American reservations.⁵² Any group that is traditionally underserved by mainstream lenders is vulnerable to predatory lending.⁵³

Predatory lenders also gravitate toward the elderly. Some seniors become susceptible to fraud as they gradually lose cognitive functioning later in life.⁵⁴ Independent of declining mental abilities, seniors also often face physical impairments such as deteriorating vision, hearing, and mobility, which can all impede the examination and comparison of credit contracts.⁵⁵ The GAO found “[i]n such situations, potential borrowers may be susceptible to the first lender to offer what seems to be a good deal, especially if the lender is willing to visit them

49. Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 387-88 (1994); Donita Judge, *Predatory Lending: Legalized Theft of Home Equity*, 5 RUTGERS RACE & L. REV. 293, 294-96 (2003); Lopez, *supra*, note 47, at 75-77; Mansfield, *supra* note 29, at 549-61.

50. *Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending: Hearings Before the U.S. Senate Comm. on Banking, Hous. and Urban Affairs*, 103d Cong. 294-95 (1993) [hereinafter *Hearings on Problems in Community Development*] (statement of John Long, Esq.); Goldstein, *supra* note 45, at 237; Lopez, *supra* note 47, at 77-78; Mansfield, *supra* note 29, at 557.

51. Mansfield, *supra* note 29, at 557.

52. Kelsey A. Begaye, President, Navajo Nation, Statement on the Implementation of the Native American Housing Assistance and Self-Determination Act before the Senate Comm. on Indian Affairs (Feb. 13, 2002), available at 2002 WL 228017; National Consumer Law Center, *DOJ Finds and Fines Higher Credit Prices, Loan Requirements for African Americans, Native Americans as Discriminatory*, 12 NCLC REPORTS, CONSUMER CREDIT AND USURY EDITION 41, 42-43 (Mar./Apr. 1994); Holden Lewis, *Mortgages Scarce on Native American Lands*, CHI. SUN-TIMES, June 2, 2002, at 11C; Richard Mize, *Predatory Lending Hits Home in State, Experts Say*, DAILY OKLAHOMAN, Jan. 25, 2002, at 8C; *Predatory Lenders Use Courthouse*, DAILY OKLAHOMAN, June 1, 2002, at 6C. Through 1994, not a single conventional mortgage had been closed within the Navajo Nation, an Indian reservation located in New Mexico, Arizona, and Utah, a land area larger than that of nine states. Yair Listokin, *Confronting the Barriers to Native American Homeownership on Tribal Lands: The Case of the Navajo Partnership for Housing*, 33 URB. LAW. 433 (2001).

53. Engel & McCoy, *supra* note 35, at 1279-80.

54. Goldstein, *supra* note 45, at 237-38; Kathleen E. Keest, *Whither Now? Truth in Lending in Transition—Again*, 49 CONSUMER FIN. L.Q. REP. 360, 365 (1995).

55. U.S. GEN. ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING at 9-10, GAO-04-412T (Feb. 24, 2004) [hereinafter GAO, CONSUMER PROTECTION].

at home or provide transportation to the closing.”⁵⁶ But more importantly, seniors tend to own a greater share of equity in their homes than other age groups.⁵⁷ They also often have limited, but reliable, monthly income from pensions or social security.⁵⁸ This house-rich/cash-poor combination makes a tempting target for lenders hoping to capture equity from high fees financed into loans at closing.⁵⁹

Other marketing stage indicators of predatory mortgages are connected to products or services financed by the loan. Most obviously, predatory loans are notoriously linked to unscrupulous home improvements.⁶⁰ Because the real objective of the contractor is arranging a highly profitable loan rather than developing a reputation as a reliable craftsman, the home repairs connected with predatory loans are often shoddy or incomplete.⁶¹ Called “tin men,” these contractors sometimes travel door-to-door selling their services to unsuspecting homeowners.⁶² Victims commonly report misleading sales pitches with misrepresentations about the quality of materials, free gifts, reduced prices, and the need for repairs.⁶³ Similarly, predatory lenders have even been accused of targeting consumers who are rebuilding in the wake of natural disasters.⁶⁴

Another predatory sales practice involves refinancing low-cost mortgages contrary to the long term interests of the home owner.⁶⁵ Because

56. *Id.* at 10.

57. Goldstein, *supra* note 45, at 237 n.55. Moreover, seniors often live in older homes in need of repairs and are unable to do those repairs themselves. GAO, CONSUMER PROTECTION, *supra* note 55, at 10-11.

58. See, e.g., Russell Grantham, *Predatory Lenders Feel the Heat: Fed's Reforms Fall Short, Say Critics and Borrowers*, ATLANTA J. CONST., Jan. 13, 2002, at C1 (describing loan to seventy-one year old widow with monthly payment constituting eighty percent of widow's monthly income from social security).

59. GAO, CONSUMER PROTECTION, *supra* note 55, at 9.

60. Forrester, *supra* note 49, at 389-90.

61. GAO, CONSUMER PROTECTION, *supra* note 55, at 11.

62. Judge Zagel of the Northern District of Illinois gives a good description:

In classic “Tin Men” fashion, defendants New Look Home Services and MDR Mortgage Brokers conned Clarice Mason into having repairs done on her home and financing those repairs through a loan from defendant Fieldstone Mortgage. The \$70,000 loan put a 30-year mortgage on a home that was free and clear of liens. New Look received \$35,000 of the loan proceeds but failed to perform many of the repairs. MDR received a \$6,000 broker fee. Mrs. Mason died and now Mr. Mason, the plaintiff, is stuck with the mortgage.

Mason v. Fieldston Mortgage Co., No. 00-C-0228, 2000 WL 1643589, at *1 (N.D. Ill. Oct. 20, 2000). See also Michael Hudson, *Loan Scams*, in *MERCHANTS OF MISERY: HOW CORPORATE AMERICA PROFITS FROM POVERTY* 72, 73 (Michael Hudson ed. 1996) (providing similar descriptions of “Tin Men”).

63. NATIONAL CONSUMER LAW CENTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 5.6.1.2 (6th ed. 2004) [hereinafter NCLC, Unfair and Deceptive Acts].

64. *Hearings on Problems in Community Development*, *supra* note 50, at 291 (statement of Eva Davis); Forrester, *supra* note 49, at 389 n.80; Eileen Zaffiro, *Local Economy has Long Haul to Weather Storm*, DAYTONA BEACH NEWS-JOURNAL, Oct. 2, 2004, at A1.

65. Richard Locker, *Bill Would Help Protect Habitat Homeowners*, COM. APPEAL (Memphis, Tenn.), May 4, 2004, at B6; Marc Perrusquia, *Herenton Lashes at Predatory Lenders*, COM. APPEAL (Memphis, Tenn.), Apr. 27, 2004, at B1.

homeownership is so important in securing a safe and comfortable lifestyle, many government, charitable, and private programs aim to foster homeownership. For instance, the charitable organization Habitat for Humanity uses volunteer labor to build low-cost housing for deserving low-income families. The organization also arranges low-cost fixed interest rate mortgages for their new homeowners. In recent years, Habitat for Humanity chapters have struggled to prevent predatory mortgage lenders from luring their families into predatory refinance loans.⁶⁶ But even consumers who have typical mortgages can be tempted with promises about lower monthly payments, which turn out to be half-truths when taxes and insurance are included.⁶⁷

In some cases, predatory practices include shifting unsecured debt into a family's home mortgage.⁶⁸ Although a home refinance loan may have lower interest rates than the family's credit cards, the lower rates come at the cost of exposing the family home to foreclosure.⁶⁹ In cases where a family is teetering on the edge of insolvency due to unemployment, medical bills, or a divorce, the family may be much better off keeping their lower monthly payment on their existing mortgage and seeking protection from unsecured creditors in bankruptcy.⁷⁰ While restructuring unsecured debt into a refinanced home mortgage may be against the family's interests, it can be highly profitable for the mortgage lender because it increases the amount of fees and interest charged without significantly increasing administrative costs or the risk of loss.⁷¹

Consumer advocates also argue that predatory lenders team up with unscrupulous mortgage brokers to steer borrowers into higher cost loans.⁷² This should come as no surprise given the millions of Americans who qualify for prime mortgages but pay subprime prices.⁷³ Yield spread premiums are an important tool brokers and lenders use to steer borrowers to overpriced loans.⁷⁴

66. Bert Caldwell, *Borrowing Trouble: Predatory Lenders Rely on Consumer Desperation, Ignorance by Deliberately Boosting Credit, and Offering Unrealistic Loans Terms*, SPOKESMAN REV. (Spokane, Wash.), Jan. 20, 2002, at D1; Jane Roberts, *Habitat Series Wins Top Award*, COM. APPEAL (Memphis, Tenn.), Mar. 30, 2004, at B7.

67. Richard Newman, *Shark Attacks: An Encounter with Predatory Lenders Can Leave You Without Your Money—Or Your Home*, RECORD (Bergen Co., N.J.), Jan. 6, 2002, at B1.

68. RENUART, NCLC, STOP PREDATORY LENDING GUIDE, *supra* note 44, at n.77.

69. *Id.*

70. Michael Moss, *Erase Debt Now. (Lose Your House Later.)*, N.Y. TIMES, Oct. 10, 2004, at §3. Because mortgage lenders are secured creditors under the Bankruptcy Code, they are entitled to receive the value of their collateral from the bankrupt estate. LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 101 (4th ed. 2003). Home mortgage lenders may lift the automatic stay applicable in typical Chapter 7 individual bankruptcy cases, sell the home, and keep the proceeds. 11 U.S.C. § 362(d) (2005). In comparison, unsecured credit card debts are more likely to be discharged. LOPUCKI & WARREN, *supra*, at 121.

71. RENUART, NCLC, STOP PREDATORY LENDING GUIDE, *supra* note 44, at n.77.

72. Sandra Fleishman, *Sarbanes to Air Concerns About HUD Loan Reforms*, WASH. POST, Jan. 8, 2002, at E1.

73. See *supra* note 33 and accompanying text for a discussion of lenders' use of subprime premiums.

74. Taiesha L. Cantwell, *Yield Spread Premiums: Who's Working for the Borrower? HUD's*

Sometimes referred to as servicing release premiums, overages, back-end compensation, or premium pricing—yield spread premiums are compensation paid directly by a lender to a mortgage broker using proceeds of the consumer's loan, which the borrower will repay (with interest) over time.⁷⁵ Predatory lenders and brokers conceal kickbacks to the broker for delivering “above par” loans inside of yield spread premiums.⁷⁶ By above par, lenders mean that the borrower is agreeing to a more costly loan than the borrower qualifies for based on the lender's standard underwriting guidelines.⁷⁷ Lenders constantly keep brokers up to date on the rates and terms lenders are willing to offer.⁷⁸ Many lenders provide this information to brokers on a daily basis by e-mailing or faxing rate sheets.⁷⁹ Predatory lenders commonly pay brokers an inflated yield spread premium if the broker can convince the borrower to sign up for a higher-rate loan than the borrower qualifies for.⁸⁰ The predatory broker agrees to do this because he receives a percentage of the extra profit made by the lender. Not only does the broker hide this large charge in the paperwork, but the borrower is also stuck with a higher interest rate. As a result, yield spread premiums “vary not by the quantum of services provided, but by how aggressive the broker/lender may be and how little the consumer knows.”⁸¹ Borrowers do not object because it never occurs to them that they are paying a fee of thousands of dollars for the privilege of paying a *higher* interest rate.⁸²

2. Consummation

A variety of indicia of predatory lending present themselves as the parties move toward finalizing a contract. Some of these practices are currently unlawful while others exploit loopholes or weaknesses in existing regulations.

Erroneous Regulation and Its Bar on Plaintiffs, 21 LAW & INEQ. 367, 372-75 (2003); Fleishman, *supra* note 72, at E1.

75. CHRISTOPHER L. PETERSON, TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH COST CREDIT MARKET 142 (2004).

76. *Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums: Hearing before the U.S. Senate Committee on Banking, Housing, and Urban Affairs*, 107th Cong. Part I (Jan. 2002) [hereinafter *Yield Spread Premium Hearing*] (prepared statement of Ira Rheingold).

77. Howell E. Jackson & Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums* 3 (Jan. 8, 2002) (unpublished manuscript, on file with author).

78. *Id.* at 2.

79. *Id.*

80. *Yield Spread Premium Hearing*, *supra* note 76, at Part I (prepared statement of Ira Rheingold) (“I have seen countless loans that contained both yield spread premiums and borrower paid broker fees, yet not *once*, have I spoken to a homeowner who knew that a YSP had been paid on their loan, or that because of the [yield spread premium], the interest rate they received was greater than they were otherwise qualified.”).

81. Barron E. Ramos, *Materials on Residential Mortgage Litigation*, PRACTICING LAW INSTITUTE CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, PLI No. B0-00ZV, at 206 (Apr. 16, 2001).

82. Jackson & Berry, *supra* note 77, at 3 (average yield spread premiums are between \$1,000 and \$2,000).

The federal Real Estate Settlement Procedures Act⁸³ presents an example of the latter. It requires lenders give borrowers a “good faith estimate” of closing costs early in the process of coming to an agreement.⁸⁴ The purpose of this rule is to allow consumers the opportunity to shop for the most inexpensive costs and thus avoid abusive pricing.⁸⁵ Unfortunately, the law provides no guidelines for how accurate the good faith estimate must be, nor does it provide any liability for wildly inaccurate estimates.⁸⁶ Predatory lenders use the law to “anchor” consumers’ perceptions of closing costs.⁸⁷ Compelling evidence suggests consumers do not sufficiently readjust their perception of early estimated costs when later, more accurate, disclosures are provided at closing.⁸⁸ But even if they do, by the time the borrower learns the true price it is often too late to turn back because the borrower has already scheduled a closing and is counting on the loan.⁸⁹ As a result, the good faith estimate creates a federally structured opportunity for lenders to use bait-and-switch consummation tactics.

The speed and complexity of most home mortgage loan closings make them intellectually inaccessible to the vast majority of borrowers. The typical loan applicant is presented with a large stack of documents and generally feels pressure to sign without reading.⁹⁰ The entire exchange often lasts no more than

83. 12 U.S.C. §§ 2601 *et seq.* (2005).

84. *Id.* § 2603; 15 U.S.C. § 1638(b)(2) (2005).

85. 12 U.S.C. § 2601.

86. See BD. OF GOVERNORS OF THE FED. RESERVE SYS. & U.S. DEP’T OF HOUS. & URBAN DEV., JOINT REPORT TO CONGRESS CONCERNING REFORM TO THE TRUTH IN LENDING ACT AND THE REAL ESTATE SETTLEMENT AND PROCEDURES ACT, at 40 (July 1998) [hereinafter FED. & HUD JOINT REPORT] (discussing recommendations for creditors to provide “a guaranteed amount for closing costs” to consumers “at first contact”), available at <http://www.federalreserve.gov/boarddocs/RptCongress/tila.pdf> (last visited Apr. 5, 2005).

87. PETERSON, *supra* note 75, at 180-82.

88. Hillel J. Einhorn & Robin M. Hogarth, *Behavioral Decision Theory: Processes of Judgment and Choice*, 32 ANN. REV. OF JUDGMENT & PSYCHIATRY 53-88 (1981); Hillel J. Einhorn & Robin M. Hogarth, *Decision Making Under Ambiguity*, in RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS AND PSYCHOLOGY 46-48 (Robin M. Hogarth & Melvin W. Reder eds., 1987); Robin M. Hogarth, *Beyond Discrete Biases: Functional and Dysfunctional Aspects of Judgmental Heuristics*, 90 PSYCHOL. BULL. 197-211 (1981); Daniel Kahneman & Amos Tversky, *Conflict Resolution: A Cognitive Perspective*, in BARRIERS TO CONFLICT RESOLUTION 54-55 (Kenneth J. Arrow, et al. eds. 1995); Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499, 1504 (1998); Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175, 1188 (1997); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124-31 (1974).

89. PETERSON, *supra* note 75, at 180.

90. One debtor recently described a typical high-cost home mortgage closing:

When it comes time to sign the loan papers, they just sail right through them. When you arrive at the closing, they’ve already prepared all the papers, with the life insurance and the points and extras added on. At the closing, they point at this and that in the papers but they don’t explain really what any of it means. There’s a whole lot of fine print in the papers that even now I just don’t know what it means. At the loan closing they don’t give you any chance to figure it out. They don’t want you to understand what’s going on. And since they always act so nice and friendly, you come to trust them and rely on them to tell you all the important information about the loan.

half-an-hour despite the voluminous paper work involved.⁹¹ Little incentive exists consumers to read the documents, even if there is sufficient time allotted for them to do so, because at this point consumers feel obligated to sign irrespective of the “details.” While all home mortgage loan closings are problematic, predatory lenders in particular tend to circumvent relevant federal consumer protection laws. For instance, the Truth in Lending Act gives borrowers a temporary three day right to cancel a home mortgage without incurring any financial penalty.⁹² Under the rule, lenders must provide borrowers a separate notice informing them of this right.⁹³ The three day “cool off” period does not begin to run until the consumer receives this notice.⁹⁴ Predatory lenders often obscure, omit, or mischaracterize the consumer’s right to back out of the transaction.⁹⁵

Consumer advocates also often accuse predatory lenders of providing false information on applications or closing documents.⁹⁶ Originators typically resell their loans to assignees shortly after consummation.⁹⁷ In order to receive the best price on assignment, a strong incentive exists to portray borrowers as better credit risks than they actually are.⁹⁸ For instance, there are widespread reports of predatory lenders inflating consumers’ income to conceal dangerously high income-to-payment ratios.⁹⁹ Some predatory lenders simply make up false

Equity Predators: Stripping, Flipping, and Packaging their Way to Profits: Hearing before the U.S. Senate Special Committee on Aging, 105th Cong. 19 (Mar. 1998) [hereinafter Equity Predators Hearing] (testimony of Gael Carter).

91. Many loan officers schedule closing after closing all day long, creating pressure to finish meetings quickly. *See, e.g.,* Jenifer K. Nii, *Broker Business*, DESERET NEWS (Salt Lake, UT), Sept. 21, 2003, at M01 (quoting broker describing “going to a title company and spending eight straight hours closing one loan after another after another”).

92. 15 U.S.C. § 1635(b) (2005) (“When an obligor exercises his right to rescind . . . he is not liable for any finance or other charge, and any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission.”).

93. *Id.* § 1635(a). Actually, the Federal Reserve Board’s implementing regulations require lenders give two separate copies of the rescission notice, one that the consumer can keep, and another that the consumer can mail in to the lender should they decide to rescind. Truth In Lending (Regulation Z), 12 C.F.R. § 226.23(b)(1) (2004) (“In a transaction subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind . . .”).

94. 12 C.F.R. § 226.23(a)(3).

95. *See* Donna S. Harkness, *Predatory Lending Prevention Project: Prescribing a Cure for the Home Equity Loss Ailing the Elderly*, 10 B.U. PUB. INT. L.J. 1, 13-14 (2000) (noting similar practices with respect to the three-day advance disclosures mandated by the Home Ownership and Equity Protection Act).

96. *See, e.g.,* RENUART, NCLC, STOP PREDATORY LENDING GUIDE, *supra* note 44, at n.79 (discussing lenders who “‘help’ consumers by exaggerating or even falsifying extra income on their loan applications”).

97. Eggert, *supra* note 32, at 546.

98. Engel & McCoy, *supra* note 35, at 1268.

99. *See, e.g.,* Dan Niedzwiecki, *The Massachusetts High Cost Home Loan Regulations: Is this the End of Predatory Lending in the Commonwealth?*, 21 ANN. REV. BANKING L. 335, 383 (2002) (discussing lenders’ practice of “phantom income” and “gross up” income); Grantham, *supra* note 58, at C1 (describing lender that reported inflated income for disabled seventy-one year-old widow).

sources of income.¹⁰⁰ Using overestimated appraisals of home value to justify ill-advised loans is a rampant predatory practice.¹⁰¹ Similarly, supplying a forged signature or a fictitious letter can speed along consummation and at the same time eliminate the risk that the borrower will spot overpriced charges or unfair terms.¹⁰² The departure from reliable underwriting practices matters little to the predatory lenders because they plan on selling the loan anyway. The assignee will not complain so long as sufficient equity exists in the home to cover foreclosure costs when the consumer defaults.¹⁰³ The closing process involves so many different and confusing documents, consumers rarely know the difference. And best of all, if a legal dispute with the consumer arises, the lender can claim it was the borrower who supplied the false information, thus committing fraud against the lender, and creating pressure on the borrower to settle or abandon any claims for violations of consumer protection laws.¹⁰⁴

Predatory lenders also tend to make loans appear more attractive to assignees by convincing insincere or confused co-signers to guarantee loans.¹⁰⁵ Guarantors may be extended family members who are hoping to help the borrower overcome a financial hurdle or assist in the purchase a home.¹⁰⁶ In the predatory market, these co-signers typically often do not fully understand the implications of their commitment and have no intention of making monthly payments.¹⁰⁷ Borrowers who are unfamiliar with the legal system, have limited literacy skills, or are not native English speakers, may recognize little apparent distinction between serving as a co-signer and serving as a character reference.¹⁰⁸ Unscrupulous lenders and brokers can cultivate and encourage this naiveté.¹⁰⁹ When the borrower falls into default, the assignee can pursue the cosigner,

100. Moss, *supra* note 70, at §3 (quoting Iowa Attorney General stating, “we are very concerned about incomes that are inflated or completely made up”).

101. *Id.*

102. *Id.*

103. *Id.*

104. RENUART, NCLC, STOP PREDATORY LENDING GUIDE, *supra* note 44, at 30.

105. Niedzwiecki, *supra* note 99, at 383.

106. Mansfield, *supra* note 29, at 513-14.

107. Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL. REV. 233, 258-61 (2002). The FTC has explained:

[M]any cosigners are unaware of the nature of the obligation they undertake absent a disclosure. Some believe that they are merely acting as a reference. Legal aid attorneys estimate that only 20 percent of cosigners understand the nature and extent of their obligation. Although some cosigners are aware of the basic fact of liability, even cosigners who realize that they are not merely references are often not fully aware of the extent of their obligation.

FTC Credit Practices Rule, 49 Fed. Reg. 7,740, 7,773 (Mar. 1, 1984) (codified at 16 C.F.R. pt. 444).

108. The Federal Trade Commission has attempted to counter this reality by requiring a cosigner disclosure in loans that fall within its jurisdiction. FTC Credit Practices Rules, 16 C.F.R. § 444.3(c). Cf. Steven W. Bender, *Consumer Protection for Latinos: Overcoming Language Fraud and English-Only in the Marketplace*, 45 AM. U. L. REV. 1027, 1092-95 (1996) (discussing limitations of this rule).

109. PETERSON, *supra* note 75, at 132.

destroying not only the borrower's credit history, but pitching the tragedy into the borrower's extended family as well.¹¹⁰ But, if the home is of sufficient value to cover the debt, often the lender will just foreclose on the home.¹¹¹ Often, the point of including the cosigner is to artificially inflate income to create the appearance of sound underwriting.¹¹²

3. Contract Terms

Predatory home mortgage loans tend to have high interest rates. Lenders argue that greater risks of default in low-income borrower pools justify higher prices.¹¹³ The hallmark of predatory lending is the combination of rates unreasonably disproportionate to the lenders origination and servicing costs where adequate collateral secures the loan. However, predatory loans also often include balloon payments, which can facilitate deceptively affordable monthly payments.¹¹⁴ Balloon payments are large payments that usually come due at the end of a loan term.¹¹⁵ A predatory loan with a relatively short duration and artificially low monthly payments followed by a large balloon payment can force the borrower into refinancing a new round of closing costs to avoid foreclosure.¹¹⁶ Because at the beginning of a home mortgage loan, most of the consumer's monthly payments go to interest, predatory lenders use balloon payments to ensure the borrower does not earn equity in the home despite regular monthly payments. Similarly, some predatory lenders structure non-amortizing loans where monthly payments are less than monthly finance charges, leading to a loan that grows larger, rather than smaller, over time.¹¹⁷

Another predatory lending tactic involves using closing fees to generate revenue rather than cover closing costs.¹¹⁸ Tactics include padding title recording fees, credit reports, courier services, notary fees, and inflating appraisal costs.¹¹⁹ Sometimes these services are provided by affiliated companies, other times lenders hold a portion of the third party fee for themselves. Moreover, these "junk fees" are difficult for consumers to compare because Regulation Z of the Truth in Lending Act often excludes them from the finance charge.¹²⁰

Predatory mortgage lenders tend to use credit insurance to create a similar

110. Mansfield, *supra* note 29, at 513-14.

111. Niedzwiecki, *supra* note 99, at 383.

112. *Id.*

113. PETERSON, *supra* note 75, at 42-44.

114. FED & HUD JOINT REPORT, *supra* note 86, at 56.

115. RENUART, NCLC, STOP PREDATORY LENDING GUIDE, *supra* note 44, at n.81.

116. FED & HUD JOINT REPORT, *supra* note 86, at 53.

117. *Id.* at 56.

118. Christopher L. Peterson, *Truth, Understanding, and High-cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 899 (2003).

119. NATIONAL CONSUMER LAW CENTER, TRUTH IN LENDING § 1.2.5 (5th ed. 2003) [hereinafter NCLC, TRUTH IN LENDING].

120. 12 C.F.R. § 226.4(c)(7).

effect. Credit insurance, which is offered in mainstream credit contracts as well as with high-cost loans, makes payments to the lender for the consumer when covered events occur.¹²¹ For example, credit life insurance typically pays off the debtor's remaining balance on a loan, home equity line, or credit card account if the borrower dies during the term of coverage.¹²² Other types of coverage include credit disability insurance and involuntary unemployment credit insurance.¹²³ Credit insurance companies are often third parties with no relationship to the lender, but can also be a wholly owned subsidiary of the lender.¹²⁴ In either case, consumer investments in credit insurance tend to have poor value.¹²⁵ Moreover, because high-cost lenders often finance insurance policies in a single lump sum premium paid out of the proceeds of the loan—thus the term “single premium credit insurance”—borrowers must pay interest on the policy for the duration of the loan.¹²⁶ This also tends to be a poor value, because as the loan is gradually paid off, the insurance coverage is worth less and less.¹²⁷ Moreover, at the beginning of the term, almost all of the borrower's payments go toward interest and fees rather than the principle.¹²⁸ Therefore, up front single premiums spent on credit insurance forestall the borrower's chance to make headway on the loan and accumulate equity in the home.¹²⁹ While credit insurance is a bad investment generally, predatory lenders tend to use the product as an opportunity to gouge unsuspecting consumers by packing unreasonable amounts of insurance into their loans.¹³⁰

Distinct from credit insurance, which protects the borrower by waiving monthly payments when a triggering event occurs, is collateral protection insurance. Sometimes called forced place insurance, this coverage insures the value of the dwelling that serves as collateral for the loan.¹³¹ Its purpose is to protect the lender by insuring the collateral from fire, flood, or some other

121. CONSUMER FEDERATION OF AMERICA & CENTER FOR ECONOMIC JUSTICE, CREDIT INSURANCE OVERCHARGES HIT \$2.5 BILLION ANNUALLY 1-2 (Nov. 2001) [hereinafter CFA & CEJ CREDIT INSURANCE STUDY], available at <http://www.consumerfed.org/credins.pdf>.

122. Rita Gordon Pereira, *Credit Insurance, Obtaining Relief for Postclaim Ineligibility Determinations*, 28 CLEARINGHOUSE REV. 891, 891 (Dec. 1994).

123. *Id.*

124. PETERSON, *supra* note 75, at 183. In the case of a subsidiary, the label of “insurance” is something of a misnomer, since upon the occurrence of the covered event the lending corporation only loses a legal entitlement to a debt payment they probably would not have collected anyway. *Id.*

125. CONSUMERS UNION & CENTER FOR ECONOMIC JUSTICE, CREDIT INSURANCE: THE \$2 BILLION A YEAR RIP OFF 2-4 (1999), available at <http://www.consumersunion.org/pdf/credit.pdf> (last visited Apr. 5, 2005).

126. CFA & CEJ CREDIT INSURANCE STUDY, *supra* note 121, at 23; PETERSON, *supra* note 75, at 189.

127. Erick Bergquist, *Single-Premium Rout Doesn't End Fight*, AM. BANKER, Oct. 5, 2001, at 1; *Fed's Gramlich-Fed Continues Efforts vs. High-Cost Mortgages*, MARKET NEWS INT'L, Mar. 1, 2002.

128. PETERSON, *supra* note 75, at 189.

129. *Id.*

130. CFA & CEJ CREDIT INSURANCE STUDY, *supra* note 121, at 2-3; NCLC, TRUTH IN LENDING, *supra* note 119, at § 3.9.4.1.

131. NCLC, TRUTH IN LENDING, *supra* note 119, at § 3.9.4.4.2.

property damage. By all accounts, collateral protection insurance is a legitimate commercial tool.¹³² However, predatory lenders have used it as another opportunity to overcharge for insurance of limited value.¹³³ For example, a lender might include collateral protection coverage provided by an affiliated company with restrictive payout terms at actuarially over-priced premiums. In these cases, consumers are often unaware that they can seek superior insurance from another provider, or that they are even paying for the coverage.¹³⁴

Increasingly, predatory home mortgage loan contracts also include mandatory binding arbitration clauses.¹³⁵ Often consumers are unaware of these provisions that forswear their access to the civil justice system.¹³⁶ Although alternative dispute resolution has a long history of inexpensive resolution of commercial disputes, many consumer advocates and scholars insist arbitration agreements have become a contractual tool allowing businesses to exploit unsophisticated consumers.¹³⁷ They complain that arbitrators have a financial incentive to favor lenders who typically choose the arbitration forum and that this leads to higher, rather than lower, actual costs for borrowers.¹³⁸ Critics of arbitration also argue that because arbitration decisions are unpublished and

132. *Jenkins v. Heintz*, 124 F.3d 824, 826-27 (7th Cir. 1997) (discussing use of forced place insurance in auto lending).

133. NCLC, *TRUTH IN LENDING*, *supra* note 119, at §3.9.4.4.2.

134. *Id.*

135. Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. ON DISP. RESOL. 267, 268 (1995).

136. *See id.* at 304-05 (discussing how arbitration contracts “may be vulnerable to a procedural unconscionability attack on the grounds that the contract fails to adequately explain the arbitration procedure and what the consumer is surrendering”).

137. *E.g.*, Richard A. Bales, *The Laissez-Faire Arbitration Market and the Need for a Uniform Federal Standard Governing Employment and Consumer Arbitration*, 52 U. KAN. L. REV. 583, 606-08 (2004); Budnitz, *supra* note 135, at 305; Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945, 1960-63 (1996); Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 240-43 (1995); Stephen K. Huber, *Consumer Arbitration in the United States Supreme Court: Greentree Financial Corporation v. Randolph*, 4 J. TEX. CONSUMER L. 267, 267-68 (2001); Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV. 583, 598-600 (1990); Jeremy Senderowicz, *Consumer Arbitration and Freedom of Contract: A Proposal to Facilitate Consumers' Informed Consent to Arbitration Clauses in Form Contracts*, 32 COLUM. J.L. & SOC. PROBS. 275, 276-77 (1999); Shelly Smith, *Mandatory Arbitration Clauses in Consumer Contracts: Consumer Protection and the Circumvention of the Judicial System*, 50 DEPAUL L. REV. 1191, 1191-94 (2001); Jeffrey W. Stempel, *Bootstrapping and Slouching Toward Gomorrah: Arbitral Infatuation and the Decline of Consent*, 62 BROOK. L. REV. 1381, 1428-31 (1996); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 688 (1996); Patricia Sturdevant & Dwight Golaan, *Should Binding Arbitration Clauses Be Prohibited In Consumer Contracts?*, 1 DISP. RESOL. MAG. 4, 4-5 (1994); Michael Schneidereit, Note, *A Cold Night: Unconscionability as a Defense to Mandatory Arbitration Clauses in Employment Agreements*, 55 HASTINGS L.J. 987, 996-98 (2004).

138. Joan Claybrook, *Mandatory Arbitration Undermines Law: More and More Businesses Use Clause to Evade Legal Obligations*, CHARLOTTE OBSERVER (N.C.), May 1, 2002, at 17A; Jackson Williams, *The Costs of Arbitration*, CONGRESS WATCH 1-3, 77-78 (2002); FED. & HUD JOINT REPORT, *supra* note 86, at 71.

often confidential, arbitrators are free to ignore actual black letter law and sometimes, in fact, do so.¹³⁹

4. Servicing and Collections

Predatory servicing and collection practices may be as simple as incorrectly calculating interest charges, particularly with respect to complex variable rate loans and open end lines of credit.¹⁴⁰ Excessive or inappropriately levied late fees can also significantly increase consumers' indebtedness over time. For instance, consumer advocates have complained about lenders' failure to timely post monthly payments.¹⁴¹ In some cases, late fees are imposed after timely monthly payments are held in a "suspense" account.¹⁴² One variation of excessive late fees is "pyramiding" late fee practices.¹⁴³ Here, a borrower makes an initial late payment causing a fee to be deducted from her check.¹⁴⁴ The next month, when the borrower makes the regular payment on time, the lender nevertheless charges another late fee on the rationale that the borrower is "behind" on the loan since the second payment does not include the previous month's late fee.¹⁴⁵

For many predatory lenders, the most important aspect of servicing a loan is diverting consumers back to the beginning of the process. In the mortgage lending industry, "flipping" refers to repeated refinancing of a loan.¹⁴⁶ This is advantageous to lenders because closing offers more opportunities for lenders to charge points and fees that are usually financed over the life of the loan.¹⁴⁷

139. See Budnitz, *supra* note 135, at 313 (noting that successful consumers can only report an award of X dollars to the press, which "lacks the force of specific findings of fact and rulings of law which accompany judicial proceedings"). At least some arbitrators seem to agree with this claim. A recent half page color advertisement for the National Arbitration Forum in the American Bar Associations ABA Journal states, "All Arbitration is not the same. Unlike the others, the [National Arbitration] Forum offers a national panel of seasoned legal professionals and a procedural code requiring arbitrators follow the law in making decisions and awards." *Not All Arbitration is the Same*, ABA J., Aug. 2004, at 45 (advertisement). Indeed, it is a strange legal system where the primary referees of the legality of contracts feel obliged to boast that they actually follow the law—as though whether or not this should be done were an open question.

140. Maxwell v. Fairbanks Capital Corp., 281 B.R. 101, 117 (Bankr. D. Mass. 2002); Elizabeth Renuart, *Toward One Competitive and Fair Mortgage Market: Suggested Reforms in a Tale of Three Markets Point in the Right Direction*, 82 TEX. L. REV. 421, 426 (2003).

141. Renuart, *supra* note 140, at 426. Ms. Renuart also points out that some lenders delay crediting and adjusting homeowner's escrow accounts resulting in unnecessarily high monthly escrow payments. *Id.*

142. *Id.*

143. DEE PRIDGEN, CONSUMER CREDIT AND THE LAW § 11:7 (2003).

144. Michael J. Herbert, *Straining the Gnat: A Critique of the 1984 Federal Trade Commission Consumer Credit Regulations*, 38 S.C. L. REV. 329, 353 (1987).

145. *Id.*

146. See FED. & HUD JOINT REPORT, *supra* note 86, at XXII ("Loan 'flipping' or 'churning' refers to the frequent refinancing of home-secured loans, which typically provides little economic benefit to the consumer in comparison to its cost, but which provides significant income to the creditor, principally in points and fees charged on the new loan.").

147. *Id.*

When a borrower falls behind on payments, lenders can use the situation to “flip” the loan. Because cash-strapped delinquent borrowers are eager to cooperate in order to prevent additional late payment penalties or foreclosure proceedings, they are easy fodder for sales staff paid on commission.¹⁴⁸ Moreover, because “these charges do not come directly out of the borrower’s pocket, debtors often do not understand the true cost.”¹⁴⁹ Rather, the lender adds the charges on to the total amount the borrower owes on the home. Or—put a different way—the lender deducts these charges from the equity the borrower has built up in the home over time.¹⁵⁰ Predatory lenders commonly include a small amount of cash out of the proceeds of the new loan to help encourage borrowers to sign.¹⁵¹ The unsuspecting but satisfied borrower walks away with placated collectors, a few hundred dollars in her pocket, and no idea she has just been taken for thousands. After only a few flips, borrowers can lose a lifetime investment in home equity, never having realized the true consequences of their contracts.¹⁵²

The risks to naive consumers from flipping are even greater when a loan contains a prepayment penalty. In the prime mortgage market, the principal concern of lenders is not that the borrower will fail to pay, but that the borrower will pay too soon.¹⁵³ If a consumer pays back a loan too quickly, the lender cannot collect sufficient interest to cover its administrative costs. In order to protect their investment, some lenders include a penalty that they assess only in the event the consumer pays in full before a specified duration.¹⁵⁴ But, in the predatory market, prepayment penalties are just one more opportunity to drain home equity, particularly when combined with collection efforts that aim to flip loans.¹⁵⁵ For instance, if a consumer is in default and believes he or she is facing foreclosure on their home, the borrower will often agree to refinance a loan – even if this means financing thousands of dollars of prepayment costs to do so.¹⁵⁶ Thus, consumers who are only a few hundred dollars behind in their mortgage

148. *Equity Predators Hearing*, *supra* note 90 (statement of “Jim Dough”) (stating that “Delinquent customers made good flipping candidates because we could put additional pressure on them. . . . [T]hese customers would almost always agree to refinance because they didn’t have the money to pay on their current loan and did not want the finance company to institute foreclosure or collection proceedings.”).

149. PETERSON, *supra* note 75, at 33.

150. FED. & HUD JOINT REPORT, *supra* note 86, at 59.

151. See Jack Guttentag, *Your Mortgage: Lenders Entice Passive Borrowers*, L.A. TIMES, Sept. 30, 2001, at K4 (stating that the prospect of cash usually causes borrowers to exercise a “complete lack of judgment”); Gene A. Marsh, *The Hard Sell in Consumer Credit: How the Folks in Marketing Can Put You Into Court*, 52 CONSUMER FIN. L.Q. REP. 295, 296-97 (1998) (explaining the process of baiting a borrower with a few hundred dollars in exchange for a new, higher rate, loan).

152. Odette Williamson, *Protecting Elderly Homeowners from Predatory Mortgage Lenders*, 34 CLEARINGHOUSE REV., 297, 298 (2000) (describing how seventy-five year-old widow’s promised \$8,000 loan flipped into \$75,000 loan at 16 percent interest rate).

153. Bhattacharya et al., *supra* note 20, at 10.

154. See *id.* at 16 (summarizing two typical prepayment penalty contract terms).

155. PETERSON, *supra* note 75, at 32-33.

156. *Id.* at 33.

can sometimes be convinced to forfeit thousands of dollars in home equity.¹⁵⁷ Moreover, some originators are careful to sell their notes in less than a month.¹⁵⁸ While this allows the lender to quickly reinvest its capital into new loans, it also has the added bonus of transferring ownership before the borrower receives her first bill.¹⁵⁹ Under the holder in due course rule, the most important defenses to the enforcement of the contract can be cut off before the borrower even realizes her monthly payments are higher than promised.¹⁶⁰ Furthermore, after the originator refuses to talk to the borrower, the borrower may have trouble finding someone to whom to complain.¹⁶¹ This can create an important and frustrating hurdle for already intimidated borrowers.

C. *Predatory Capitalizing and the Secondary Securitization Market*

Many predatory lending practices also flow from and are intrinsically related to assignment of promissory notes. While in general the holder in due course doctrine is familiar to students of commercial law, a closer look at the still emerging securitization markets is necessary to understand how predatory lenders fund their operations and often avoid liability. Traditionally, home mortgages were made by banks and thrifts that gathered deposits from consumers and businesses and then loaned these deposits out to consumers, gradually collecting payments over the life of the loan.¹⁶² Because lenders held their notes for the duration of the loan, the law of assignment played a relatively small role in mortgage loans.¹⁶³ While the market for home mortgages underwent many transformations in the mid-twentieth century,¹⁶⁴ a new means of financing loans, often called securitization, dominated the last two decades.¹⁶⁵

In a typical securitization transaction, after a mortgage lender makes the home mortgage loan, it sells the loan to an assignee.¹⁶⁶ This assignee is usually an investment bank that then, in turn, sells the loan with many other loans from

157. *Id.*

158. Eggert, *supra* note 32, at 557.

159. *Id.* See also Debra Sparks, *Bad Loans Made Good*, BUS. WK., Oct. 26, 1998, at 128 (describing the mortgage securitization process for subprime borrowers), available at 1998 WL 19884632.

160. U.C.C. §§ 3-302, 3-305 (2004).

161. Caldwell, *supra* note 66, at D1 (“[B]orrowers have no idea who their lender is.”).

162. See JERRY W. MARKHAM, 1 A FINANCIAL HISTORY OF THE UNITED STATES 85-86 (2002) (describing early banking development in the United States).

163. *Id.*

164. I provide a more thorough exposition of the development of the secondary market for home mortgages in a forthcoming Article entitled: *Predatory Lending and the Assignment of Blame* (on file with the author) (forthcoming Spring 2006).

165. FED & HUD JOINT REPORT, *supra* note 86, at 54 (“Creditors testified . . . that industrywide, the number of securitized home-equity loans rose from approximately 40 percent of loans originated in 1991 to about 80 percent [in 1997].”); Robin Paul Malloy, *The Secondary Mortgage Market—A Catalyst for Change in Real Estate Transactions*, 39 SW. L. J. 991, 995-99 (1986) (discussing implications of securitization).

166. Eggert, *supra* note 32, at 538.

additional originators to a business entity established for the specific purpose of holding the pool of loans.¹⁶⁷ The business entity can be a corporation, partnership, or limited liability company, but most often is a trust.¹⁶⁸ Aside from the pool of mortgages, the business entity has no other assets, employees, or function. What the business entity does do is sell pieces of itself to investors.¹⁶⁹ Investors invest in the pool by purchasing “securities”—here meaning derivative income streams drawn from payments on the underlying mortgages—issued by the pool.¹⁷⁰ Insurance companies, pension funds, mutual funds, and individuals all can purchase a financial interest in a large pool of mortgages.¹⁷¹ Assuming all goes as planned, investors often receive a favorable return on relatively moderate risks.¹⁷²

Cumulatively, these market players have created an extremely powerful and lucrative device for marshaling capital into home mortgage loans, as securitization dramatically decreases the information costs for investors interested in investing in home mortgages.¹⁷³ But more important for our purposes, securitization allows loan originators to make great profit from origination fees by leveraging relatively small amounts of capital to make many loans.¹⁷⁴ These advantages have increased consumer access to home mortgages. And while, in general, that is a positive development for American consumers, it has had profound and less beneficial consequences for some borrowers.

Using securitization, many predatory originators and brokers have learned to specialize in running judgment-proof operations. When a mortgage lender makes a loan, the promissory note becomes a negotiable instrument. While some important exceptions exist,¹⁷⁵ an assignee who purchases the note becomes

167. Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1377-78 (1991). Sometimes the loan will be held in a special purpose vehicle that is a wholly owned subsidiary of the originator or the underwriter while awaiting assignment into an independent business entity that will issue securities. See Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 142 (1994) (describing advantages of “two tier” securitization conduit structures).

168. Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061, 1067 n.25, 1098 n.162 (1996).

169. Eggert, *supra* note 32, at 539 n.156 (“[E]xactly what the SPV transfers to the seller may depend on the form of the SPV and how it is set up. For example, if the SPV is a corporation, the investors may purchase debt obligations rather than securities.”).

170. Although the term “securities” is commonly used to describe investors’ purchased interests in asset pools, the actual legal rights may or may not be securities for purposes of federal and state securities laws. Hill, *supra* note 168, at 1067-68 (1996); Shenker & Colletta, *supra* note 167, at 1378-79.

171. See *Wall Street’s Soiled Hands*, THE NATION, July 15, 2002, at 29 (describing how companies like Lehman Brothers, Prudential and First Union “provide the initial cash to make the loans, find banks to act as trustees, pull together the layers of financial and insurance institutions, and create the ‘special vehicles’ . . . that shield investors from risk”).

172. Schwarcz, *supra* note 167, at 153-54.

173. See *id.* at 136-37 (discussing how companies benefit from securitization).

174. See Eggert, *supra* note 32, at 546 (explaining that by quickly securitizing loans and receiving payment for them, lenders are able to use that capital to make new loans and thereby lend significantly more money than would otherwise be possible).

175. For instance, the assignee must take the note in good faith without notice of the borrowers

a holder in due course under the Uniform Commercial Code ("UCC").¹⁷⁶ Under section 3-305, the assignee can generally take the note free from many of the most important defenses that the borrower might have made against the original lender. Thus an underwriter may take the obligation to receive a borrower's payments without taking liability risk from most claims or defenses assertable against the originator. In turn, the underwriter can pass the right to receive payment on to an investment trust, which once again is not subject to the borrower's claims or defenses. The result is that too often courts are allowing mortgage loan originators to *cleanse* a loan of the most important defenses simply by assigning it.¹⁷⁷

In theory, even if the borrower cannot assert claims or defenses against the assignee, which is usually an investment trust, she may still assert those claims against the original lender. Thus, technically, the borrower still has a remedy, and the marketplace still has a deterrent against predatory lending. The reality, however, falls far short of the theory. Often a cause of action against the originator, instead of the actual holder of the note, has little or no value to predatory lending victims for at least two key reasons.¹⁷⁸

First, for many years consumer advocates have complained about "fly by night" lending operations.¹⁷⁹ The cheap supply of capital from securitization markets has lowered the entry and exit costs for subprime mortgage brokers and originators.¹⁸⁰ This has, in turn, decreased the incentive many businesses have to invest in reputational capital and other sunk costs.¹⁸¹ Consumer advocates

claims and defenses against the original lender. If an assignee has close business ties to the originator, the assignee may be particularly vulnerable to challenges regarding her good faith or notice. See *Vasquez v. Superior Court*, 484 P.2d 964, 978 (Cal. 1971) (noting that "it has long been settled in California that a financial institution may be denied the status of a holder in due course because of its close connection with the seller"); *Arcanum Nat'l Bank v. Hessler*, 433 N.E.2d 204, 209-10 (Ohio 1982) (recognizing the "close connectedness doctrine"). However, as Vern Countryman understood, making a claim of bad faith on the part of the assignee is destined to offer "only fortuitous and episodic relief to the consumer, since it depends on a demonstrated connection between the [originator] and the [assignee] that does not exist in many cases and that any prudent financier can avoid." Vern Countryman, *Holder in Due Course and Other Anachronisms in Consumer Credit*, 52 TEX. L. REV. 1, 5 (1973). See also KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER, THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES § 11.13 (2d ed. 2000) (providing a discussion of potential exceptions to the holder in due course doctrine).

176. See generally Eggert, *supra* note 32 (providing a thorough discussion of the impact of the holder in due course doctrine on predatory lending).

177. See *Wall Street's Soiled Hands*, *supra* note 171, at 29 (noting that "[f]requently shifting ownership also complicates attempts to create accountability").

178. Jonathan Sheldon and Carolyn L. Carter make exactly this point. See NATIONAL CONSUMER LAW CENTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 6.6.1.1 (6th ed. 2004) [hereinafter NCLC, UNFAIR AND DECEPTIVE ACTS] (noting that "the seller or original creditor may be judgment proof, so that consumers would be left without a remedy if they had to pay the holder of the note and then recover all or some of this amount from the original seller or creditor").

179. Countryman, *supra* note 175, at 11.

180. See Eggert, *supra* note 32, at 545-49 (outlining the advantages of securitization to investors and lenders).

181. Gillian K. Hadfield et al., *Information-Based Principles for Rethinking Consumer Protection Policy*, 21 J. CONSUMER POL'Y 131, 155 (1998).

complain that individual business persons have learned to flip loans and then disappear, leaving consumers with no remedy.¹⁸² Moreover, going beyond stereotypes of the small, shady lender, over the past decade some of the nation's largest subprime lenders have undergone boom and bust lending cycles using bankruptcy to leave "a vast number of subprime borrowers" without a remedy for predatory lending.¹⁸³ Literally "hundreds of small and midsize mortgage banks" periodically go bankrupt.¹⁸⁴ As for the largest lenders, since 1988, most of them helped themselves to judgment lien immunity from borrower lawsuits with respect to a staggering 125 billion of home mortgage dollars by declaring bankruptcy.¹⁸⁵

Second, assignment of mortgage loans also makes lawsuits against mortgage originators and brokers tactically difficult to litigate.¹⁸⁶ Most individual consumers bring their predatory lending claims not as plaintiffs, but as counterclaims in defense of foreclosure proceedings.¹⁸⁷ Rarely do borrowers seek out an attorney until they are on the verge of foreclosure.¹⁸⁸ However, at this point, predatory lending victims universally lack resources—that is, after all, why they did not pay their mortgages in the first place. These participants in the legal system, who are facing the imminent prospect of homelessness, simply lack the capability to simultaneously defend a collection action and bring an affirmative lawsuit against the original lender. Even if they do have the wherewithal to sue an originator or broker, that affirmative suit is likely to drag on many months or even years after the assignee, acting as a holder in due

182. See NCLC, UNFAIR AND DECEPTIVE ACTS, *supra* note 178, at § 6.6.1.1 (noting that the consumer may be left without a remedy if the seller or original creditor is judgment proof). See also Tamara Loomis, *Predatory Lending Law Has Investment Firms in Arms*, 229 N.Y. L.J., March 27, 2003, at 1 ("Consumer groups say assignee liability is critical in the fight against predatory lending because many of the loan originators are shady individuals who flip the loans and disappear.").

183. Eggert, *supra* note 32, at 603. The posterchild for boom-to-bust predatory lending is First Alliance Mortgage Corp. of Irvine, California. See *id.* at 592-603 (detailing First Alliance's rise and fall). See also LOPUCKI & WARREN, *supra* note 70, at 4-7 (predicting nothing less than the "death of liability" from corporate judgment-proofing strategies).

184. Robert Julavits, *Warehouse Lenders Struggle Through Merger Boom*, AM. BANKER, Oct. 27, 2000, at 9A.

185. See Erick Bergquist, *Preparing for a Bad-Loan Boom*, AM. BANKER, Oct. 6, 2000, at 1 ("Since the liquidity crisis of October 1998, most of the major subprime mortgage lenders have filed for bankruptcy. Given that these failed lenders have issued \$125 billion of mortgage- and asset-backed securities over the past three years, . . . it would not be a surprise if 10% to 20% of the loans underlying those securities go bad."). Analysts are familiar with this boom-bust cycle, and carefully appraise where any given lender is in the cycle. See, e.g., Laura Mandaro & Robert Julavits, *Wamu Goal: 500 Cafe Loan Sites*, AM. BANKER, June 21, 2001, at 1 (analyzing whether Washington Mutual boom will lead to a bust); Aaron Elstein, *Analysts: No End in Sight to Consolidation*, AM. BANKER, July 23, 1998, at 16 (analyzing investment credit risk from overpriced subprime mortgage loans).

186. See NCLC, UNFAIR AND DECEPTIVE ACTS, *supra* note 178, at §6.6.1.1 (suggesting that "even if the seller is solvent, it is usually impractical to expect a consumer to defend a collective action and simultaneously bring an affirmative suit against the seller or original creditor").

187. See *id.* (asserting that "[b]y far the most practical action for the consumer is to defend the collection action by raising in that case the consumer's claims and defenses against the seller or original creditor").

188. *Id.*

course, succeeds in foreclosing on the family home. After losing the home, most borrowers and their advocates will quickly tire of the remaining lawsuit because the most important objective—saving the home—has already been defeated. The potential damages against the originator or broker, assuming it is not judgment proof, will often be relatively small in comparison to the complexity of the litigation. Brokers and lenders typically have existing relationships with tough, litigation savvy, collection attorneys, while borrowers have great difficulty finding counsel. Private lawyers may be unable to represent the borrower because the potential damages make the claim not cost effective for their practice. Additionally, legal services lawyers may be forced to make difficult resource allocation choices where more pressing and catastrophic legal needs, such as obtaining unemployment benefits and protecting spouses from domestic violence, outweigh the value of an affirmative claim against an originator, which will, after all, never bring the family home back. As a practical matter, the severance of the borrower's right to sue over claims closely connected to the home from the note holder's right to take away that home, deeply undermines the actual value of the borrower's affirmative litigation right.

The new secondary market for home mortgages has given dangerous and unscrupulous predatory lenders access to the vast capital markets of Wall Street. The combination of an industry that has refined its skills in offering misleading and overpriced loans to vulnerable borrowers with seemingly unlimited access to capital through securitization has created explosive growth in predatory lending. The next section discusses the state and federal laws, which protect consumers from this mixture.

III. THE LAW OF PREDATORY LENDING: MIXED-FEDERALIST AND MIXED RESULTS

The system of American law addressing or attempting to address predatory home mortgage lending is exceptionally diverse and confusing.¹⁸⁹ In some instances it is redundant, while in others it leaves glaring gaps in coverage. The law applicable to predatory mortgage lending sounds in traditional contract, tort, and property law, as well as many different statutory frameworks. The breadth of law relevant to this topic defies easy description and even a cursory account demands some length.¹⁹⁰ Two themes, however, do emerge: first, in the United States, the regulation of predatory home mortgage lending has been fundamentally a mixed-federalist endeavor. State and federal government, as well as to a lesser extent local government, have historically all been actively involved in regulating predatory home mortgage lending. And, second, each

189. See, e.g., KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER, *THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES* § 2.4.2 (1995) [hereinafter KEEST, NCLC, *COST OF CREDIT*] ("discussing the problems of mortgage deregulation efforts and noting that "[t]he goals of mortgage deregulation could have been achieved by far more modest legislative changes").

190. See, e.g., Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1299-1316 (2002) (providing a solid introduction to this body of law).

legal and social strategy has thus far found only limited success in preventing predatory mortgage lending.

In the next Section, I will build upon a previous Article where I used case studies from world history to propose a framework for understanding legal strategies that protect consumers from the consequences of indebtedness.¹⁹¹ In that Article I surveyed the legal strategies of ancient civilizations and then suggested lessons for policy makers. In this Section, I use my earlier framework to set out an account of contemporary American law addressing predatory home mortgage lending. Roughly speaking, we have used seven principle strategies to prevent predatory lending, or at least to ameliorate its consequences when it does occur: debtor amnesty, restrictions on permissible contractual provisions, antidiscrimination laws, charitable lending, facilitation of cooperative credit institutions, anti-deception laws, and price disclosure.

A. Amnesty

Amnesty-based policy protects debtors by limiting the ability of creditors to collect debts. The earliest and most simple method of granting amnesty involves requiring a creditor to forgive a debt.¹⁹² Governments have actively used this strategy since the very first civilizations when ancient Sumerian and Babylonian kings periodically absolved the debts of citizens.¹⁹³ Other methods of amnesty involve limiting the methods debtors may use to collect a debt. Obviously, outlawing physical violence and extortion is an uncontroversial contemporary amnesty-based method of protecting consumers from predatory lenders.¹⁹⁴ However, the most prominent example of amnesty-based protection against predatory lending is federal consumer bankruptcy protections.¹⁹⁵ Consistent

191. Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 815-32 (2003).

192. See *id.* at 818-19 (describing the cancellation by royal decree of certain debts by Sumerian and Babylonian kings).

193. See SAMUEL NOAH KRAMER, *THE SUMERIANS: THEIR HISTORY, CULTURE, AND CHARACTER* 82 (1963) (describing how the ruler Urukagina “amnestied and set free the citizens . . . who had been imprisoned for debt”); JAMES G. MACQUEEN, *BABYLON* 21-22 (1964) (noting the protection given to the poor under the reign of the reformer Urukagina); J.N. POSTGATE, *EARLY MESOPOTAMIA: SOCIETY AND ECONOMY AT THE DAWN OF HISTORY* 194-96 (1992) (discussing the “periodic annulment of debts” under King Urukagina’s reign); H.W.F. SAGGS, *BABYLONIANS: PEOPLES OF THE PAST* 97 (1995) (noting the Old Babylonian ruler, Lipit-Ishtar’s cancellation by royal decree of certain debts); Peterson, *supra* note 191, at 818-19 (describing Babylon and Sumeria’s amnesty decrees).

194. Extortionate credit practices are a crime under Title II of the Consumer Credit Protection Act. 18 U.S.C. §§ 891-896 (2005). Extortionate credit transactions are based on “the use, or an express or implicit threat of use, of violence or other criminal means to cause harm to the person, reputation, or property” as a means of enforcing repayment. 18 U.S.C. § 891(7). See also *United States v. Fiore*, 434 F.2d 966, 967 (1st Cir. 1970) (setting out prima facie elements of extortionate credit extension).

195. HENRY J. SOMMER ET AL., NATIONAL CONSUMER LAW CENTER, *CONSUMER BANKRUPTCY LAW AND PRACTICE* § 1.1.2 (7th ed. 2004) [hereinafter SOMMER ET AL., NCLC, *CONSUMER BANKRUPTCY*] (calling the Bankruptcy Reform Act of 1979 “the most important federal legislation ever passed, in terms of its benefits for consumers”). Of course, different countries structure consumer debt relief in different ways. See, e.g., Jason J. Kilborn, *The Innovative German Approach to*

with the American value of opportunity, bankruptcy offers overburdened consumers a chance to “reorder their finances and obtain a fresh start.”¹⁹⁶ Although a discussion of the bankruptcy code and system is beyond the scope of this Article, suffice it to say consumers who are unable to pay their financial obligations are entitled to declare bankruptcy and, possibly, have their debts discharged.¹⁹⁷

Another type of consumer amnesty which protects consumers from predatory lending is fair debt collection laws. At the federal level, the Fair Debt Collection Practices Act prohibits third party debt collectors from threatening or harassing borrowers,¹⁹⁸ from using false or misleading representations to collect,¹⁹⁹ from publishing the debtor’s identity or the nature of the debt to third parties,²⁰⁰ and also gives consumers an opportunity to contest the validity of a debt.²⁰¹ Although the federal Fair Debt Collection Practices Act does not apply to lenders who collect their own debts, many states passed similar statutes that fill in this gap.²⁰² “All but eight states have statutes specifically dealing with abuses by debt collectors.”²⁰³ While some state statutes merely require licensing and bonding for debt collectors, twenty-seven states explicitly provide consumers with a private right of action for prohibited behavior.²⁰⁴ Additionally, in all fifty

Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States, 24 NW. J. INT’L L. & BUS. 257, 289-95 (2004) (providing thoughtful comparative analysis of German and American consumer amnesty laws); Jason J. Kilborn, *La Responsabilisation de l’Economie: What the U.S. Can Learn From the New French Law on Consumer Overindebtedness*, 26 MICH. J. INT’L L. (forthcoming 2005).

196. SOMMER ET AL., NCLC, CONSUMER BANKRUPTCY, *supra* note 195, § 1.1.1.

197. Any individual residing in the U.S. can file a bankruptcy case. 11 U.S.C. § 109 (2000). However, to obtain a discharge of debts under chapter 7 the individual must meet certain requirements enumerated in § 727(a) of the Bankruptcy Code. Similarly, to file a chapter 13 petition the consumer must have “an income sufficiently stable and regular” to make payments under a chapter 13 plan. 11 U.S.C. § 101(30) (2004).

198. 15 U.S.C. § 1692d (2000) (“A debt collector may not engage in any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt.”).

199. *Id.* § 1692e (“A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt.”).

200. *See, e.g., id.* § 1692d(3) (prohibiting the publication of a list of consumers who allegedly refuse to pay debts); *id.* § 1692f(7) (prohibiting communication with debtor by means of a postcard); *id.* § 1692f(8) (prohibiting the use of language or a symbol on a mailed envelope revealing the nature of the communication inside).

201. 15 U.S.C. § 1692g (requiring debt collectors send a notice informing borrowers of the right to request that the debt collector verify the validity of the obligation).

202. ROBERT J. HOBBS ET AL., NATIONAL CONSUMER LAW CENTER, FAIR DEBT COLLECTION § 1.5.3.2 (4th ed. 2000) [hereinafter HOBBS ET AL., NCLC, FAIR DEBT COLLECTION]. *See, e.g.,* IOWA CODE ANN. § 537.7102(5) (1997) (defining “debt collector” as a “person engaging, directly or indirectly, in debt collection”); *Miller v. Nat’l Farmer’s Org.*, 278 N.W.2d 905, 906 (Iowa 1979) (noting that debt collection provisions apply to creditors generally in addition to debt collector agencies).

203. HOBBS ET AL., NCLC, FAIR DEBT COLLECTION, *supra* note 202, § 11.2.1.

204. *Id.* § 11.2.3. Moreover, some courts have inferred a private right of action for debt collection abuses from inexplicit statutory language. *See, e.g., Trull v. GC Servs.*, 961 F. Supp. 1199, 1206 (N.D. Ill. 1997) (concluding that the Illinois Collection Agency Act contains an implied private right of

states potential common law tort remedies exist for the most egregious debt collection abuses.²⁰⁵

Moreover, a variety of statutes and common law doctrines provide consumer debtors amnesty by exempting some income and some property from some creditors.²⁰⁶ For instance, Congress exempts a portion of all consumers' earnings from wage garnishment with the specific purpose of reducing predatory extensions of credit.²⁰⁷ Congress has also specifically exempted social security and veterans' benefits from seizure by creditors.²⁰⁸ The government requires creditors to comply with special rules for collecting debts from military personnel.²⁰⁹ Many states have garnishment restrictions that go well beyond federal protections, including North Carolina and Texas, which both restrict all wage garnishment from the head of a household.²¹⁰ Forty-five states have some form of a homestead law placing consumers' family homes beyond the reach of unsecured creditors.²¹¹ Every state gives consumers some version of a right of redemption in the home mortgage foreclosure process.²¹² At common law, homeowners may redeem a mortgage by paying the total outstanding balance up until the time of sale.²¹³ Some states also have statutory rights of redemption, which may, for instance, allow a borrower to redeem the mortgage even after

action); *Sherman v. Field Clinic*, 392 N.E.2d 154, 161 (Ill. App. Ct. 1979) (holding that a private right of action for damages may be founded on a violation of section 9 of the Illinois Collection Agency Act). Other states allow consumers to sue for violations of debt collection statutes under a private right of action found in a state unfair and deceptive act or practices statute. See *Fuller v. Pacific Med. Collections, Inc.*, 891 P.2d 300, 304 (Haw. Ct. App. 1995) (allowing consumer to bring suit for any unfair and deceptive practices).

205. See, e.g., *Norris v. Moskin Stores, Inc.*, 132 So. 2d 321, 326 (Ala. 1961) (husband successfully alleged invasion of privacy cause of action where female debt collector contacted wife falsely pretending to be debtor's mistress).

206. See William T. Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 797 (1974) (providing an introduction to state exemption rights).

207. 15 U.S.C. § 1671(a)(1); *Brown v. Liberty Loan Corp.*, 392 F. Supp. 1023, 1032 (M.D. Fla. 1974) (noting federal garnishment provisions were intended to deter abusive consumer lending), *rev'd on other grounds*, 539 F.2d 1355 (5th Cir. 1976), *cert. denied*, 430 U.S. 949 (1977). Under federal law, creditors may not garnish more than the lesser of twenty-five percent of a consumer's weekly disposable earnings or the amount by which weekly disposable earnings exceed thirty times the federal minimum wage. 15 U.S.C. § 1673(a); 29 U.S.C. § 206(a)(1) (2000) (defining minimum wage).

208. 38 U.S.C. § 3101 (2000) (addressing veterans benefits); 42 U.S.C. § 407 (2000) (addressing social security benefits).

209. *Soldiers' & Sailors' Civil Relief Act of 1940*, 50 U.S.C. app. §§ 501-593. See also HOBBS ET AL., NCLC, FAIR DEBT COLLECTION, *supra* note 202, § 12.4.3.1 (providing short summary of garnishment from military personnel).

210. N.C. GEN. STAT. § 1-362 (2004); TEX. PROP. CODE ANN. § 42.001 (Vernon 2000).

211. HOBBS ET AL., NCLC, FAIR DEBT COLLECTION, *supra* note 202, § 12.5.2.1. Florida, for instance, provides a particularly generous homestead exemption. It allows rural consumers to exempt 160 acres and urban consumers to exempt ½ acre irrespective of the dollar amount of the residence. FLA. STAT. ANN. §§ 222.01-.03, .05 (West 1998).

212. CAROLYN L. CARTER ET AL., NATIONAL CONSUMER LAW CENTER, REPOSSESSIONS AND FORECLOSURES §16.2.6 (5th ed. 2002) [hereinafter CARTER ET AL., NCLC, REPOSSESSIONS & FORECLOSURES].

213. *Id.*

foreclosure and the home is sold at auction.²¹⁴ Similarly, judicial foreclosure limitations in about half of the states protect consumers by requiring the lender file an action in court proving foreclosure is justified.²¹⁵ This gives borrowers an opportunity to raise defenses to the foreclosure, such as fraud or Truth in Lending violations.²¹⁶ Altogether, American lenders make residential mortgage loans subject to extremely diverse federal and state debtor amnesty laws.

While combined federal and state debtor amnesty is an important facet of the American response to predatory home mortgage lending, it has not and will not prevent it. For instance, while federal bankruptcy discharge provisions certainly provide a safety valve for overburdened debtors, they do little to protect a family home from foreclosure on a perfected mortgage. Home mortgage lenders are secured creditors in bankruptcy and entitled to protection of the value of their collateral from discharge. If a debtor cannot come up with sufficient funds to repay the debt or an alternative source of security for the underlying obligation, lenders are entitled to petition the court to have the automatic stay lifted with respect to the home.²¹⁷ This allows the lender to foreclose its mortgage and sell the home at auction under normal state foreclosure rules.²¹⁸ Moreover, both federal and state fair debt collection practices statutes may restrain lenders from overly aggressive collection tactics, but they do not prevent or eliminate overpriced mortgage loans in the first place. Similarly, state homestead protections do not typically apply to home mortgages.²¹⁹ Additionally, borrowers can only use their rights of redemption if they have the funds to redeem the home. These limitations certainly do not imply amnesty based consumer protections are poor policy, but rather that they are unlikely—by themselves—to address consumer problems with predatory lending.

B. *Limitations on Contracting*

A second policy strategy for protecting consumers from predatory loans involves prohibiting abusive, unfair, or excessive contractual provisions. The most simple—and the oldest—example of this strategy is interest rate caps or usury law.²²⁰ Early state government imported statutory interest rate caps from

214. See, e.g., MD. CODE. ANN. TAX-PROP. § 14-827 (2001) (providing statutory right of redemption for minimum of one year after foreclosure sale); *Ex parte Lynn*, 727 So. 2d 90, 91 (Ala. 1999) (noting that one-year state statutory right of redemption commences on date home purchaser receives deed from sheriff).

215. CARTER ET AL., NCLC, REPOSSESSIONS & FORECLOSURES, *supra* note 212, § 16.2.2.

216. *Id.*

217. 11 U.S.C. § 362(d) (1998).

218. LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 121 (4th ed. 2003).

219. See, e.g., WIS. STAT. ANN. § 815.20(1) (West 1994) (“An exempt homestead . . . shall be exempt from execution, from the lien of every judgment and from liability for the debts of the owner . . . *except mortgages . . .*”) (emphasis added).

220. The first recorded interest rate cap dates back to the Code of Hammurabi c. 1750 B.C.E., which capped interest rates at about 20% per annum for loans on silver and 33% on loans of grain.

England during colonial times.²²¹ These interest rate caps, which are often called general usury laws, typically limited interest rates on all credit contracts to between 4% and 10%.²²² State general usury laws remained intact and largely unchanged throughout most of the history of the United States.²²³ It was not until the early twentieth century that socially progressive reformers in the northeastern United States began to convince state legislatures to grant special licenses to a limited number of lenders allowing them to charge between 36% and 42% a year on small consumer loans.²²⁴ These reformers hoped to allow legitimate, honest, and closely regulated businesses to legally compete against black market illegal lenders who were charging triple digit interest rates to a significant portion of the working class.²²⁵ After these small loan laws, a variety of business interests convinced legislatures to pass special usury laws exempting them from general usury laws as well.²²⁶ Soon American interest rate regulation became a patchwork, with each state possessing its own unique regulatory environment crafted by democratic compromise in state legislatures.²²⁷

In the 1960s and 1970s a steady drumbeat of economically-minded scholarship criticizing interest rate caps set the stage for dramatic change in American usury law.²²⁸ The Supreme Court marched in step with these

Peterson, *supra* note 191, at 820-21.

221. James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61, 85 (1981).

222. KEEST, NCLC, COST OF CREDIT, *supra* note 189, § 2.2.2 (2d ed. 2000); Peterson, *supra* note 191, at 844.

223. KEEST, NCLC, COST OF CREDIT, *supra* note 189, §§ 2.2.2-2.2.3, 2.3.3.2.

224. Peterson, *supra* note 191, at 861-63.

225. LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 127 (1999).

226. Peterson, *supra* note 191, at 862-63.

227. *Id.*

228. *E.g.*, Douglas Austin & David A. Lindsey, *Ohio Usury Ceiling and Residential Real Estate Development*, 4 AM. REAL EST. & URB. ECON. A.J. 83 (1976); Marion Benfield, *Money Mortgages, and Migraine—The Usury Headache*, 19 CASE W. RES. L. REV. 819 (1968); Rudolph C. Blitz & Hillard F. Long, *The Economics of Usury Regulation*, 73 J. POL. ECON. 608 (1965); William J. Boyes & Nancy Roberts, *Economic Effects of Usury Laws in Arizona*, 1981 ARIZ. ST. L.J. 35; Steven M. Crafton, *An Empirical Test of the Effect of Usury Laws*, 23 J.L. & ECON. 135 (1980); Barbara A. Curran, *Legislative Controls As A Response To Consumer-Credit Problems*, 8 B.C. INDUS. & COM. L. REV. 409 (1967); Carl Felsenfeld, *Consumer Interest Rates: A Public Learning Process*, 23 BUS. LAW. 931 (1968); S. Hugh High, *Consumer Credit Regulation In Texas—A Rejoinder By An Economist*, 50 TEX. L. REV. 463 (1972); Robert W. Johnson, *Regulation of Finance Charges on Consumer Installment Credit*, 66 MICH. L. REV. 81 (1967); Robert L. Jordan & William D. Warren, *A Proposed Uniform Code For Consumer Credit*, 8 B.C. INDUS. & COM. L. REV. 441 (1967); Robert L. Jordan & William D. Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387 (1968); Michael Kawaja, *The Case Against Regulating Consumer Credit Charges*, 5 AM. BUS. L.J. 319 (1967); Homer Kipke, *Consumer Credit Regulation: A Credit-Oriented Viewpoint*, 68 COLUM. L. REV. 445 (1968); Gene C. Lynch, *Consumer Credit at Ten Per Cent Simple: The Arkansas Case*, 1968 U. ILL. L.F. 592 (1968); James R. Ostas, *Effects of Usury Ceilings in the Mortgage Market*, 31 J. FIN. 821 (1976); Philip K. Robins, *The Effects of State Usury Ceilings on Single Family Homebuilding*, 29 J. FIN. 227 (1974); Robert P. Shay, *The Uniform Consumer Credit Code: An Economist's View*, 54 CORNELL L. REV. 491 (1969); William D. Warren, *Consumer Credit Law: Rates, Costs, and Benefits*, 27 STAN. L. REV. 951 (1975); Bruce

commentators in the landmark decision of *Marquette National Bank of Minneapolis v. First Omaha Service Corp.*²²⁹ *Marquette* interpreted section 85 of the National Bank Act passed by Congress in 1864.²³⁰ In the 1860s, states and the federal government were aggressively competing for regulatory and tax control over the emerging American banking industry.²³¹ Banks could (and still can) receive their charters either from state governments or from the federal government.²³² In order to entice banks to charter at the state level, some states passed more relaxed usury laws applicable only to state chartered banks.²³³ Claiming discrimination against federally chartered banks, and fearing encroachment on its tax and regulatory powers, Congress drew on its commerce clause authority to pass a law that prohibited states from authorizing higher permissible interest rate caps for state banks than for federal banks.²³⁴ It was not for over a hundred years that the Supreme Court faced the question of what state's interest rate cap applies when a bank located in one state loans money at an interest rate in excess of the state interest rate cap where the borrower lives. The *Marquette* court held that section 85 of the National Bank Act—which originally leveled the playing field between federal and state banks—now authorized banks to export the high rates permissible in a bank's home state to consumers living in other jurisdictions.²³⁵ The Supreme Court's intervention in what had been state lawmaking was a starting gun in a corporate race to the bottom that significantly eroded the power of state governments to set meaningful interest rate caps.²³⁶ Lenders quickly relocated in states with no interest rate caps, such as Delaware and South Dakota, and exported deregulation to states that chose more aggressive price regulation.²³⁷ And, states

Ackerman, Comment, *Interest Rate and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61 (1981); Rondald W. Del Sesto, Comment, *Should Usury Statutes Be Used To Solve The Installment Sales 'Problem'?*, 5 B.C. INDUS. & COM L. REV. 389 (1964); *An Empirical Study of the Arkansas Usury Law: 'With Friends Like That ...'*, 1968 U. ILL. L.F. 544; Mark Barry Riley, Comment, *Usury Legislation—Its Effects on the Economy and a Proposal for Reform*, 33 VAND. L. REV. 199 (1980).

229. 439 U.S. 299 (1978).

230. *Marquette*, 439 U.S. at 310 n.23.

231. James J. White, *The Usury Trompe L'Oeil*, 51 S.C. L. REV. 445, 450 (2000).

232. Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 540 (2004).

233. See, e.g., *Tiffany v. Nat'l Bank of Missouri*, 85 U.S. (18 Wall.) 409, 411 (1874) (discussing state law which provided an 8 percent interest rate cap for state banks and a 10 percent cap for all other lenders)

234. Thus, Section 85 allows national banks to charge:

interest at the rate allowed by the laws of the state or territory where the bank is located, and no more, except that where by the laws of any state a different rate is limited for banks of issue organized under state laws, the rate so limited shall be allowed for [national banks] organized [or existing] in any such state . . .

National Bank Act, ch. 106, § 30, 13 Stat. 99, 108 (1864) (codified as amended at 12 U.S.C. § 85 (2000)).

235. *Marquette*, 439 U.S. at 310-12.

236. William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare*, 1995 UTAH L. REV. 1009, 1010-11; Schiltz, *supra* note 232, at 619-20.

237. White, *supra* note 231, at 447-48.

with interest rate caps became much more amenable to removing them in order to hold on to their financial services industry jobs.²³⁸

In the early 1980s, Congress also specifically intervened in state interest rate limitations with respect to home mortgage lending.²³⁹ At the time, the economy was suffering from high inflation and interest rates.²⁴⁰ Depository institutions' cost of funds was so high, they had difficulty profitably lending without exceeding some state interest rate caps.²⁴¹ Fearing this would dry up the supply of home mortgage loans, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA").²⁴² DIDMCA set a relatively high variable-rate ceiling for all banks, thrifts, and preempted state usury laws with respect to first mortgages on debtors' homes.²⁴³ Also, in the Alternative Mortgage Transactions Parity Act of 1982 ("AMTPA"), Congress preempted state laws that limited lenders to fixed-rate, amortizing home mortgages.²⁴⁴ "As a result," explain Professors Engel and McCoy, "lenders received the green light to make adjustable-rate mortgages, mortgages with balloon payments, and non-amortizing mortgages where borrowers pay off the interest but not the principal."²⁴⁵ Collectively, these legal developments have largely abolished usury limits on home mortgage lending in the United States, even though interest rate caps remain on the books of most state legislatures. The result has become what Professor White calls a *tromp l'oeil*, or a grand illusion, where the public and state legislatures believe there are price limits when, in fact, there are not.²⁴⁶

In addition to usury law, state and local governments have passed other contract restrictive consumer credit protections such as caps on late fees or even the amount of points chargeable.²⁴⁷ Another more important example of contractual limitation policy in the United States is unconscionability law. Where rate, fee, and point caps set an inflexible, yet somewhat artificially contrived, bright line price limit, the unconscionability doctrine sets a loose *post*

238. *Id.*

239. For a thorough discussion of congressional home mortgage interest rate preemption in the 1970s and 1980s, see Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 484-510 (2000).

240. *Id.* at 499-501

241. *Id.*

242. *Id.*

243. Engel & McCoy, *supra* note 190, at 1275.

244. *Id.*

245. *Id.*

246. White, *supra* note 231, at 447-48.

247. California, for example, limits late fees to no more than five dollars or six percent of the amount of the past due installment. CAL. CIV. CODE § 2954.4(a) (West 1993). Similarly, the District of Columbia allows a maximum of one non-bonafide discount point on second mortgages. D.C. CODE ANN. § 28-3301(e)(2) (2001) ("A lender may not charge a borrower more than 1 point unless the borrower agrees to pay additional points to a lender for the sole purpose of qualifying for and obtaining a loan or financial transaction at a lower rate of interest than would otherwise have been offered.").

hoc judicial standard against unfair loans.²⁴⁸ The unconscionability doctrine dates at least back to the Roman doctrine of *laesio enormis*, also called the fair exchange doctrine, which invalidated grossly unfair contracts.²⁴⁹ Some have suggested unconscionability may have been imported into the common law tradition specifically as a response to high interest rates.²⁵⁰ Traditionally courts gave import to the unconscionability doctrine by denying relief to parties guilty of unconscionable conduct.²⁵¹ The doctrine currently appears in the Uniform Commercial Code Article II, the Restatement (Second) of Contracts, and some consumer credit statutes.²⁵²

Most courts now follow the influential analysis of Professor Arthur Leff delineating two types of unconscionability: procedural and substantive.²⁵³ While these courts typically require “some quantum of both procedural and substantive unconscionability to establish a claim,” at least one court has recently suggested substantive unconscionability alone can be sufficient to invalidate enforcement of a home mortgage contract.²⁵⁴ In *Maxwell v. Fidelity Financial Services, Inc.*,²⁵⁵ a door-to-door salesman sold a hotel maid a solar water heater financed by a 19.5% loan secured by not only the water heater but also her modest home.²⁵⁶ Even though the water heater was improperly installed and never actually worked, the borrower made payments on this and a related loan for six years until she sued for a declaratory judgment that the original contract was unenforceable for unconscionability.²⁵⁷ The Supreme Court of Arizona held that “the apparent injustice and oppression” presented a triable issue of unconscionability even absent a finding of procedural unconscionability.²⁵⁸ A complete discussion of the unconscionability doctrine is beyond the scope of this

248. Using Carol Rose’s colorful terminology, interest rate caps and fee limits are “crystals” and unconscionability is “mud.” Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 577-78 (1988).

249. Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Interest Rates Under the Unconscionability Standard*, 31 HOUS. L. REV. 721, 735 (1994); Dando B. Cellini & Barry L. Wertz, Comment, *Unconscionable Contract Provisions: A History of Unenforceability from Roman Law to the UCC*, 42 TUL. L. REV. 193, 193 (1967).

250. Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 153-54 n.12 (1988).

251. DAN B. DOBBS, 2 LAW OF REMEDIES 703 (2d ed. 1993).

252. U.C.C. § 2-302 (2004).

253. Arthur A. Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485, 487 (1967). See also JAMES J. WHITE & ROBERT S. SUMMERS, 1 UNIFORM COMMERCIAL CODE 213 n.9 (4th ed. 1995) (following Leff’s framework by distinguishing between procedural and substantive unconscionability).

254. *Maxwell v. Fidelity Fin. Servs., Inc.*, 907 P.2d 51, 58-59 (Ariz. 1995) (“[W]e conclude that under A.R.S. § 47-2302, a claim of unconscionability can be established with a showing of substantive unconscionability alone, especially in cases involving either price-cost disparity or limitation of remedies.”).

255. 907 P.2d 51 (Ariz. 1995).

256. *Maxwell*, 907 P.2d at 53-54.

257. *Id.* at 54.

258. *Id.* at 60.

project. For our purposes, it is enough to remember that unconscionability law governing home mortgage lending has its origins in state law and has not been adopted by federal laws.

Unconscionability standards have suffered from serious limitations, however. Initially, the approach provides no guidance for or pressure on businesses to offer fair bargains at the time of transaction formation.²⁵⁹ To exert pressure, courts must use a case-by-case evaluation of questionable loans, which turns out to be an extremely expensive method of social policy making.²⁶⁰ Borrowers who wish to challenge their loans must hire attorneys and manage the attention and sympathies of courts or arbitrators. This is a tall order for those who are struggling to service debt to begin with, especially because unconscionability standards typically do not have attorney fee and court cost shifting provisions. For this reason, one commentator called the doctrine a “middle class solution to what is in reality, a lower-class problem.”²⁶¹ Fearing a litigation explosion from a robustly enforced doctrine, courts have historically been extremely reluctant to label loans unconscionable.²⁶² For perhaps the same reasons, drafters of the UCC, as well as state legislators, have generally refused to define unconscionability in a way that invites rigorous application. Accordingly, like interest rate caps, unconscionability standards provide more of a facade of fairness, rather than an effective instrument of consumer protection.

C. Antidiscrimination Laws

Both Congress and state legislatures have attempted to prevent discrimination in home mortgage lending, passing numerous statutes with roots both in the civil rights movement and in consumer protection. In this context, antidiscrimination laws primarily seek to prevent discrimination on an impermissible basis against borrowers seeking low-cost financing. But, these laws also attempt to deter predatory lenders from targeting borrowers who are members of protected classes. At the federal level, the primary legislation includes the Fair Housing Act (“FHA”) and the Equal Credit Opportunity Act (“ECOA”).²⁶³ State laws tend to be patterned after either the FHA or the ECOA.²⁶⁴ Although state laws are usually similar in their substantive

259. Richard E. Spiedel, *Unconscionability, Assent, and Consumer Protection*, 31 U. PITT. L. REV. 359, 364, 374-75 (1970) (arguing an individual consumer’s consent to a contract should not be considered in determining whether a bargain is unconscionable).

260. Morris, *supra* note 250, at 154 n.12. Recent proposals in favor of suitability doctrine may suffer from the same problem.

261. Spiedel, *supra* note 259, at 364.

262. See Eben Colby, Note, *What Did the Doctrine of Unconscionability Do to the Walker-Thomas Furniture Company?*, 34 CONN. L. REV. 625, 660 (2002) (arguing adoption of unconscionability had virtually no effect on day to day operations of consumer lenders).

263. A third federal statute, the Home Mortgage Disclosure Act, requires that covered financial institutions report data on demographic characteristics of their customers. See 12 U.S.C.A. §§ 2801-2809 (1975). Beyond reporting, the law does not have any substantive requirements.

264. DEANNE LOONIN & CHI CHI WU, NATIONAL CONSUMER LAW CENTER, CREDIT DISCRIMINATION, §§ 12-13 (3d ed. 2002) [hereinafter LOONIN & WU, NCLC, CREDIT

requirements, some state laws include additional prohibited bases of discrimination, such as sexual orientation or occupation, which are not included in federal law.²⁶⁵

Adopted by Congress as a part of the Civil Rights Act of 1964,²⁶⁶ the FHA²⁶⁷ was a response to the lingering economic impact of centuries of segregation and racial discrimination that exploded into inner-city rioting in 1967.²⁶⁸ Influencing the legislation, a national advisory commission report found inner-city ghettoization was due, in part, to the reluctance of mortgage lenders to finance minority borrowers that hoped to buy in areas dominated by majority racial groups.²⁶⁹ Generally speaking, the FHA prohibited discrimination in the financing of housing on the basis of race, color, religion, or national origin.²⁷⁰ Later on, Congress amended the act to include sex, handicap and familial status as prohibited bases.²⁷¹ The FHA is enforced either with administrative action²⁷² or through a private cause of action.²⁷³ Private litigants are entitled to actual damages, punitive damages, equitable relief, and attorney fees.²⁷⁴

In contrast, the ECOA grew out of Congressional concerns during the early 1970s that women had more difficulty obtaining credit than men with the same financial characteristics.²⁷⁵ When married women applied for credit, lenders

DISCRIMINATION].

265. See, e.g., JAMES A. KUSHNER, *FAIR HOUSING: DISCRIMINATION IN REAL ESTATE, COMMUNITY DEVELOPMENT AND REVITALIZATION* 101 n.255, 109-110 nn.290-92 (2d. ed. 1995) (discussing state and local laws prohibiting bias based on occupation, sexual orientation and number of unrelated persons in a household).

266. 42 U.S.C. § 2000a (2003).

267. *Id.* §§ 3601-3619.

268. Robert G. Schwemm, *Introduction to Mortgage Lending Discrimination Law*, 28 J. MARSHALL L. REV. 317, 317-18 (1995).

269. *Laufman v. Oakley Bldg. & Loan Co.*, 408 F. Supp. 489, 496-97 (S.D. Ohio 1976); NATIONAL ADVISORY COMMISSION ON CIVIL DISORDERS, REPORT OF THE NATIONAL ADVISORY COMMISSION ON CIVIL DISORDERS ch. 6 (1968); Schwemm, *supra* note 268, at 317-18.

270. Pub. L. No. 90-284, §§ 804-805, 82 Stat. 81, 83 (1968).

271. Housing and Community Development Act of 1974, Pub. L. No. 93-383, § 808(b), 88 Stat. 633, 729 (amending the FHA to include sex); Fair Housing Amendments Act of 1988, Pub. L. No. 100-430, § 6, 102 Stat. 1619, 1620 (amending the FHA to include handicap and familial status). The 1988 amendments were a fairly significant extension of the Act, including, among others, more liberal recovery of attorney fees, the elimination of the statutory cap on punitive damages, and an expansion of standing to sue. LOONIN & WU, NCLC, CREDIT DISCRIMINATION, *supra* note 264, at 11; ROBERT G. SCHWEMM, HOUSING DISCRIMINATION LAW AND LITIGATION §§ 18-2 to 18-5 (2001).

272. Primary enforcement authority lies with the Secretary of the Department of Housing and Urban Development, 42 U.S.C. § 3610 (2005), but the U.S. Attorney General's office can also initiate suits on its own initiative where it perceives a pattern or practice of discrimination and an issue of general public importance. 42 U.S.C. § 3614(a); *United States v. Inc. Vill. of Island Park*, 888 F. Supp. 419, 449 (E.D.N.Y. 1995). Other federal regulators responsible for specific types of financial institutions, such as the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration, must also "affirmatively further the purposes of the Act." 42 U.S.C. § 3608(d).

273. 42 U.S.C. § 3613(a).

274. *Id.* § 3613(d).

275. LOONIN & WU, NCLC, CREDIT DISCRIMINATION, *supra* note 264, at 7.

often asked them to reapply in their husbands' name. And, because credit histories were tracked only in husbands' names, recently widowed or divorced women had no established credit history, precluding them from access to low-cost financing. In 1974, Congress passed the ECOA as a response to these problems.²⁷⁶ Pointing to similar problems for senior citizens and racial minorities, Congress amended the Act in 1976 to include race, color, religion, national origin, and age as prohibited bases to discrimination.²⁷⁷ The amendments also prohibited discrimination against individuals for exercising any rights under the Consumer Credit Protection Act generally.²⁷⁸

Often (but by no means always) overlapping the FHA, the ECOA prohibits discrimination on a protected basis at any stage in a credit transaction.²⁷⁹ The ECOA also has prophylactic procedural rules creditors must follow while deciding whether to grant credit. For instance, the Act requires that creditors provide credit applicants with notices stating the reasons for denying an application as well as retaining records supporting those reasons.²⁸⁰ Moreover, creditors may not inquire about the race, color, religion, or national origin of a credit applicant, and may only inquire about the gender of the credit applicant in limited situations.²⁸¹ Creditors may not request information about an individual's intentions to bear or raise children.²⁸² In addition to enforcement authority of several federal agencies, consumers have a private cause of action for actual damages, punitive damages up to \$10,000, equitable relief, and attorney fees.²⁸³

Antidiscrimination rules such as the FHA and the ECOA as well as their

276. The ECOA amended the Consumer Credit Protection Act adding a Title VII component on credit discrimination. 15 U.S.C. § 1691(a)(1).

277. *Equal Credit Opportunity Act Amendments and Consumer Leasing Act—1975: Hearings on S. 483, S. 1900, S. 1927, S. 1961 and H.R. 5616 Before the Subcomm. On Consumer Affairs of the Senate Comm. On Banking, Housing and Urban Affairs*, 94th Cong. 39 (1975).

278. 15 U.S.C. § 1691 (a)(3).

279. *Id.* § 1691; 12 C.F.R. §§ 202.2(z), 202.4 (2004). It is worth noting the prohibited bases of discrimination in the FHA and ECOA are not always parallel. Race, color, religion, creed, political affiliation, national origin, and sex/gender are prohibited bases in both acts. Bases covered by the ECOA but not the FHA include age, public assistance status, and exercise of Consumer Credit Protection Act rights. Bases covered by the FHA, but not the ECOA include familial status and disability. 15 U.S.C. § 1691(b).

280. LOONIN & WU, NCLC, CREDIT DISCRIMINATION, *supra* note 264, at 7.

281. 12 C.F.R. § 202.5(d)(5), (d)(3). *See also* LOONIN & WU, NCLC, CREDIT DISCRIMINATION, *supra* note 264, at 83 (stating that credit discrimination permeates American society).

282. 12 C.F.R. § 202.5(d)(3).

283. Like the FHA, government agency authority for enforcement of the ECOA is splintered. At least twelve agencies are responsible for bringing suits for non-compliance. LOONIN & WU, NCLC, CREDIT DISCRIMINATION, *supra* note 264, at 201-02. In general, the Federal Trade Commission has jurisdiction, but only if the lender is not regulated by an agency having jurisdiction over that particular type of credit institution. For instance, the Comptroller of the Currency has authority to bring ECOA suits against national banks and federal branches of foreign banks, while the National Credit Union Administration has authority for federal credit unions. 15 U.S.C. § 1691(c); 12 C.F.R. § 202.14(a), app. A. Finally, the U.S. Attorney General can bring a case either upon its own investigation or upon referral by another agency. 15 U.S.C. § 1691e(h).

state counterparts have proven to be of only limited value in addressing predatory home mortgage lending. First, commentators have disagreed whether these federal statutes and their state counterparts adequately prevent discrimination in home mortgage lending. It is difficult to prove discrimination in any lawsuit, but particularly so in predatory lending cases. Lenders virtually never see themselves as culprits, and a “smoking gun” of racially charged comments, marketing plans, or other information may or may not be forthcoming, and will usually only be found after costly discovery which borrowers’ counsel can rarely afford.²⁸⁴ Evidence of disparate impact-based discrimination is also difficult to prove but for different reasons. Plaintiffs must produce this evidence with the aid of costly accounting, geographic, and financial experts.²⁸⁵ Because lending discrimination damage awards tend to be “low and uncertain,” consumers who believe they have been discriminated against have trouble finding counsel willing to incur the financial risk of litigation.²⁸⁶ The most vulnerable minorities often fare more poorly than we might expect in front of juries, further reducing the incentive of counsel to pursue claims.²⁸⁷ Finally, borrowers themselves have trouble knowing whether they have been discriminated against, or have been turned down for a desirable loan (or targeted for a high-cost loan) simply because of their credit history.²⁸⁸ But at a more fundamental level, antidiscrimination laws are not generally well suited to preventing predatory home mortgage lending. Rather, as Professors Engel and McCoy explain, these laws “necessarily are tangential in their focus, because they address differential treatment of customers . . . rather than abusive loan terms per se.”²⁸⁹ This is because predatory home mortgage lending is not inherently a product of discriminatory behavior.²⁹⁰ Some predatory home mortgage lenders, perhaps most, may be equally willing to cheat those not included in protected classes as those who are. Although targeting of vulnerable groups is a major tactic of predatory lending, antidiscrimination laws are, at best, “useful adjuncts” in the prevention of predatory home mortgage lending.²⁹¹

284. Engel & McCoy, *supra* note 190, at 1315-16.

285. *Id.*

286. *Id.* at 1316.

287. See generally, David Benjamin Oppenheimer, *Verdicts Matter: An Empirical Study of California Employment Discrimination and Wrongful Discharge Jury Verdicts Reveals Low Success Rates for Women and Minorities*, 37 U.C. DAVIS L. REV. 511 (2003) (concluding that jury bias, often at the unconscious level, is the most likely explanation for the disadvantage suffered by women and minorities in employment discrimination jury trials).

288. Michele L. Johnson, Casenote, *Your Loan is Denied, But What about Your Lending Discrimination Suit?*: *Latimore v. Citibank Federal Savings Bank*, 151 F.3d 712 (7th Cir. 1998), 68 U. CIN. L. REV. 185, 214-15 (1999).

289. Engel & McCoy, *supra* note 190, at 1317.

290. Professor Taibi makes a similar point. See Anthony D. Taibi, *Banking, Finance, and Community Economic Empowerment: Structural Economic Theory, Procedural Civil Rights, and Substantive Racial Justice*, 107 HARV. L. REV. 1463, 1484 (1994) (“Lending discrimination contributes to neighborhood disinvestment, but such discrimination is only a part of the story. Even if all lending discrimination were eliminated, it would have little impact on low income neighborhoods.”).

291. Engel & McCoy, *supra* note 190, at 1317.

D. Charity

Charitable attempts to prevent predatory lending have ancient roots.²⁹² The most prominent current example of this strategy with respect to predatory home mortgage lending is the federal Community Reinvestment Act (“CRA”). Focusing particularly on the local and regional nature of credit markets, Congress concluded that public bank charters and deposit insurance create a “continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered.”²⁹³ Congress was concerned that in some specific neighborhoods and communities depository lenders accepted deposits but did not give out an equivalent amount in loans—a process sometimes called “disinvestment.”²⁹⁴

Accordingly, the CRA requires financial institutions receiving federal deposit insurance to make efforts to meet the credit needs of their “entire communit[ies].”²⁹⁵ In particular, the Act encourages lenders to make efforts to lend in low and moderate income neighborhoods within the contiguous area surrounding a lender’s office or group of offices. The CRA does not provide a private cause of action, nor does it provide automatic sanctions for failure to meet local community credit needs. Rather, it requires federal regulators to monitor and evaluate depository lenders’ compliance with the goals of the Act. Federal regulators apply pressure on lenders with poor CRA evaluations by denying authorization to open new bank branches or withholding permission to merge with or acquire other lenders.²⁹⁶ Congressional amendments in 1989 required regulators to publish written evaluations of the CRA performance of

292. Elsewhere I have highlighted the Italian *montes pietatum*, which were charitable pawnshops sponsored by the medieval Catholic Church. See Peterson, *supra* note 191, at 834-37 (arguing that *montes pietatum* were established by religious leaders as a way to provide small loans to the poor). Analogous but relatively short-lived lending sources for Americans developed in the nineteenth century, often with the sponsorship or encouragement of state governments. *Id.* at 856-57.

293. 12 U.S.C. § 2901(a)(3) (2000).

294. *Community Credit Needs: Hearings on S. 406 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 95th Cong. 17 (1977); Robert G. Boehmer, *Mortgage Discrimination: Paperwork and Prohibitions Prove Insufficient—Is it Time for Simplification and Incentives?*, 21 HOFSTRA L. REV. 603, 622 (1993). Related to the FHA and ECOA, some members of Congress were concerned about racial undertones that appeared to influence local credit markets. S. REP. NO. 95-175, at 33 (1977). But unlike the FHA and ECOA which focus on credit discrimination against individuals, the CRA addresses the problem by applying pressure to depository institutions to lend within certain geographic areas. I recognize the distinction between antidiscrimination and charitable lending is in some cases thin. Many commentators see the Community Reinvestment Act as primarily an antidiscrimination statute which aims to remedy past discriminatory credit rationing. Where banks tend to view CRA requirements as charity, civil rights leaders tend to view them as akin to affirmative action policy—at least where disinvested communities are made up of minority groups. In this Article, my nomenclature is merely one of convenience intended to help exposit the law relevant to predatory lending.

295. 12 U.S.C. § 2903 (2000).

296. *Id.* See Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 300 (1993) (“Thus, any bank that contemplates establishing new branches, acquiring other banks, or merging into or being acquired by another bank must consider the possibility that its business plan will be stymied by an adverse CRA finding.”).

financial institutions that apply for permission to expand their operations.²⁹⁷ These public CRA evaluations created an opportunity for community groups to discover performance of lenders and put pressure on regulators to delay or deny applications.²⁹⁸ The efficacy of charitably motivated lending has been controversial. Both left and right leaning commentators have criticized the Community Reinvestment Act as economically inefficient, unenforceable, and misguided.²⁹⁹ Consumer advocates tend to complain that the Act has not been sufficiently enforced,³⁰⁰ while creditors tend to complain that the administrative costs are too high or that the more aggressive enforcement would force lenders into uncollectible loans.³⁰¹ Even worse are recent allegations that lenders now

297. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub.L. No. 101-73, § 1212, § 807, 103 Stat. 183, 527-28.

298. Macey & Miller, *supra* note 296, at 300-01; Michael E. Schrader, *Competition and Convenience: The Emerging Role of Community Reinvestment*, 67 IND. L.J. 331, 342-44 (1992).

299. See, e.g., Leonard Bierman et al., *The Community Reinvestment Act: A Preliminary Empirical Analysis*, 45 HASTINGS L.J. 383, 384, 408 (1994) (empirical study suggesting the CRA creates pressure on banks to make unprofitable loans); Marion A. Cowell, Jr. & Monty D. Hagler, *The Community Reinvestment Act in the Decade of Bank Consolidation*, 27 WAKE FOREST L. REV. 83, 97-100 (1992) (discussing administrative burdens created on large banks from CRA); Stephen M. Dane, *Eliminating the Labyrinth: A Proposal to Simplify Federal Mortgage Lending Discrimination Laws*, 26 U. MICH. J.L. REFORM 527, 552-53 (1993) (arguing vagueness of CRA requirements and lack of private cause of action undermine effectiveness); Macey & Miller, *supra* note 296, at 303-12, 347 (challenging fundamental premises of the CRA); Peter D. Schellie, *Current Developments with the Community Reinvestment Act*, 42 BUS. LAW. 943 (1987) (discussing lender strategies for responding to CRA protests); Taibi, *supra* note 290, at 1544 (arguing the CRA fails to address the underlying economic forces leading to insufficient capitalization of vulnerable communities); Jonathan P. Tomes, *The "Community" in the Community Reinvestment Act: A Term in Search of a Definition*, 10 ANN. REV. BANKING L. 225, 240 (1991) (discussing the difficulty of defining the geographic boundaries of lenders' communities); Lawrence J. White, *The Community Reinvestment Act: Good Intentions Headed in the Wrong Direction*, 20 FORDHAM URB. L.J. 281, 282 (1993) (arguing the CRA is an inefficient cross-subsidy forcing profitable financial services to offset losses incurred from unprofitable local lending).

300. E.g., GREGORY D. SQUIRES, *Community Reinvestment: An Emerging Social Movement*, in FROM REDLINING TO REINVESTMENT: COMMUNITY RESPONSES TO URBAN DISINVESTMENT 1, 11 (Gregory D. Squires ed., 1992); LOONIN & WU, NCLC, CREDIT DISCRIMINATION, *supra* note 264, at 13; Robert C. Art, *Social Responsibility in Bank Credit Decisions: The Community Reinvestment Act One Decade Later*, 18 PAC. L.J. 1071, 1139 (1987); Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, But Strengthened Federal Enforcement Is Needed*, 20 FORDHAM URB. L.J. 293, 296 (1993); Stephen A. Fuchs, *Discriminatory Lending Practices: Recent Developments, Causes and Solutions*, 10 ANN. REV. BANKING L. 461, 479-80 (1991); Richard D. Marisco, *Fighting Poverty Through Community Empowerment and Economic Development: The Role of the Community Reinvestment and Home Mortgage Disclosure Acts*, 12 N.Y.L. SCH. J. HUM. RTS. 281, 282 (1995); Richard D. Marisco, *A Guide to Enforcing the Community Reinvestment Act*, 20 FORDHAM URB. L.J. 165, 171 (1993).

301. See Cowell & Hagler, *supra* note 299, at 93-94 (recognizing the CRA's unintended "heavy paperwork burden," which increased administrative costs); Macey & Miller, *supra* note 296, at 346-47 (arguing that the "bad effects" of the CRA outweigh the good ones); A. Brook Overby, *The Community Reinvestment Act Reconsidered*, 143 U. PA. L. REV. 1431, 1531 (1995) ("[A]rguments about localism and community are unproductive for assessing the proper scope of legal intervention to further the cause of community reinvestment."); cf. Christopher A. Richardson, *The Community Reinvestment Act and the Economics of Regulatory Policy*, 29 FORDHAM URB. L.J. 1607, 1624-26

purchase predatory mortgages from unscrupulous brokers and use the investment to satisfy community reinvestment obligations—an ironic upending of the policy behind the Act.³⁰² Although the law has undoubtedly helped many communities, especially those who have aggressively organized around it, at its heart the CRA reinvestment effort, like its forebears, suffers from undercapitalization.³⁰³ Lenders will understandably refuse to make ill-advised loans, or they will only do so upon harsh and unfavorable terms.

E. Cooperative Lending

Another venerable social strategy for insulating consumers from predatory lending—once again with mixed federalist roots—lies in the cooperation of like-minded fellows. By pooling the resources of a group, members can create pools of low-cost funds from which to borrow and thus insulate themselves from financial predators. While families can use this strategy on a small scale, during the industrial revolution institutions evolved which allowed larger groups to pool resources. Organized cooperative lending institutions aiming to protect consumers from predatory lenders have been well entrenched in the United States for over a century.³⁰⁴ In 1912, President Taft spurred the development of American credit unions by asking that all states adopt a credit union statute modeled on a Massachusetts statute.³⁰⁵ Today, cooperative lenders receive significant oversight and support including both deposit insurance and tax exemptions from both federal and state governments.³⁰⁶ Both state and federal governments charter credit unions.³⁰⁷ State credit unions are governed primarily by state law, while federally chartered credit unions are governed “almost exclusively” by federal law.³⁰⁸ And, although dual chartering and regulation has

(2002) (arguing a market for tradable CRA compliance vouchers would lower administrative costs).

302. Peterson, *supra* note 191, at 870.

303. *Id.*

304. John W. Hofeldt, *Cooperative Consumer Credit: Credit Unions*, 1943 WIS. L. REV. 567, 567 (“Another aspect of the credit union movement . . . is that it has been considered and used in the past as an instrument to rid the state of loan sharks and their attendant evils.”). American building societies, modeled after earlier British counterparts, first appeared in 1831 and were well established by the late nineteenth century. See Peterson, *supra* note 191, at 857 (noting that “by the late nineteenth century savings and loan associations became entrenched”); M. MANFRED FABRITIUS & WILLIAM BORGES, *SAVING THE SAVINGS & LOAN: THE U.S. THRIFT INDUSTRY AND THE TEXAS EXPERIENCE 1950-1988*, 12-13 (1989) (reviewing the history of the savings and loan industry in the United States).

305. Hofeldt, *supra* note 304, at 568-69.

306. William A. Lovett, *Federalism, Boundary Conflicts and Responsible Financial Regulation*, 18 LOY. L.A. L. REV. 1053, 1055, 1070-71 (1985) (“Federalism and the desire for decentralized financial institutions have been powerful themes in American law.”).

307. Stanely P. Spence et al., *Federal Preemption of State Consumer Lending Laws: A Focus on Credit Unions*, 45 BUS. LAW. 1931, 1931 (1990).

308. *Id.* The National Credit Union Administration has preempted the application of state law with respect to federal credit unions where the law affects imposition of interest rates, finance charges, late fees, terms of repayment loan amounts, loan purposes, eligible borrowers, or the imposition or enforcement of liens. 12 C.F.R. § 701.21(b)(5) (2004).

created complexity in the law, cooperative lenders have generally thrived despite it.³⁰⁹

For millions of Americans, membership in cooperative credit organizations, such as a credit union, has provided a valuable and socially constructive source of financial services and inexpensive credit.³¹⁰ However, these organizations, both federal and state, have not prevented the recent entrenchment of predatory home mortgage lending.³¹¹ This may be in part because the most vulnerable borrowers are often beyond the reach of cooperative lenders.³¹² Many credit unions, for instance, have consolidated in recent years, focusing on providing services to a more stable clientele, instead of higher risk borrowers.³¹³ Moreover, predatory lenders adversely impact credit unions by skimming their clientele pool of some of the best borrowers.

F. *Anti-Deception Law*

While rules attempting to prevent and punish deceptive business practices apply in a broad range of contexts, they do have a special relevance to predatory lending regulation. The common law intentional tort of fraud is often the first line of defense for vulnerable consumer borrowers. It is the traditional civil action to deter and punish lying.³¹⁴ In many states punitive damages are available for fraud victims, increasing the stakes and defendants' incentives to settle.³¹⁵

309. Professor Lovett even suggests that the multiple layers of scrutiny in dual federal and state regulation segments the financial services marketplace helping to prevent herd mentality cycles of speculation and panic associated with the Great Depression. Lovett, *supra* note 306, at 1057-59.

310. JACK DUBLIN, CREDIT UNIONS: THEORY AND PRACTICE 166 (2d ed. 1971); OLIN S. PUGH & F. JERRY INGRAM, CREDIT UNIONS: A MOVEMENT BECOMES AN INDUSTRY 12-13, 25, 34-35 (1984).

311. See Melissa Allison, *Group Creating Credit Union in Low-Income Neighborhoods*, CHI. TRIB., May 12, 2002, Business, at 9 (discussing lack of affordable alternatives to high-cost predatory lenders in low income neighborhoods).

312. PUGH & INGRAM, *supra* note 310, at 6.

313. See CHARLES FERGUSON & DONAL MCKILLOP, THE STRATEGIC DEVELOPMENT OF CREDIT UNIONS 23-24 (1997) (characterizing saver and borrower membership bias as being merged rather than distinct); SCOTT B. MACDONALD & ALBERT L. GASTMAN, A HISTORY OF CREDIT AND POWER IN THE WESTERN WORLD 231-32 (2001) (describing the "United States corporate world" in 1980); PUGH & INGRAM, *supra* note 310, at 10, 19, 26, 34-35 (tracking the recent trends of the credit unions); Melissa Allison, *Area Credit Unions Not Serving All, Study Says*, CHI. TRIB., Feb. 15, 2001, Business, at 1 (suggesting that credit unions reach out to low-income groups instead of merely the working class).

314. DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW 12 (3d ed. 2002).

315. See, e.g., *Black v. Iovino* 580 N.E.2d 139, 149 (Ill. App. Ct. 1991) (recognizing that punitive damages may be awarded in an action for fraud); *Newton v. Standard Fire Ins. Co.*, 229 S.E.2d 297, 301 (N.C. 1976) (discussing North Carolina's position on punitive damages); *Freeman v. A & M Mobil Home Sales, Inc.*, 359 S.E.2d 532, 536 (S.C. Ct. App. 1987) (looking at the standard for "excessive" punitive damages by focusing on the extent of the fraud committed by the defendant). Where a fraud claim involves mail fraud or wire fraud, plaintiffs can create additional leverage with federal and state Racketeer Influenced and Corrupt Organization statutes ("RICO"). The federal statute was originally conceived as a response to organized crime syndicates. However, broad statutory language and the Supreme Court's decision in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985) paved the way for

In addition to fraud, Congress and all fifty state legislatures have passed statutes governing unfair and deceptive commercial acts or practices.³¹⁶ The result is a complex and delicate mixed-federalist web of consumer protection. At the federal level, Congress empowered the Federal Trade Commission (“FTC”) to suppress unfair or deceptive acts or practices in section 5 of the Federal Trade Commission Act.³¹⁷ Rather than taking on the project of following the ever-shifting trends in commercial deception, Congress left the task of defining unfair and deceptive trade practices for the FTC.³¹⁸ In general, the FTC currently defines deceptive practices to include actions where “there is a representation, omission, or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer’s detriment.”³¹⁹ In more specific terms, the FTC has issued many rules dealing with everything from mail order sales³²⁰ to funeral services,³²¹ including consumer credit practices.³²²

However, the Federal Trade Commission Act does not include a private right of action allowing consumers to sue on their own behalf.³²³ Eventually, most state legislatures stepped in to fill this gap with what are often called “Little FTC Acts,” which allow private unfair and deceptive acts or practices lawsuits.³²⁴ Importantly, state courts usually look to the FTC for guidance in determining

interpretations governing some forms of consumer fraud. *Sedima*, 473 U.S. at 497 (holding violations need not involve a “RICO-type injury”). Generally a RICO plaintiff must show conduct of an enterprise through a pattern of racketeering activity. *Id.* at 526. While RICO cases introduce considerable complexity into a fraud claim, it does have fee shifting and treble damage provisions.

316. NATIONAL CONSUMER LAW CENTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 1.1 (5th ed. 2001) [hereinafter NCLC, UNFAIR AND DECEPTIVE ACTS].

317. 15 U.S.C. § 45(a)(1) (2000) (“Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.”).

318. *See* 15 U.S.C. § 57a(a)(1)(A) (2000) (granting the Commission the authority to prescribe “interpretive rules and general statements of policy with respect to unfair or deceptive acts or practices in or affecting commerce”); *State ex rel. Bryant v. R & A Investment Co.*, 985 S.W.2d 299, 301 (Ark. 1999) (holding that “the Attorney General has standing to enforce the provisions of the DTPA for unconscionable business practices involving usurious contracts”); *State ex rel. Webster v. Eisenbeis*, 775 S.W.2d 276, 281 (Mo. Ct. App. 1989) (addressing alleged violations of the Merchandising Practice Act); Jeff Sovern, *Private Actions Under the Deceptive Trade Practices Acts: Reconsidering the FTC Act as a Rule Model*, 52 OHIO ST. L.J. 437, 440 (1991) (noting that “Congress chose simply to proscribe ‘deceptive and unfair trade practices’ and left the task of defining that phrase to the FTC, and to some extent, the courts”).

319. *See* Sovern, *supra* note 318, at 444 (citing FTC Policy Statement on Deception at 4, contained in letter of James C. Miller, III (FTC Chair) to Senator Bob Packwood, dated Oct. 14, 1983). *See also*, NCLC, UNFAIR AND DECEPTIVE ACTS, *supra* note 316, § 4.2.9.

320. FTC Mail or Telephone Order Merchandise Rule, 16 C.F.R. §§ 435 (2003).

321. FTC Funeral Industry Practices Rule, 16 C.F.R. §§ 453 (2003).

322. FTC Credit Practices Rule, 16 C.F.R. §§ 444 (2003). *See also* Jean Noonan, *Federal Trade Commission Activity: Pursuing Unfair and Deceptive Practices in Consumer Financial Services*, 43 BUS. LAW. 1069, 1079 (1988) (recognizing the Commissions’ shifting focus upon fair and deceptive practices not specifically set out in the consumer credit statutes).

323. NCLC, UNFAIR AND DECEPTIVE ACTS, *supra* note 316, § 5.1.3.1.10.

324. *Id.* § 1.1; William A. Lovett, *Private Actions for Deceptive Trade Practices*, 23 ADMIN. L. REV. 271, 274-75 (1970); Sovern, *supra* note 318, at 446-48.

what practices are unfair or deceptive.³²⁵ In fact, many state statutes specifically give FTC opinions force of law under state authority, creating an unusual hybrid regulatory system.³²⁶ While federal law has been influential in defining unfair and deceptive practices, state law provides the real teeth in enforcement. Unlike the federal FTC Act, most state "Little FTC Acts" provide for enhanced damage provisions as well as attorney fee shifting.³²⁷

One important limitation to anti-deception rules in the prevention of predatory home mortgage lending is the greater threshold of proof these rules often invoke. By virtually all accounts, "fraud is a difficult claim to prove."³²⁸ Fraud claims require proof of the subjective state of mind of both parties: first with respect to the tortfeasor's intent, and second with respect to the victim's reliance.³²⁹ Moreover, while predatory lending victims may lose a family home, often the actual damages for a common law fraud claim are not particularly high, especially relative to the substantial resources necessary to wage a protracted battle to prove fraud and receive punitive damages.³³⁰ Savvy lenders have an incentive to defraud borrowers up to that point at which damages would make victims' costs and risks of litigation worthwhile for victims to pursue.³³¹ Moreover, rules preventing the assignment of fraud claims make consolidation of

325. See, e.g., *McKeown Distribs., Inc. v. Gyp-Crete Corp.*, 618 F. Supp. 632, 643 (D. Conn. 1985) ("[F]ederal courts called upon to construe [the Connecticut Unfair Trade Practices Act] . . . should look for guidance to decisions interpreting Section 5(a)(1) of the Federal Trade Commission Act."); *Western Acceptance Corp. v. Jones*, 788 P.2d 214, 216 (Idaho 1990) (deferring to Federal Trade Commission's interpretation of FTC Act as covering debt collection).

326. See, e.g., FLA. STAT. ANN. § 501.204(2) (West 2002) ("It is the intent of the Legislature that . . . due consideration and great weight shall be given to the interpretations of the Federal Trade Commission and the federal courts relating to § 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) as of July 1, 2001."); MONT. CODE ANN. § 30-14-104(1) (2003) (stating that "due consideration and weight shall be given to the interpretations of the federal trade commission and the federal courts relating to section 5(a)(1) of the Federal Trade Commission Act"); W. VA. CODE § 46A-6-101(1) (1999) ("[T]he purpose of this article is to complement the body of federal law governing . . . unfair, deceptive, and fraudulent acts or practices It is the intent of the legislature that, in construing this article, the courts be guided by the interpretation given by the federal courts to the various federal statutes dealing with the same or similar matters.").

327. *Sovern*, *supra* note 318, at 448-49.

328. Teal E. Luthy, *Assigning Common Law Claims for Fraud*, 65 U. CHI. L. REV. 1001, 1002 (1998).

329. Proving intent can be particularly difficult against large corporate lenders. In such cases, it is difficult even to trace the lines of responsibility and nearly impossible to tie that in with accountability. Where the defendant lacks human characteristics, including a recognizable conscience, it makes little sense to talk about the kind of individual scienter that is the hallmark of common law fraud. Ellen Byers, *Addressing the Consumer's Worst Nightmare: Toward a More Expansive Development of the Law of Tortious Fraud and Deceptive Practices in Kansas*, 38 WASHBURN L.J. 455, 459 (1999).

330. Byers, *supra* note 329, at 459. In a predatory lending case, damages might reflect the difference between the loan the borrower thought she would receive and the loan she actually did receive. While this difference may push monthly payments beyond the borrower's ability to pay, this marginal monetary difference may not be large enough to justify extensive litigation. *Id.*

331. Luthy, *supra* note 328, at 1016 ("Under the current system, a tortfeasor can impose collectively large costs on people without reprisal as long as the individual harms are small enough that the fixed costs of litigation make it impractical for any single victim to file a claim.").

multiple claims unfeasible.³³² Although class action lawsuits have the potential to reduce this problem, arbitration clauses explicitly or implicitly forbidding class actions.³³³ Additionally, individual evidentiary issues with respect to the reliance element³³⁴ make class certification extremely difficult.³³⁵ Finally, many states require proof of common law fraud claims with clear and convincing evidence, rather than a preponderance of the evidence, which significantly raises the bar plaintiffs must surmount.³³⁶

Federal and state unfair and deceptive trade practices statutes are at least in part a response to the evidentiary hurdles of common law fraud. At the federal level, the FTC has the authority to define certain practices as deceptive, based on the likelihood that consumers will be deceived irrespective of the intent or reliance. However, because FTC resources are limited, it brings only a circumscribed number of actions, often focusing exclusively on the most high-profile cases.³³⁷ Despite some notable successes, the FTC is not equipped to prevent the vast majority of predatory lending.

Like the FTC Act, state Unfair and Deceptive Acts or Practices ("UDAP")

332. Luthy advocates adopting rules allowing the assignment of fraud claims. He suggests this would allow plaintiffs to aggregate claims and capture economy of scale in litigation which would make small fraud cases financially feasible and increase deterrence of fraudulent behavior. *Id.* at 1025.

333. See *Johnson v. West Suburban Bank*, 225 F.3d 366, 378-79 (3d Cir. 2000) (holding arbitration clause precluded consumer lending plaintiffs from participating in a class action); NCLC, UNFAIR AND DECEPTIVE ACTS, *supra* note 316, at § 8.5.9.2 ("It is not surprising that no arbitration mechanisms and no consumer arbitration agreements provide affirmatively for class relief, since avoiding class actions is the major reason merchants resort to arbitration agreements.").

334. See, e.g., *In re Woodward & Lothrop Holdings, Inc.*, 205 B.R. 365, 371 (Bankr. S.D.N.Y. 1997) ("A class action is generally not appropriate to resolve claims based upon common law fraud because each class member must prove his or her own reliance."); *Antonson v. Robertson*, 141 F.R.D. 501, 508 (D. Kan. 1991) ("With respect to plaintiffs' common law fraud claims . . . each individual plaintiff would be required to prove his or her individual reliance, causing individual questions of fact to predominate in the case."); *Bunch v. KMart Corp.*, 898 P.2d 170, 172 (Okla. Civ. App. 1995) ("[Plaintiffs] must have facts in common sufficient to meet their initial burden of proof. This is not possible in common law fraud where a basic element of proof is 'reliance' which must be proven for each plaintiff."); Luthy, *supra* note 328, at 1016 ("[F]raud is difficult to pursue as a class action because the element of reliance often prevents fraud plaintiffs from meeting the commonality requirement.").

335. *Engel & McCoy*, *supra* note 190, at 1302-03.

336. See *N. Tx. Prod. Credit Ass'n v. McCurtain County Nat'l Bank*, 222 F.3d 800, 813 (10th Cir. 2000) (noting that under Oklahoma law, elements of fraud must be found by clear and convincing evidence); *Tunis Bros. Co., Inc. v. Ford Motor Co.*, 952 F.2d 715, 731 (3d Cir. 1991) (stating that Pennsylvania law requires clear and convincing evidence for each element for a claim of fraudulent misrepresentation); *Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 961 F. Supp. 305, 309 (D. D.C. 1997) (concluding that in the District of Columbia, there are five traditional elements of fraud, each which must be established by clear and convincing evidence); *Weisblatt v. Minn. Mut. Life Ins. Co.*, 4 F. Supp. 2d 371, 377 (E.D. Pa. 1998) (holding that for claims of common law fraud and fraudulent violation of the Pennsylvania Unfair Practices and Consumer Protection Law, plaintiff must prove each element of clear and convincing evidence); *Scaife Co. v. Rockwell-Standard Corp.*, 285 A.2d 451, 454 (Pa. 1971) (stating that Pennsylvania courts consistently enunciate a very high standard for proof of fraud), *cert. denied*, 407 U.S. 920 (1972).

337. *Sovern*, *supra* note 318, at 442. Most agree that the FTC also limits its caseload for political reasons with the aggressiveness of enforcement changing based on the political climate in Washington. *Id.* at 441; *Engel & McCoy*, *supra* note 190, at 1304.

statutes do not require private litigants to prove a tortfeasor's intent, nor the victim's reliance.³³⁸ In most states, the burden of proof for private UDAP claims is a preponderance of the evidence.³³⁹ While this represents one of the best options for many predatory lending victims, state UDAP statutes still come up short. Many courts have adopted narrow interpretations limiting the usefulness of the UDAP statutes for deserving plaintiffs.³⁴⁰ For instance, many states have limited fee shifting rules, either by statute or by virtue of actual judicial practice.³⁴¹ In some states, courts have held that mortgage lending is not covered under state UDAP statutes, which govern only the sale of goods and services.³⁴² Moreover, some states exempt application of state UDAP rules to banks, mortgage companies, or even to the extension of credit altogether.³⁴³ The Ohio state code, for instance, explicitly excludes financial institutions from application of its state UDAP statute.³⁴⁴ But perhaps even more fundamentally, many predatory loans do not involve deception *per se*. Lenders can always assert that neither fraud nor state UDAP statutes provide a remedy where borrowers simply agree to honestly and carefully described loans that nevertheless have outrageous prices and repayment terms. In these cases, a UDAP claim becomes

338. NCLC, UNFAIR AND DECEPTIVE ACTS, *supra* note 316, at § 4.2.3.1 ("UDAP statutes clearly provide more flexible remedies for consumer abuse than was previously available under common law, since deception liberalizes the traditional elements for the torts of fraud or deceit. The essence of deception is not evil intent, negligent merchant behavior, or even breach of an agreement, but misleading consumers by a merchant's statements, silence, or actions.") (footnotes omitted).

339. *See, e.g., Weisblatt*, 4 F. Supp. 2d at 377 (applying clear and convincing standard to common law fraud but preponderance of evidence for non-fraud unfair and deceptive practices claims); *State v. Alpine Air Prods., Inc.*, 500 N.W.2d 788, 791 (Minn. 1993) (applying preponderance of the evidence standard).

340. *Sovern*, *supra* note 318, at 437.

341. North Carolina, for example, only authorizes fee awards upon a court finding that the defendant's conduct is willful and there is an unwarranted refusal to settle. N.C. GEN. STAT. § 75-16.1 (Supp. 2004). Few attorneys know before deciding to take a case whether these elements will be met, making the development of a practice representing consumers under the statute difficult.

342. *See, e.g., Barber v. Nat'l Bank of Alaska*, 815 P.2d 857, 861 (Alaska 1991) (mortgage lender exempted from state UDAP statute because financing and sale of real property was not the sale of a good); *Haeger v. Johnson*, 548 P.2d 532, 534 (Or. Ct. App. 1976) (holding lending of money is not a sale of goods or services within the meaning of the state UDAP statute); James R. Cox, *State Consumer Protection or Deceptive Trade Practices Statutes: Their Application to Extensions of Credit and Other Banking Activities*, 105 BANKING L.J. 214, 214 (1988) ("Courts have reached conflicting conclusions . . . when considering whether extensions of credit and other banking activities fall under the prohibitions of [UDAP] statutes.").

343. *See, e.g., Deerman v. Fed. Home Loan Mortgage Corp.*, 955 F. Supp. 1393, 1399 (N.D. Ala. 1997) (holding that "the Alabama legislature did not intend to include loans and mortgages within the definition of goods or services for purposes of [the Alabama UDAP] statute."); *Idaho First Nat'l Bank v. Wells*, 596 P.2d 429, 432 (Idaho 1979) (excluding banks from application of the Idaho UDAP statute).

344. OHIO REV. CODE ANN. §§ 1345.01(A), 5725.01(A) (Anderson 2002). *See also Vannoy v. Capital Lincoln-Mercury Sales, Inc.*, 623 N.E.2d 177, 182 (Ohio Ct. App. 1993) (recognizing that consumer transactions between financial institutions and their customers are not covered under the CSPA); NCLC, UNFAIR AND DECEPTIVE ACTS, *supra* note 316, at § 2.2.1.5 (acknowledging Ohio's exemption of finance companies or banks from Ohio UDAP statute).

nearly indistinguishable from an unconscionability argument—and equally unlikely to succeed.

G. Disclosure and Education

Three federal consumer credit disclosure statutes address predatory mortgage lending. The Truth in Lending Act (“TILA”) is the primary American consumer credit regulation price disclosure statute.³⁴⁵ Passed in 1968, Congress hoped it would create a uniform terminology for credit prices, allowing consumers to more efficiently compare credit contracts.³⁴⁶ At the time, Congress found that creditors used a broad variety of methods to calculate interest rates.³⁴⁷ Some lenders quoted yearly rates, others quoted monthly rates.³⁴⁸ Some lenders used the actuarial method, others used the add-on method, and still others used the discount method.³⁴⁹ As a result, consumers could rarely locate the least expensive bargain.³⁵⁰ TILA’s sponsors hoped uniform price disclosure would force more efficient competition and, in turn, lower prices.³⁵¹ In this regard, the Act’s most fundamental provisions are the twin definitions of finance charge and annual percentage rate.³⁵² Generally speaking, a finance charge is any charge incident to the extension of credit.³⁵³ Similar to an interest rate, the annual percentage rate is a yearly expression of the finance charge.³⁵⁴ Most commentators agree, that while far from perfect, this terminology and TILA’s approach in general has made significant progress in homogenizing the comparison of credit prices.³⁵⁵

345. 15 U.S.C. § 1601-1667 (2004).

346. See, e.g., H.R. REP. NO. 90-1040 (1968), *reprinted in* 1968 U.S.C.C.A.N. 1962, 1963 (“It is the view of your committee that such full disclosure would aid the consumer in deciding for himself the reasonableness of the credit charges imposed and further permit the consumer to ‘comparison shop’ for credit.”). The Truth in Lending Act is generally thought to include the principle disclosure provisions of the Consumer Credit Protection Act. The CCPA is often described as an “umbrella” statute which houses a variety of federal acts dealing with credit, including among others the Equal Credit Opportunity Act and the Fair Debt Collection Practices Act, as well as the Truth in Lending Act.

347. H.R. REP. NO. 90-1040.

348. *Id.*

349. WHALEY, *supra* note 314, at 389-90.

350. H.R. REP. NO. 90-1040.

351. Peterson, *supra* note 191, at 876-80.

352. DEE PRIDGEN, CONSUMER CREDIT AND THE LAW § 6:2 (1990 & Supp. 2002).

353. 15 U.S.C. § 1605(a) (2004); Regulation Z, 12 C.F.R. § 226.4(a) (2004).

354. PRIDGEN, *supra* note 352, at § 6:9.

355. See, e.g., Barry A. Abbott & John W. Campbell, *The Truth in Lending Act After 15 Years: Its Goals and Its Limitations*, 9 OKLA. CITY U. L. REV. 1, 16 (1984) (recognizing the Act as an effective tool to encourage competition and provide information to consumers); Elwin Griffith, *Searching for Truth in Lending: Identifying Some Problems in the Truth in Lending Act and Regulation Z*, 52 BAYLOR L. REV. 265, 351 (2000) (suggesting ways to improve the effectiveness of the Act). It is worth noting that in recent years high-cost “payday” lenders have been making aggressive efforts to reverse this progress by insisting on quoting finance charges as a percent of the principal, rather than as an annual percentage rate, or even as an interest rate. While lenders say otherwise, in reality this reflects a thinly veiled effort to obscure extremely high prices. Thus, a finance charge of \$60 represents only

In the context of home mortgages, TILA works hand-in-hand with the Real Estate Settlement and Procedures Act ("RESPA").³⁵⁶ In 1974, Congress concluded that abusive mortgage lending settlement practices artificially inflated consumer costs.³⁵⁷ Like TILA, RESPA relies on price disclosure as its primary mechanism for checking market imperfections.³⁵⁸ Initially, RESPA requires that both lenders and mortgage brokers give borrowers a "good faith estimate" of settlement costs no later than three business days after a borrower applies for a loan.³⁵⁹ Congress also requires lenders and brokers, when providing a good faith estimate, to deliver a booklet prepared by the Secretary of the Department of Housing and Urban Development ("HUD").³⁶⁰ The pamphlet attempts to explain the nature and costs of real estate services.³⁶¹ At closing, RESPA requires that settlement agents provide a complete settlement statement that itemizes all settlement charges imposed on the borrower. Lenders are usually required to use a particular uniform government form, the HUD-1 settlement statement, in providing this information.³⁶² In particular, the statement must include all discount points, real estate agent fees, loan broker fees, and other miscellaneous closing costs.³⁶³

By the early 1990s, it became clear to Congress that the TILA and RESPA disclosures were not preventing vulnerable borrowers from encumbering themselves with unfavorable home mortgages.³⁶⁴ The Home Ownership and Equity Protection Act of 1994 ("HOEPA")³⁶⁵ required heightened disclosures for a special class of high-cost home mortgages.³⁶⁶ In addition to its enhanced disclosures, HOEPA also includes several substantive requirements and remedies for loans within its scope.³⁶⁷ Two price threshold triggers delineate this

20 percent of the principal on a two week \$300 payday loan. This, of course, sounds much more reasonable than the loan's actual annual percentage rate of about 520 percent. CHRISTOPHER L. PETERSON, *TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH-COST CREDIT MARKET* 138-42 (Christopher P. Banks ed., 2004).

356. 12 U.S.C. §§ 2601-2617 (2000). The Act originally applied only to first liens on residential property of one to four units, but was amended in 1992 to include subordinate liens as well. Housing Community Development Act of 1992, Pub. L. No. 102-550, § 908, 106 Stat. 3672 (Oct. 28, 1992); The Real Estate Settlement Procedures Act Regulation, 59 Fed. Reg. 6506, 6511 (Feb. 10, 1994).

357. SENATE BANKING, HOUSING AND URBAN AFFAIRS COMM., *REAL ESTATE SETTLEMENT PROCEDURES*, S. REP. NO. 93-866 (1974), reprinted in 1974 U.S.C.C.A.N. 6546, 6551.

358. Michael S. Glassman, *Real Estate Settlement and Procedures Act of 1974 and Amendments of 1975: The Congressional Response to High Settlement Costs*, 45 U. CIN. L. REV. 448, 457 (1976).

359. 12 U.S.C. § 2603; Real Estate Settlement Procedures Act, 24 C.F.R. § 3500.7 (2004).

360. 12 U.S.C. § 2604.

361. *Id.*

362. 12 U.S.C. § 2603(a); 24 C.F.R. § 3500.8(a). The HUD-1A form is used for refinances and for junior lien mortgages.

363. 12 U.S.C. § 2603(a); 24 C.F.R. § 3500.8(a).

364. See generally *Home Ownership and Equity Protection Act: Hearing on S. 924 Before the Senate Banking Comm.*, 103d Cong. 1 (May 19, 1993) (hearing on predatory lending abuses).

365. Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, 108 Stat. 2160 (1994) (codified in scattered sections of 12 U.S.C.).

366. 15 U.S.C. §§ 1602(aa), 1639(c)-(i).

367. *Id.* §§ 1639(c)-(i).

scope. Thus, HOEPA protections apply to loans (excluding home-purchase loans) that exceed either a particular annual percentage rate, or charge points and fees at closing in excess of a specified amount.³⁶⁸ The annual percentage rate trigger covers first lien loans with annual percentage rates more than eight percentage points above comparable term treasury notes.³⁶⁹ The Act's points and fees trigger generally covers loans where the total points and fees exceed eight percent of the total loan amount.³⁷⁰ In high-cost HOEPA loans, lenders must deliver to consumers a special advance warning at least three days prior to consummation.³⁷¹ This advance disclosure must include an annual percentage rate disclosure, a notice that it is not too late for the borrower to back out of the transaction, the size of any balloon payments, and the cost of credit insurance charges.³⁷² The advance disclosure also includes a warning that the consumer could lose her home if she does not meet her obligations.³⁷³

In addition to these disclosure rules, HOEPA loans must conform to several substantive requirements, making HOEPA a relatively innovative *hybrid* of disclosure strategy and contract restriction strategy. First, HOEPA loans must amortize because of consumer abuses associated with negative amortization.³⁷⁴ HOEPA loans also may not include penalty interest rate increases activated by late payments or other forms of default.³⁷⁵ The Act prohibits balloon payments where the loan term is greater than five years.³⁷⁶ Additionally, it attempts to address flipping by restricting the use of prepayment penalties in some cases. Prepayment penalties are allowed if they are exercised within the first five years of the loan term, the loan does not cause the borrower to devote more than half of her gross monthly income to the debt, and the lender itself is not the source of the prepaying funds.³⁷⁷ Responding to home repair abuses, lenders also violate the Act if they make HOEPA loan proceeds payable only to a home

368. *Id.* § 1602(aa).

369. 15 U.S.C. § 1602(aa)(1)(A). For example, if the yield on 30-year treasury securities at the time of loan origination was four percent, then loans with an APR of twelve percent or greater are covered by the Act. HOEPA originally covered only loans with annual percentage rates ten percentage points higher than comparable term T-Bills. *See infra* note 651 and accompanying text (noting that the Federal Reserve Board lower the AP trigger in 2001). Responding to complaints that many of the most abusive loans were not covered by HOEPA, the federal reserve board used its authority to lower the trigger to eight percentage points in 2001. *Id.* Junior lien mortgages are still only covered at ten percentage points above comparable treasury notes. *Id.*

370. 15 U.S.C. § 1602(aa)(1)(B). The total points and fees must also be greater than \$400. *Id.*

371. 15 U.S.C. § 1639(b)(1).

372. *Id.*

373. *Id.* § 1639(a)(1)(B).

374. Regulation Z, 12 C.F.R. § 226.32(d)(2).

375. *Id.* § 226.32(d)(4).

376. *Id.* § 226.32(d)(1)(i).

377. *Id.* § 226.32(d)(7). Lenders must verify the gross monthly income of the debtor with a signed financial statement, a credit report and payment records. *Id.* § 226.32(d)(7)(iii). Furthermore, it is clear that this provision allowing some prepayment penalties under HOEPA does not preempt contrary state rules, since the provision only authorizes prepayment penalties "otherwise permitted by law." Regulation Z, 12 C.F.R. § 226.32(d)(7).

improvement contractor.³⁷⁸ The Act prohibits lenders from engaging in a pattern or practice of offering HOEPA covered loans based on the consumers' collateral rather than their ability to repay the debts.³⁷⁹

One of the most significant additional protections HOEPA provides against predatory lending lies in the relationship between its assignee liability rules and state claims and defenses. In typical TILA cases, assignees are liable for an original lender's violations only if the violations are apparent from the face of the disclosure documents.³⁸⁰ Instead, HOEPA changes this rule, holding assignees liable on high-cost mortgages even when violations are not apparent from the face of the documents. Under HOEPA, assignees are liable for the original creditor's violations unless the assignee can show by a preponderance of evidence that it could not have discovered that the loan was a high-cost loan using ordinary due diligence.³⁸¹ Even more significant than the lenient assignee liability standard, assignees are not only liable for HOEPA and TILA violations, but *as a matter of federal law*, assignees are also liable for *state law* claims against the original lender.³⁸² This means that even if a state law claim does not provide for assignee liability, if the loan is a high-cost loan under HOEPA, the borrower can use federal law as a vehicle to assert the state law claim against the assignee anyway.³⁸³ Within the limited scope of HOEPA, this assignee liability rule provides a significant hedge on the harshness of state UCC holder in due course rules. Moreover, it is yet one more example of our long tradition of amalgamated federal and state consumer borrower protections.

378. 12 C.F.R. § 226.34(a)(1).

379. 15 U.S.C. § 1639(h).

380. *Id.* § 1641(e).

381. *Id.* § 1641(d) (providing for assignee liability unless the assignee "demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation required by this subchapter, the itemization of the amount financed, and other disclosure of disbursements that the mortgage was a [high-cost mortgage]"); *Mason v. Fieldston Mortgage Co.*, No. 00-C-0228, 2000 WL 1643589, *2 (N.D. Ill. Oct. 20, 2000).

382. Thus the language: "Any person who purchases . . . a [high-cost mortgage] shall be subject to *all claims and defenses* with respect to that mortgage that the consumer could assert against the creditor of the mortgage . . ." 15 U.S.C. § 1641(d)(1) (emphasis added). See also NATIONAL CONSUMER LAW CENTER, TRUTH IN LENDING § 9.7.5.1 (5th ed. 2003) ("Where assignees are found to be liable, they will be subject to the full range of claims which could have been asserted against the maker of the loan. This includes liability for the originator's unfair trade practices, fraud, consumer credit abuses, RICO violations, and any other claims which are supported by the facts of the case.").

383. The extent to which this provision encourages secondary market players to police originators' predatory lending is severely limited because damages made available through HOEPA's assignee liability rule are strictly capped. HOEPA-induced assignee liability for state law claims is limited to "the amount of all remaining indebtedness" and "the total amount paid by the consumer in connection with the transaction." 15 U.S.C. § 1641(d)(2)(B). This means that, under HOEPA's provision of assignee liability, whatever the practices engaged in by originators—no matter how bad—secondary market participants generally need not fear the large punitive damage claims which might provide the strongest incentive to police subprime originators. Assignee liability for violations of HOEPA itself (as opposed to other non-HOEPA claims asserted against assignees *through* HOEPA) are limited by the relatively insignificant statutory damages available under HOEPA: actual damages, plus up to \$2000 in statutory damages, and, where the violation was "material," special damages equal to the sum of all finance charges and fees paid by the consumer. 15 U.S.C. §§ 1640, 1641.

State governments have also come to use disclosure to address consumer credit problems, once again creating a mixed federalist legal environment. TILA preempts state law whenever it contradicts federal law.³⁸⁴ For example, the Federal Reserve Board has preempted a state statute requiring disclosure of an “annual percentage rate” in an amount different from that specified by federal law.³⁸⁵ Nevertheless, Congress has in the past made clear its intention that court interpretations of TILA should show deference to state law.³⁸⁶ Accordingly, many state laws enhancing federal disclosure rules are not preempted and remain in effect. For instance, while TILA makes an itemization of the amount financed optional,³⁸⁷ California has required this disclosure.³⁸⁸ Similarly, state plain language laws are not generally preempted, nor are laws requiring notice of consumer rights under state antidiscrimination or other consumer protection laws.³⁸⁹

Theoretically analogous to disclosure rules are initiatives which promote consumer financial education. Gaining in popularity in recent years, a variety of different types of education have been proposed.³⁹⁰ Some education programs target school-age children.³⁹¹ Others target the general adult population through advertising campaigns.³⁹² Some education programs are given as home ownership counseling for first-time home buyers.³⁹³ Some programs use one-on-one counseling while others use classroom presentations or even telephone counseling.³⁹⁴ Moreover, a controversial and long debated piece of bankruptcy

384. Regulation Z, 12 C.F.R. § 226.28(a)(1). The Federal Reserve Board has explained that the TILA contradiction standard is evaluated based on whether state laws “impede or interfere” with the purposes of federal law. Regulation Z, 48 Fed. Reg. 4454 (Feb. 1, 1983); 48 Fed. Reg. 20,725 (May 9, 1983). For a more detailed discussion of TILA preemption, see Nancy R. Wilsker, et al., *Relation to Other Law*, in RALPH J. ROHNER & FRED H. MILLER, *TRUTH IN LENDING* 935, 949 (Robert A. Cook et al., eds. 2000); Fred H. Miller, *The Problem of Preemption in Consumer Credit Regulation*, 3 OKLA. CITY U. L. REV. 529, 529-56 (1979); Barbara S. Leonard & Drew V. Tidwell, *Consumer Credit Regulation: Is Federal Preemption Necessary?*, 35 BUS. LAW. 1291 (1980); Fred H. Miller & Ralph J. Rohner, *In Search of a Uniform Policy—State and Federal Sources of Consumer Financial Services Law*, 37 BUS. LAW. 1415, 1433 (1982).

385. Federal Reserve Board Official Staff Commentary to Regulation Z, 55 Fed. Reg. 13103 (Apr. 9, 1990) (codified at 12 C.F.R. pt. 226).

386. S. REP. NO. 96-73 (1979), *reprinted in* 1980 U.S.C.A.N. 236, 280, 291 (explaining Congress’ intent to “show deference to the laws of the State”).

387. Regulation Z, 12 C.F.R. § 226.18(c).

388. CAL. CIV. CODE § 1803.3(c) (West 1998).

389. Federal Reserve Board Official Staff Commentary to Regulation Z, *supra* note 385, 12 C.F.R. pt. 226 supp. I ¶ 226.28(d)-3.

390. Jeanne M. Hogarth, *Financial Literacy and Family and Consumer Sciences*, 94 J. FAM. & CONSUMER SCI. 14 (2002).

391. Ben Jackson, *Programs Tout Financial Literacy for All Ages*, AM. BANKER, April 5, 2002, at 5.

392. *Id.*

393. Sissy R. Osteen, *Homebuyer Education: A Doorway to Financial Literacy*, 94 J. FAM. & CONSUMER SCI. 29, 29 (2002).

394. Abigail Hira & Peter M. Zorn, *A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling* 1-2 (May 22, 2001), at

legislation requires borrower education as a precondition for the discharge of a petitioner's debts.³⁹⁵ Like disclosure statutes, the hope is that more informed borrowers will make better borrowing decisions and, thus, be more resilient to predatory lending.

Education initiatives do highlight one of the principle weaknesses of price disclosure statutes. Although disclosure rules provide sophisticated shoppers an opportunity to discover home mortgage prices, many critics have complained that those most vulnerable to predatory lending are exactly those who are least likely to make use of disclosures.³⁹⁶ Predatory lenders target precisely those vulnerable populations who have difficulty effectively utilizing disclosed information.³⁹⁷ One recent study suggests nearly 90% of predatory home mortgage lending victims fail to comparison shop.³⁹⁸ Borrowers' age, education, literacy and math skills, non-native English speaking, lack of available options, and lack of access to shopping tools, such as reliable transportation or the Internet, are all factors that contribute to this problem.³⁹⁹ Because predatory mortgage lenders tend to target precisely those who do not make use of credit price disclosures, the legal strategy is least likely to assist those who need its protection most.

Beyond this general criticism are many troublesome details in the

<http://www.jchs.harvard.edu/publications/homeownership/liho01-4.pdf> (last visited Apr. 7, 2005).

395. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. §§ 106, 111 (2005). See also Jean Braucher, *Means Testing Consumer Bankruptcy: The Problem of Means*, 7 FORDHAM J. CORP. & FIN. L. 407, 411 (2002); Richard L. Stahl, *The Failings of the Credit Counseling and Debtor Education Requirements of the Proposed Consumer Bankruptcy Reform Legislation of 1998*, 7 AM. BANKR. INST. L. REV. 133, 158-59 (1999).

396. See Jeffrey Davis, *Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts*, 63 VA. L. REV. 841, 904-06 (1977) (recognizing the need to improve comprehension of disclosure statements among low-income consumers).

397. Steven W. Bender, *Consumer Protection for Latinos: Overcoming Language Fraud and English-Only in the Marketplace*, 45 AM. U. L. REV. 1027, 1034-36, 1044-45 (1996) (arguing the "Spanish-Only" consumer is a target of choice for predatory lenders); Michelle W. Lewis, *Perspectives on Predatory Lending: The Philadelphia Experience*, 12 J. HOUSING & COMMUNITY DEV. L. 491, 515 (2003) (noting that predatory lenders tend to focus their efforts on borrowers who do not understand the loan process and who cannot effectively utilize the information that is disclosed); Rick Brundrett, *"How Mounting Loans Devastated 87-Year-Old,"* THE STATE (Columbia, South Carolina), Feb. 24, 2002 at A1 (discussing an 87-year old man whose illiteracy made him a prime target for predatory lenders).

398. Lewis, *supra* note 397, at 500. Comments made to a journalist by a former branch manager with The Associates, a major subprime lender, are revealing in this regard:

[W]ith all the numbers and documents involved, it's easy for a loan officer to throw out some figures and say, 'I can save you \$25,000, isn't that great?' The loan officer nods his head up and down and makes eye contact. The bewildered customers nod their heads yes too. 'They'll be signing their lives away. . . .' It's not until too late that they suddenly realize, 'I have an \$800-a-month house payment.'

Michael Hudson, *"Signing Their Lives Away" – Ford Profits Big from Vulnerable Consumers*, in MERCHANTS OF MISERY: HOW CORPORATE AMERICA PROFITS FROM POVERTY 47 (Michael Hudson ed., 1996).

399. PETERSON, *supra* note 355, at 128-36.

implementation of disclosure rules. Initially, credit disclosures usually come too late.⁴⁰⁰ Regulations require lenders give standard TILA disclosures before or at consummation.⁴⁰¹ This allows lenders to deliver disclosures at closing where consumers are often psychologically or financially committed to the loan and unlikely to back out of the deal or even read the disclosures.⁴⁰² Consumers must also frequently pay a fee before they receive any disclosures at all, outweighing incentives to use disclosures to shop for the best deal.⁴⁰³ Furthermore, disclosures contain a great deal of complex information, making them difficult for even well educated consumers to digest, and nearly impossible for those with literacy problems.⁴⁰⁴ Complex contract provisions can also provide creditors a plausible threat of enforcement sufficient to coerce repayment from uninformed borrowers who typically lack access to legal representation.⁴⁰⁵

TILA rules do a poor job of imparting information on contract provisions that may seem ancillary to consumers, but which may greatly effect the price of the loan. For instance, because TILA does not usually require disclosure of credit insurance as a finance charge, consumers do not have the benefit of an annual percentage rate disclosure reflective of the cost of the insurance premium. TILA treats credit insurance premiums as a finance charge only where the lender requires the insurance.⁴⁰⁶ For this reason, the great majority of lenders treat credit insurance as optional. But predatory lenders tend to lead consumers to believe the insurance is necessary, or to omit any mention of the insurance at all, then slipping a form for the consumer to initial into a stack of documents at closing.

But even the most fundamental consumer credit disclosures, which we would expect to be relatively simple, are currently problematic. Particularly in the subprime home mortgage market, TILA finance charge and annual percentage rate ("APR") disclosures can be both nonuniform and misleading. Regulation Z provides numerous exceptions allowing creditors to exclude many

400. Jonathan M. Landers & Ralph J. Rohner, *A Functional Analysis of Truth in Lending*, 26 UCLA L. REV. 711, 715-16 (1979).

401. Regulation Z, 12 C.F.R. § 226.17(b).

402. BOARD OF GOVERNORS OF THE FED. RESERVE SYS. & U.S. DEP'T OF HOUSING & URBAN DEV., JOINT REPORT TO THE CONGRESS CONCERNING REFORM TO THE TRUTH IN LENDING ACT AND THE REAL ESTATE SETTLEMENT AND PROCEDURES ACT 40 (July 1998), available at <http://www.federalreserve.gov/boarddocs/RptCongress/tila.pdf> (last visited Apr. 5, 2005) [hereinafter FED. & HUD JOINT REPORT ON TILA AND RESPA REFORM]; William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1128-29 (1984); Landers & Rohner, *supra* note 400, at 715-16.

403. FED. & HUD JOINT REPORT ON TILA AND RESPA REFORM, *supra* note 402, at II.

404. Davis, *supra* note 396, at 906; Eskridge, *supra* note 402, at 1133-34; Kathleen E. Keest, *Whither Now? Truth in Lending in Transition – Again*, 49 CONSUMER FIN. L. Q. REP. 360, 366 (1995);

405. PETERSON, *supra* note 355, at 128-29. Judicial interpretation of contracts creates an incentive for lenders to include provisions protecting themselves in every possible circumstance. This in turn creates a large "information load" burdening credit shoppers. Davis, *supra* note 396, at 904.

406. Regulation Z, 12 C.F.R. § 226.4(d)(1).

settlement costs from the finance charge.⁴⁰⁷ The regulations allow lenders to exclude from the finance charge fees for title examination, abstract of title, title insurance, property survey, document preparation, notary services, credit reports, appraisals, pest inspections, flood hazard determinations, security interest filing, and non-filing insurance.⁴⁰⁸ The difficulty of comparing these charges creates an incentive for lenders to pack fees in these categories rather than charging traditional interest.⁴⁰⁹

Moreover, RESPA provisions inconveniently overlap with TILA disclosures. The two acts require separate disclosures for the same transaction, one dealing with settlement costs and the other dealing with financing. Because consumers finance many settlement costs, they (as well as some advocates) find it confusing to have the two treated separately.⁴¹⁰ Moreover, RESPA disclosures themselves have serious problems. Consumer advocates complain that lenders do not provide the HUD informational booklet when required.⁴¹¹ Ironically, RESPA does not require lenders to provide the booklet at all in refinance loans, where consumers are often subject to the worst predatory lending abuses.⁴¹² Furthermore, consumers who purchase manufactured homes for use on leased plots in trailer parks do not receive RESPA disclosures because the Act only governs home loans secured by residential real property.⁴¹³ This is despite the fact that these are precisely the consumers who are among the most vulnerable.⁴¹⁴ With respect to RESPA's good faith estimate of settlement costs, federal law provides little guidance on the required accuracy of good faith estimates and does not provide any liability for even dramatically inaccurate estimates.⁴¹⁵ When time between application and closing is less than three days, the good faith estimate is often thrown in with a stack of other documents.⁴¹⁶ In these cases, consumers have no federally required pre-closing notice or warning of potentially devastating settlement or loan costs. Finally, RESPA also does not provide any liability for errors in the final settlement statement given at

407. *Id.* §§ 226.4(c) & (d).

408. *Id.*

409. Keest, *supra* note 404, at 364.

410. FED. & HUD JOINT REPORT ON TILA AND RESPA REFORM, *supra* note 402, at 78.

411. See Eloisa C. Rodriguez-Dod, *RESPA—Questioning Its Effectiveness*, 24 HAMLINE L. REV. 68, 74-75 (2000) (noting that borrowers usually don't receive the informational booklet until closing).

412. See FED. & HUD JOINT REPORT ON TILA AND RESPA REFORM, *supra* note 402, at 39 (noting that informational booklet only provided for home purchase loans).

413. *Id.* at 78.

414. See *supra* notes 47-67 and accompanying text for a discussion of the consumer groups frequently targeted by predatory lenders.

415. Estimates need only bear a "reasonable" relationship to the borrower's actual costs. Some courts have allowed borrowers to pursue suits under state Unfair and Deceptive Acts and Practices statutes for disparities between a good faith estimate and actual closing costs paid. See *Brophy v. Chase Manhattan Mortgage Co.*, 947 F. Supp. 879, 880 (E.D. Pa. 1996) (dismissing borrowers' claim under Pennsylvania Unfair Trade Practices and Consumer Protection Law for misrepresentation of mortgage fees).

416. KEEST, NCLC, COST OF CREDIT, *supra* note 189, at 507.

closing, weakening any incentives for accuracy.⁴¹⁷

HOEPA, although an improvement on TILA and RESPA alone, is also not up to the task of preventing predatory home mortgage lending. Initially, the scope of HOEPA has thus far proven too narrow. The Act does not include many of the most abusive costs associated with predatory mortgages in calculating either of HOEPA's price threshold triggers. For instance, mortgage lenders commonly exclude yield spread premiums from calculation of the HOEPA points and fees trigger.⁴¹⁸ This allows lenders and brokers to charge thousands of dollars above HOEPA thresholds and still avoid any enhanced disclosure. Furthermore, HOEPA only applies to non-purchase money closed-end home-secured mortgages.⁴¹⁹ First time home buyers are never protected.⁴²⁰ Additionally, consumer advocates complain that predatory lenders often structure high-cost loans as open-ended revolving home equity lines in order to evade HOEPA.⁴²¹ Although recent Federal Reserve Board regulatory changes may have improved the situation, historically HOEPA has covered less than *less than one percent* of all home mortgages.⁴²²

In general, even where disclosure laws provide useful information, lenders may lack a strong incentive to comply with the rules because consumers have chronic difficulty in obtaining legal representation. Home mortgage lending cases are notoriously complex and time consuming.⁴²³ For many legal aid offices the opportunity costs in representation not provided on other pressing (and less difficult) legal problems are too great to devote significant resources to predatory home mortgage lending cases.⁴²⁴ Consumer attorneys acting as solo practitioners and in small firms often find they cannot profitably represent victims of predatory lending because of parsimonious attorney fee awards, costly discovery, and the long duration of mortgage loan cases. Moreover, many victims of predatory lending have trouble distinguishing trustworthy legal counsel from many expensive lender-oriented credit counselors and foreclosure consultants that provide costly services of dubious value, often under the cynical

417. Engel & McCoy, *supra* note 190, at 1306.

418. For a description of yield spread premiums see *supra* notes 74-76 and *infra* notes 615-19 and accompanying text.

419. 12 C.F.R. §§ 226.32(a)(2)(i), 226.2(a)(24).

420. See 12 C.F.R. §§ 226.32(a)(2)(i), 226.2(a)(24) (excluding residential mortgage transactions from coverage).

421. Transcript of the Federal Reserve Board Public Hearing on Home Equity Lending, at 26-27 (Aug. 16, 2000) (statement of Michelle Weinberg, Horwitz, Horwitz, & Assoc.) (stating lender structured a \$13,000 home improvement loan as line of credit with \$75,000 available in order to charge \$5,900 in broker fees), available at <http://www.federalreserve.gov/events/publichearings/20000816/20000816am.htm> (last visited Apr. 5, 2005).

422. *Id.* at 12 (citing statement of William Darr).

423. Cynthia Vinarsky, *Youngstown, Ohio, Program Helps Homeowners Victimized by Predatory Lenders*, KNIGHT-RIDDER TRIBUNE BUS. NEWS, Apr. 14, 2002.

424. See Mary Meehan, *Predatory Lending Increasing in State: Poorly Educated, Minorities, Elderly Targeted for Loans*, LEXINGTON HERALD-LEADER, June 20, 2002, at B1 (noting how lawyers are often unable to help victims of predatory lending once the loan documents are signed).

rubric of tax-exempt “not for profit” labels.⁴²⁵ While education and counseling programs offered by many credit counseling agencies have become rife with fraud and consumer abuse, they also aggressively lure consumers away from more reliable sources of information and counseling.⁴²⁶ Similarly, consumers often only turn to an attorney immediately before foreclosure, when representation may be too late to help them save their home.

Although most would agree a consumer is better served by a solid education in personal finance than by price disclosures, it is much less clear that education programs make for better policy. Education programs are notoriously expensive and difficult to target at the right individuals.⁴²⁷ Including financial education in elementary and high school curriculums is costly and may only be feasible by confronting difficult zero sum choices, such as de-emphasizing science, history, foreign languages, physical education, or the arts.⁴²⁸ When many strapped school districts around the country are shortening the school year in order to save money, there is bound to be resistance to adding to the educational load. Furthermore, the nation’s public education system has struggled to teach students basic math or even how to read at all, let alone how to understand mortgage lending documents.⁴²⁹ Moreover, school programs do nothing for those already at risk, such as the soon-to-retire baby boom generation. Advertising campaigns tend to be unfocused and short-lived. Additionally, empirical evidence suggests real results require a significant commitment of time and attention.⁴³⁰ Some community education programs are promising, but simply too few and far between.⁴³¹ Finally, the use of education as a prerequisite to discharge of debts in bankruptcy comes years too late and is probably more likely to operate as a hurdle in the way of those seeking a fresh start, rather than as a prophylactic to prevent credit problems before they start.⁴³² Ultimately, in the absence of a radical expansion of disclosure law or

425. See, e.g., Christopher Quay, *IRS Files \$ 15 Million Claim Against Credit-Counseling Agency*, 104 TAX NOTES 1361, 1361 (Sept. 20, 2004) (noting that “[t]he IRS has intensified its crackdown on credit-counseling agencies. . . .”); Caroline E. Mayer, *IRS Memo Faults Credit Counselors: Chief Counsel Finds Abuse of Nonprofit Tax-Exempt Status*, WASH. POST, Aug. 4, 2004, at E03 (“Laying out its legal analysis of credit-counseling agencies, the memo said: ‘They are not providing any meaningful education or relief of the poor,’ as would be required for the tax exemptions many are currently receiving.”).

426. PETERSON, *supra* note 355, at 151-52.

427. Hogarth, *supra* note 390 (“The major difficulty seems to be in bringing people, programs, and resources together in a timely and meaningful way.”).

428. Valerie Strauss, *Schools Investing in Fiscal Literacy; Credit Unions Help Students Learn Finance*, WASH. POST, Feb. 17, 2004, at A12.

429. Martin Crutsinger, *Better Math Education Needed: Greenspan*, CHI. SUN-TIMES, Feb. 6, 2002, at 53.

430. Hirad & Zorn, *supra* note 394, at 17-18 (empirical study showing no statistically significant reduction in borrower delinquency from pre-transactional telephone counseling).

431. See Jason Roberson, *Programs Help Risky Borrowers*, DAYTON DAILY NEWS, Mar. 3, 2002, at 1F (discussing different credit counseling services).

432. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. §§ 106, 111 (2005). Stehl, *supra* note 395, at 158-60.

education and counseling programs, it is unlikely that these legal strategies will effectively address the social problem of predatory home mortgage lending.⁴³³

With the wide breadth of traditional consumer protection remedies and theories available one might expect consumers to be well protected from predatory home mortgage lending.⁴³⁴ But the reality is disappointing. The broad and complex patchwork of law applicable to predatory mortgage lending is a mixed-federalist net with many holes.⁴³⁵ Even apologists for existing law agree that this traditional legal fabric suffers from a lack of enforcement.⁴³⁶ While scrupulous lenders, consumer advocates, and courts alike struggle with the law, aggressive predatory lenders have learned to specialize in finding and exploiting these gaps in content and enforcement. Other companies having more benevolent intentions gradually stumble into predatory practices as they attempt to squeeze more and more profit out of borrowers in a competitive marketplace. The bottom line is that each of the strategies discussed so far, even when considered collectively, suffer from significant drawbacks that leave many borrowers unprotected.

IV. EMERGING STATE AND LOCAL RESPONSE TO THE INADEQUACY OF EXISTING LAW

The constant drumbeat of foreclosures and consumer bankruptcies in recent years highlights the lack of successful strategies to prevent predatory mortgage lending. It should not be surprising that this trend increases pressure on many state legislatures to pass new legislation addressing predatory home mortgage lending. Following in the wake of disappointment over the narrow scope of the federal Home Ownership and Equity Protection Act ("HOEPA"), many state legislatures have begun crafting predatory lending statutes aimed at better protecting their citizens.⁴³⁷ The past five years have seen an eruption in state and local legislative activity attempting to respond to predatory home mortgage

433. A dramatic update and expansion of disclosure law may nevertheless be advisable. Elsewhere I have discussed at length what such reforms might look like. PETERSON, *supra* note 355, at 242-317. Disclosure law does have the not insignificant advantage of being ideologically palatable to a broad range of viewpoints.

434. GOODWIN PROCTER LLP, STATE LAWS PROTECTING CONSUMERS FROM ABUSIVE AND PREDATORY LENDING PRACTICES: PREPARED FOR THE MORTGAGE BANKERS ASSOCIATION OF AMERICA AND THE CONSUMER MORTGAGE COALITION 65 (2001) (arguing existing state laws create adequate "platform" for eradicating predatory lending), available at http://www.mbaa.org/industry/reports/01/goodwin_0720.pdf (last visited Apr. 5, 2005).

435. See Richard R. Daugherty, *Will North Carolina's Predatory Home Lending Act Protect Borrowers from the Vulnerability Caused by the Inadequacy of Federal Law?* 4 N.C. BANKING INST. 569, 576-77 (2000) (noting how federal laws have been "layered upon each other to cover gaps that allowed unfair lending practices to occur").

436. GOODWIN PROCTOR, *supra* note 434, at 65 ("Taken together, the statutory and common law platform already exists to eradicate predatory lending. Only lack of enforcement, and not insufficiency or inadequacy of the laws themselves, prevents their effectiveness.").

437. MARGOT SAUNDERS & ALYS COHEN, FEDERAL REGULATION OF CONSUMER CREDIT: THE CAUSE OR THE CURE FOR PREDATORY LENDING? 12 (Harvard University Joint Center for Housing Studies Working Paper No. BABC Apr. 21, 2004).

lending.

North Carolina is generally recognized to have led this trend. The North Carolina Legislature patterned its Predatory Lending Act of 1999⁴³⁸ on the hybrid approach taken by Congress in HOEPA.⁴³⁹ After a carefully negotiated legislative process, the North Carolina law addressed the various predatory contract terms and practices associated with a variety of detailed rules. The Act employs specific contractual restrictions by prohibiting financing of single premium credit insurance⁴⁴⁰ and prepayment penalties on first-lien mortgages of less than \$150,000.⁴⁴¹ In an attempt to prevent flipping, the Act also includes a standard, roughly analogous to substantive unconscionability, which prohibits lenders from refinancing an existing loan where no “tangible net benefit” accrues to a borrower.⁴⁴² Like HOEPA, the North Carolina Predatory Lending Act has two price threshold triggers that define “high-cost” home mortgages.⁴⁴³ Generally, high-cost home mortgages have points or fees in excess of five percent of the total loan amount⁴⁴⁴ or have interest rates more than 10% above comparable term U.S. Treasury Securities.⁴⁴⁵ Because the federal Act sets its points and fees trigger at 8% of the loan amount, the North Carolina legislature crafted its statute to include many more loans than the federal statute. For these high-cost loans, the statute prohibits a variety of contract restrictions including call provisions,⁴⁴⁶ balloon payments,⁴⁴⁷ negative amortization,⁴⁴⁸ penalty interest rates,⁴⁴⁹ and lenders generally may not finance prepayment penalties from a

438. Act to Prohibit Predatory Lending, 1999 N.C. Sess. Laws 332 (codified at N.C. GEN. STAT. § 24-1.1A-10.2 (2003)).

439. Donald C. Lampe, *Wrong from the Start? North Carolina's "Predatory Lending" Law and the Practice vs. Product Debate*, 7 CHAP. L. REV. 135, 138-39 (2004) [hereinafter, Lampe, *Wrong from the Start*] (taking a critical view of the N.C. statute); SAUNDERS & COHEN, *supra* note 437, at 12 (discussing coverage of N.C. statute).

440. N.C. GEN. STAT. § 24-10.2(b) (2003).

441. *Id.* § 24-1.1A(b)(1)(i).

442. *Id.* § 24-10.2(c). Lenders are also precluded from recommending or encouraging default on an existing loan in connection with the closing or planned closing of another loan that refinances all or a portion of the original loan. *Id.* § 24-10.2(d).

443. *Id.* § 24-1.1E(a)(4)(e).

444. N.C. GEN. STAT. § 24-1.1E(a)(6)(b)(i).

445. *Id.* § 24-1.1E(a)(6)(a). The North Carolina APR trigger merely incorporates the federal HOEPA APR trigger. *Id.* At the time the North Carolina legislature adopted the statute, the federal APR trigger was ten percent. Subsequently the Federal Reserve Board modified federal regulations to lower the APR trigger to eight percent on first lien mortgages, which had the effect of also lowering the North Carolina trigger.

446. *Id.* § 24-1.1E(b)(1) (“No high-cost home loan may contain a provision which permits the lender, in its sole discretion, to accelerate the indebtedness.”).

447. *Id.* § 24-1.1E(b)(2) (“No high-cost home loan may contain a scheduled payment that is more than twice as large as the average of earlier scheduled payments.”).

448. N.C. GEN. STAT. § 24-1.1E(b)(3) (“No high-cost home loan may contain a payment schedule with regular periodic payments that cause the principal balance to increase.”).

449. *Id.* § 24-1.1E(b)(4) (“No high-cost home loan may contain a provision which increases the interest rate after default.”).

previous loan.⁴⁵⁰ The Act precludes lenders from making a high-cost loan without due regard to the borrower's repayment ability.⁴⁵¹ The North Carolina statute also prohibits financing of yield spread premiums in high-cost loans by prohibiting financing of any charge payable to a third party.⁴⁵² The Act builds a bridge between its contract restricting provisions and anti-deception law by explicitly defining violations of the Act as unfair and deceptive trade practices under the North Carolina Unfair and Deceptive Acts or Practices ("UDAP") law.⁴⁵³ Finally, the Act employs a disclosure and consumer education component by requiring that would-be borrowers of high-cost home mortgages receive financial counseling before entering into the transaction.⁴⁵⁴

In general, the lending industry has aggressively opposed the North Carolina law as well as the many other state and local laws that have followed it. In particular, industry advocates have complained that the administrative and compliance costs imposed by these predatory lending statutes are too severe. Taking reactions to the North Carolina Predatory Lending Act as an example, lenders complained that it requires calculation of the points and fees threshold trigger differently than under HOEPA, causing needless compliance costs.⁴⁵⁵ Lenders were also critical of the potential for open-ended liability under standards requiring a tangible net benefit to borrowers. Many lenders threatened to pull out of North Carolina during the legislative debate over the Act, and a few firms actually did.⁴⁵⁶ Lenders furthermore assert that the statute has acted as a de facto usury law because "no compliance oriented lender doing business in North Carolina is (knowingly) making loans with costs high enough to trigger the additional restrictions imposed by [the act]."⁴⁵⁷ A lending industry-funded study found that the number of subprime loan originations in North Carolina declined after passage of the Act by about 14%.⁴⁵⁸ Collectively, lenders complain that the new predatory lending laws have erected a "Tower of

450. *Id.* § 24-1.1E(c)(3)(a).

451. *Id.* § 24-1.1E(c)(2).

452. *Id.* § 24-1.1E(c)(3)(c).

453. N.C. GEN. STAT. § 24-1.1E(d).

454. *Id.* § 24-1.1E(c)(1) ("A lender may not make a high-cost home loan without first receiving certification from a counselor approved by the North Carolina Housing Finance Agency that the borrower has received counseling on the advisability of the loan transaction and the appropriate loan for the borrower.").

455. Lampe, *Wrong from the Start*, *supra* note 439, at 140-41, 148, 151. For instance, the North Carolina statute requires lenders to include "[t]he maximum prepayment fees and penalties which may be charged or collected under the terms of the loan documents" in calculating the points and fees trigger. N.C. GEN. STAT. § 24-1.1E(a)(5)(a)(4).

456. David Boraks, *B of A: Subprime is Not Worth the Trouble; Bank of America to Stop Writing Auto Leases and Subprime Mortgages*, AM. BANKER Aug. 16, 2001, at 1 (noting Bank of America and Countrywide Credit Industries of Calabasas, Calif., stopped making subprime mortgages in North Carolina due at least in part to the statute).

457. Lampe, *Wrong from the Start*, *supra* note 439, at 144.

458. GREGORY ELLIEHAUSEN & MICHAEL STATEN, REGULATION OF SUBPRIME MORTGAGE PRODUCTS: AN ANALYSIS OF NORTH CAROLINA'S PREDATORY LENDING LAW 14-15 (Georgetown Univ. Credit Research Ctr. Working Paper No. 66, 2002).

Babel” for multi-state residential mortgage lenders, which threatens to choke off the flow of legitimate capital from national sources to local originators.⁴⁵⁹

Supporters of state predatory lending laws offer many equally compelling responses. For instance, consumer advocates respond that threats of lenders leaving the North Carolina after passage of the Act were largely exaggerated, given that North Carolina continued to rank sixth out of all the states and the District of Columbia in the share of all home loans that were subprime.⁴⁶⁰ Moreover, to the extent that the volume of subprime credit decreased, supporters of the Act argue this simply reflected a decline in precisely those predatory loans which consumers were better off without anyway.⁴⁶¹ The Center for Responsible Lending similarly estimated that the statute saved consumers more than \$100 million in the year 2000 alone by preventing predatory terms in subprime loans.⁴⁶² In response to the argument that nonuniform regulations unnecessarily increase compliance costs, consumer advocates often point to the weakness of federal law. For instance, supporters of the North Carolina legislation defend its different price trigger regulations by asserting they were necessary to prevent lenders from exploiting glaring loopholes in federal regulations.⁴⁶³

While a resolution of this controversy is beyond the scope of this Article, what is clear is that other state and local governments widely modeled the North Carolina Predatory Lending Act. The North Carolina statute was only the first in a wave of similar legislation around the country in the next three years. Municipal governments including Chicago,⁴⁶⁴ the District of Columbia,⁴⁶⁵ Philadelphia,⁴⁶⁶ Dayton,⁴⁶⁷ Atlanta,⁴⁶⁸ Oakland,⁴⁶⁹ Cleveland,⁴⁷⁰ Toledo,⁴⁷¹ and

459. Lampe, *Wrong from the Start*, *supra* note 439, at 148, 151, 154.

460. KEITH ERNST ET AL., NORTH CAROLINA'S SUBPRIME HOME LOAN MARKET AFTER PREDATORY LENDING REFORM: A REPORT FROM THE CENTER FOR RESPONSIBLE LENDING 3-4 (2002).

461. ROBERTO G. QUERCIA ET AL., THE IMPACT OF NORTH CAROLINA'S ANTI-PREDATORY LENDING LAW: A DESCRIPTIVE ASSESSMENT, Center for Community Capitalism, University of North Carolina at Chapel Hill 22 (2003) (arguing that the decline in subprime loans “is largely due to a decrease in the number of loans with abusive characteristics.”)

462. ERNST ET AL., *supra* note 460, at 8-9.

463. See Richard R. Daugherty, *Will North Carolina's Predatory Home Lending Act Protect Borrowers from the Vulnerability Caused by the Inadequacy of Federal Law?*, 4 N.C. BANKING INST. 569, 604 (2000) (noting that the North Carolina Act is a “critical step in encouraging more responsible lending practices and it addresses several gaps in the federal law”).

464. CHICAGO, ILL., CHICAGO MUNICIPAL CODE §§ 2-32-455, 2-92-325, 4-4-155, 8-4-325 (2004).

465. Protection from Predatory Lending and Mortgage Foreclosure Improvements Act of 2002, 48 D.C. Reg. 3505 (2001).

466. PHILADELPHIA, PA., PROHIBITION AGAINST PREDATORY LENDING, PHILADELPHIA CODE §§ 9-2400 to 9-2408 (Apr. 9, 2001). See also Leonard A. Bernstein, *Philadelphia's New “Predatory Lending” Law: What Every Lender Must Know*, 118 BANKING L.J. 445, 447-57 (2001) (summarizing key provisions).

467. DAYTON, OH., ORDINANCE 29990-01 (July 11, 2001) (codified at REV. CODE OF GEN. ORDINANCES §§ 112.40-.44).

468. ATLANTA, GA., ORDINANCE 01-O-0843 (June 6, 2001) (codified at CODE OF ORDINANCES §§ 58-100 to -102).

Los Angeles⁴⁷² all passed ordinances roughly modeled on the North Carolina statute. However, litigation seeking injunctions against enforcement, as well as subsequent efforts by state legislatures to explicitly preempt ordinances, have often hamstrung local ordinances.⁴⁷³ For instance, Philadelphia passed a tough law only to spur a controversial and heated debate in the Pennsylvania legislature that ultimately preempted the ordinance, replacing it with far weaker state provisions.⁴⁷⁴ Dayton, Ohio has had similar experiences.⁴⁷⁵

Nevertheless, the success of the North Carolina statute, local pressure, and the American Association of Retired Persons' publishing and promotion of influential model legislation, have created a legislative climate many state legislatures have been unable to ignore.⁴⁷⁶ Indiana,⁴⁷⁷ New Jersey,⁴⁷⁸ New

469. OAKLAND, CA., ORDINANCE 12361 C.M.S. (Oct. 2, 2001).

470. CLEVELAND, OH., ORDINANCE 737-02 (Mar. 4, 2002), *amended at* Ordinance 45-03 (Apr. 22, 2002). *See generally* Stephen F.J. Ornstein & Mathew S. Yoon, *Amendments to the City of Cleveland Predatory Lending Ordinance*, 57 CONSUMER FIN. L.Q. REP. 183 (2003) (summarizing key provisions).

471. TOLEDO, OH., ANTI-PREDATORY LENDING ORDINANCE 291-02 (Nov. 5, 2002). *See generally* Stephen F.J. Ornstein & Mathew S. Yoon, *The City of Toledo Anti-Predatory Lending Ordinance*, 56 CONSUMER FIN. L.Q. REP. 327 (2002) (summarizing key provisions).

472. LOS ANGELES, CAL., CAL. FIN. CODE DIVISION §§ 1.6 *et seq.* (Dec. 18, 2002). *See generally* Stephen F.J. Ornstein & Mathew S. Yoon, *The City of Los Angeles Anti-Predatory Lending Ordinance*, 56 CONSUMER FIN. L.Q. REP. 318 (2002) (summarizing key provisions).

473. Donald C. Lampe, *Predatory Lending Initiatives, Legislation and Litigation: Federal Regulation, State Law and Preemption*, 56 CONSUMER FIN. L.Q. REP. 78, 83 (2002) [hereinafter Lampe, *Predatory Lending*]; Mike Sorohan, *Predatory Lending Ordinances Shot Down*, REAL EST. FIN. TODAY, November 12, 2001, at 5, [hereinafter Sorohan, *Predatory Lending*], available at 2001 WL 8193546.

474. Compare Jonathan L. Levin, *Complying With the New Pennsylvania Subprime Lending Law*, 56 CONSUMER FIN. L.Q. REP. 107, 107 (2002) (providing positive view of state preemption) with Kimm Tynan, Note, *Pennsylvania Welcomes Predatory Lenders: Pennsylvania's Act 55 Preempts Philadelphia's Tough Ordinance But Provides Little Protection for Vulnerable Borrowers*, 34 RUTGERS L.J. 837, 837 (2003) (criticizing state preemption).

475. Sorohan, *Predatory Lending*, *supra* note 473, at 5. One Dayton, Ohio paper gave the following explanation of Ohio predatory lending politics:

Legislators were awakened from their slumber when lenders became nervous about Ohio's cities. With Dayton City Commissioner Dean Lovelace in the vanguard, urban centers became so fed up with predatory lending, they moved to fix the problem themselves, through tough local ordinances. That got the lending industry to work. State representatives were the first to be brought to heel. One experienced legislator called it a "razzle-dazzle, ram it through job" by lobbyists. The goal was to put emergency brakes on local lending legislation, such as Dayton's ordinance.

Predatory Lending Bill Scams Public, DAYTON DAILY NEWS, Jan. 25 2002, at 10A. *See also* Julie Carr Smyth, *State Bill on Predatory Lending Laws Spurs Protest*, PLAIN DEALER (Cleveland, Oh.), Jan. 24, 2002, at C1 ("Dozens of Cleveland area protestors, including four members of Cleveland City Council, descended on the Statehouse yesterday to protest a bill that would block Ohio cities from passing local laws on predatory lending."), available at 2002 WL 6357770.

476. Mike Sorohan, *AARP Predatory Model Gains Clout*, REAL ESTATE FIN. TODAY, March 11, 2002, at 6, available at 2002 WL 10349762; AARP, HOME LOAN PROTECTION ACT: A MODEL STATE STATUTE (Nov. 2001), available at http://research.aarp.org/consume/d17346_loan.html (last visited Mar. 21, 2005).

Mexico,⁴⁷⁹ New York,⁴⁸⁰ and Massachusetts⁴⁸¹ have all adopted strong predatory lending laws echoing the North Carolina approach. In 2002, the Georgia legislature passed the nation's most aggressive predatory lending law,⁴⁸² only to repeal it after much controversy, eventually replacing it with a much weaker statute.⁴⁸³ Some states have passed laws that consumer advocates argue only mimic pre-existing federal protections and are no more than cosmetic efforts intended to forestall meaningful protections.⁴⁸⁴ These states include Colorado,⁴⁸⁵ Connecticut,⁴⁸⁶ Florida,⁴⁸⁷ Kentucky, Maryland, Michigan,⁴⁸⁸ Ohio,⁴⁸⁹ Pennsylvania,⁴⁹⁰ and Utah.⁴⁹¹ Other states, including Arkansas,⁴⁹² California,⁴⁹³

477. IND. CODE §§ 24-9-4-1 to 24-9-4 (West Supp. 2004).

478. N.J. STAT. ANN. §§ 46:10B-22, 46:10B-26, 46:10B-27 (West Supp. 2005). See Baher Azmy & David Reiss, *Modeling a Response to Predatory Lending: The New Jersey Home Ownership Security Act of 2002*, 35 RUTGERS L.J. 645, 649 (2004) (noting that New Jersey's Home Ownership Security Act was in response to the problem of predatory lending); Robert M. Jaworski, *New Jersey Jumps on the Anti-Predatory Lending Bandwagon*, 56 CONSUMER FIN. L.Q. REP. 324, 326 (2002) (providing critical summary of N.J. statute); Richard F. DeMong, *The Impact of the New Jersey Home Ownership Security Act of 2002* (March 26, 2004) (unpublished manuscript on file with author) (discussing survey of New Jersey mortgage lenders showing decline in certain types of subprime lending within New Jersey).

479. N.M. STAT. ANN. §§ 58-21A-1 to 58-21A-14 (Michie Supp. 2003).

480. N.Y. BANKING LAW § 6-L (McKinney 2003). The New York Banking Board initially adopted anti-predatory lending regulation in October of 2000. See Marc J. Lifset & Geoffrey C. Rogers, *The New York Part 41 Predatory Lending Rules and Remedies*, 56 CONSUMER FIN. L.Q. REP. 87, 87 (2002) (noting that New York Part 41 was intended to "curb predatory lending practices"). See generally Stephen F.J. Ornstein, *New York State Banking Department Final Regulation Part 41 Restriction and Limitations on High-Cost Home Loans*, 55 CONSUMER FIN. L.Q. R. 93 (2001) (discussing the major provisions of New York's predatory lending law). The regulation has subsequently been superseded by a strong statute. Robert M. Jaworski, *Anti-Predatory Lending Efforts Continue in New York*, 56 CONSUMER FIN. L.Q. REP. 309, 309 (2002).

481. An Act Prohibiting Certain Practices in Home Mortgage Lending, 2004 Mass. Acts, ch. 258.

482. 2002 Ga. Laws 488.

483. 2003 Ga. Laws Act 1; Tucker Barr, *Development, Banking and Finance*, 20 GA. ST. U. L. REV. 1, 2 (2003) (citing Don Reichardt, *Back in Business: Gov. Sonny Perdue Has Signed a New Predatory Lending Act*, ATL. BUS. CHRON., Mar. 17, 2003).

484. See Lampe, *supra* note 473, at 83 (noting that consumer advocates often dislike state legislation modeled after HOEPA); Elizabeth Renuart, *Toward One Competitive and Fair Mortgage Market: Suggested Reforms in a Tale of Three Markets Point in the Right Direction*, 82 TEX. L. REV. 421, 422 (2003) (suggesting that some states' laws will have little effect on predatory lending).

485. COLO. REV. STAT. §§ 5-3.5-101 TO 5-3.5-104 (2004).

486. CONN. GEN. STAT. ANN. §§ 36a-746-747, 36a-746-754 (West 2004).

487. FLA. STAT. ANN. §§ 494.0078 to 494.00797 (West 2005).

488. MICH. COMP. LAWS ANN. §§ 445, 1631-1645 (West Supp. 2004). The Michigan law preempts local regulation, does not contain a private right of action, does not contain price thresholds which trigger enhanced disclosure or contract restrictions, and does not include assignee liability provisions. Stephen F.J. Ornstein & Mathew S. Yoon, *The Michigan Consumer Mortgage Protection Act*, 56 CONSUMER FIN. L. Q. REP. 305, 305 (2002).

489. OHIO REV. CODE ANN. §§ 1349.25 to 1349.39 (2002).

490. 63 PA. CONS. STAT. ANN. §§ 456.501 to 456.524 (2004).

491. UTAH CODE ANN. §§ 61-2d-101 to 61-2d-114 (2004).

492. ARK. CODE ANN. §§ 25-53-101 to 25-53-106 (Michie 2004).

Idaho,⁴⁹⁴ Illinois,⁴⁹⁵ Texas,⁴⁹⁶ and Wisconsin⁴⁹⁷ currently fall somewhere in between.⁴⁹⁸ Collectively, the result has been one of the most dynamic and experimental periods in consumer home finance law in the past generation.

What is simply beyond dispute is that the experience has been a classic example of state governments acting as laboratories of our democracy.⁴⁹⁹ While industry critics may be correct in pointing out the costs of allowing different regulations in different jurisdictions, those costs are part of the price of federalism. One comparative government text explains that:

[Our federal system is] a compromise, and like all compromises tends to have built-in disadvantages. Federal countries have to maintain at great expense a disproportionately large army of politicians, manning federal and regional governments and legislatures, the general administration tends to be slow, cumbersome and expensive, and the checks and balances which are provided to protect the interests of the constituent regions or states are liable to frustrate effective and decisive government.⁵⁰⁰

To this list of disadvantages of state policymaking, today's financial industry leaders might add the necessity of employing a host of lawyers to comply with state predatory lending laws.

But the founders built so costly a system of government for sound reasons. One New York opponent of an unrestricted national government, writing in

493. CAL. FIN. CODE §§ 4970 to 4979.7 (West 2004).

494. IDAHO CODE §§ 26-3101 to 26-3117 (Michie 2004). *See also* Stephen F.J. Ornstein & Mathew S. Yoon, *Idaho House Bill 28*, 57 CONSUMER FIN. L.Q. REP. 149, 149-53 (2003) (summarizing legislation).

495. 815 ILL. COMP. STAT. §§ 137/1 to 137/175 (2004).

496. TEX. FIN. CODE §§ 343.001 to 343.205 (2004); Julie R. Caggiano & Lawrence A. Young, *Texas Legislation—New Disclosure for Home Loans With an Interest Rate of 12 Percent or Greater*, 56 CONSUMER FIN. L.Q. REP. 110, 110-11 (2002); Robert R. Wisner, *New Texas Predatory Lending Law*, 56 CONSUMER FIN. L.Q. REP. 112, 112-16 (2002).

497. WIS. STAT. §§ 428.101 to 428.211 (2004).

498. Other states which have adopted predatory lending regulation of some sort in the past five years include: Colorado, Maine, Maryland, Minnesota, Oklahoma, South Carolina, Virginia, Washington, and West Virginia. COLO. REV. STAT. §§ 5-3.5-101 to 5-3.5-104 (2004); ME. REV. STAT. ANN. tit. 9-A, §§ 8-101 to 8-106 (West 2004); MD. CODE ANN., COM. LAW §§ 12-101 to 12-127 (2005); MINN. STAT. §§ 58.01-58.17 (2002); OKLA. STAT. ANN. tit. 14A, §§ 3-301 to 3-304 (West 2004); S.C. CODE ANN. §§ 37-23-10 to 37-23-70 (Law. Co-op. 2004); VA. CODE ANN. § 6.1-422 (Michie 2004); WASH. REV. CODE §§ 43.180.010—43.180.080 (2004).

499. Justice Brandeis first described states as laboratories of democracy when emphasizing the importance of state experimentation in nurturing social progress. He famously explained:

To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country. This Court has the power to prevent an experiment. [But] in the exercise of this high power we must ever be on guard, lest we erect our prejudices into legal principles. If we would guide by the light of reason, we must let our minds be bold.

New State Ice Co. v. Lieberman, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

500. J. H. PRICE, *COMPARATIVE GOVERNMENT: FOUR MODERN CONSTITUTIONS* 49-50 (1970).

1787, still sounds fresh when considering American diversity and the importance of preserving state power:

The United States includes a variety of climates. The productions of the different parts of the union are very variant, and their interests, of consequence, diverse. Their manners and habits differ as much as their climates and productions; and their sentiments are by no means coincident. The laws and customs of the several states are, in many respects, very diverse, and in some opposite.

....

In a republic of such a vast extent as the United States, the legislature cannot attend to the various concerns and wants of its different parts. It cannot be sufficiently numerous to be acquainted with the local condition and wants of the different districts, and if it could, it is impossible it should have sufficient time to attend to and provide for all the variety of cases of this nature, that would be continually arising.⁵⁰¹

Indeed, the costs of a federal system may be thought of as a purchase price for government that can satisfactorily accommodate wide cultural, regional, geographic, ethnic, and even linguistic differences. While state predatory lending laws may require the hiring of additional counsel and variation in compliance programs, it may nevertheless be a bargain when weighed against an inability to accommodate local needs with local regulation.

V. THE FEDERAL EXECUTIVE RESPONSE: PREEMPTION IN SERVICE OF UNIFORMITY OR IN SERVICE OF DEREGULATION?

The tension between state experimentation and uniform national policy is addressed in extensive political and legal literature.⁵⁰² For example, many legal scholars have explored how and to what extent the courts should use their constitutional authority to manage the allocation of power between national and state governments.⁵⁰³ Others have focused on the application of federalism to

501. Brutus I (anonymous), *To the Citizens of the State of New York*, N.Y. JOURNAL, Oct. 18, 1787, reprinted in *FEDERALISTS AND ANTIFEDERALISTS: THE DEBATE OVER THE RATIFICATION OF THE CONSTITUTION* 4, 11-13 (John P. Kaminski & Richard Leffler eds., 1989).

502. See Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485, 1485 (1994) (colorfully describing the breadth of federalism scholarship).

503. See, e.g., RAOUL BERGER, *FEDERALISM: THE FOUNDERS DESIGN* 5 (1987) (advocating courts return to original historical sources in policing the balance of national and state power); Akhil Reed Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425, 1428-29 (1987) (advocating a "race to the top" model of federalist protection of individual rights); Stephen A. Gardbaum, *The Nature of Preemption*, 79 CORNELL L. REV. 767, 769-70 (1994) (characterizing the field preemption doctrine of the supremacy clause as simple statutory interpretation); Herbert Hovenkamp, *Judicial Restraint and Constitutional Federalism: The Supreme Court's Lopez and Seminole Tribe Decisions*, 96 COLUM. L. REV. 2213, 2213-14 (1996) (labeling the Supreme Court's recent restraints on federal power as judicial activism); Kramer, *supra* note 502, at 1560-61 (advocating more historical nuance in constitutional review); Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century*, 88 COLUM. L. REV. 1, 78 (1988) (advocating a new state's rights jurisprudence based on article IV, section four of the Constitution); Ilya Somin, *Closing the Pandora's Box of Federalism: The Case for Judicial Restriction of Federal Subsidies to State Governments*, 90 GEO. L.J. 461, 461-62 (2002)

particular legal issue areas such as environmental protection,⁵⁰⁴ health care reform,⁵⁰⁵ or labor law.⁵⁰⁶ Several commentators have complained that federalism lacks meaning and value, with two professors going so far as to suggest abandoning American federalism for similarly beneficial substitute systems.⁵⁰⁷

What is clear, however, is that the concept of federalism is, in and of itself, powerful. Professor Barry Friedman has noted that for Americans, federalism is “invoked regularly in much the same way as ‘Mom’ and ‘apple pie’: warm images with little content.”⁵⁰⁸ Similarly, Professors Edwin Rubin and Malcom Feeley smirk that “‘Our Federalism’ . . . conjures up images of Fourth of July parades down Main Street, drugstore soda fountains, and family farms with tire swings in the front yard.”⁵⁰⁹ While perhaps providing a shallow foundation upon which to construct a coherent constitutional jurisprudence, this contrasting gravity of emotional import and levity of theoretical content makes for a useful political weapon. When home mortgage financial reform is cast as a debate over a federal versus state balance of power, it draws upon a different strain of legal, political, and cultural meaning, than it does when cast as a debate over predatory lending regulation. Casting the debate as one over federalism is likely to “help shape the cognitive, emotive, ethical, and political preoccupations, goals, values, and anxieties” of those who will bring about legal change.⁵¹⁰

In the wake of new state predatory lending laws, longstanding lending industry complaints about regulatory compliance costs have grown louder and different in tone.⁵¹¹ Although consumer mortgage lending has been subject to

(arguing federal subsidies to state governments are a bigger threat to state power than coercive federal directives).

504. Richard Revesz, *Federalism and Environmental Regulation: A Public Choice Analysis*, 115 HARV. L. REV. 555, 555-58 (2001).

505. Candice Hoke, *Constitutional Impediments to National Health Reform: Tenth Amendment and Spending Clause Hurdles*, 21 HASTINGS CONST. L.Q. 489, 491-96 (1994).

506. Cynthia L. Estlund, *The Ossification of American Labor Law*, 102 COLUM. L. REV. 1527, 1569-79 (2002).

507. Erwin Chermersky, *The Values of Federalism*, 47 FLA. L. REV. 499, 503-04 (1995) (arguing for more robust analysis of benefits of federalism prior to striking down federal action); Barry Friedman, *Valuing Federalism*, 82 MINN. L. REV. 317, 319 (1997) (arguing federalism advocates have not yet persuasively linked the federal system to values we hold dear); Edwin L. Rubin & Malcom Feeley, *Federalism: Some Notes on a National Neurosis*, 41 UCLA L. REV. 903, 906-09 (1994) (arguing American federalism has no real benefit and should be displaced by administrative decentralization).

508. Friedman, *supra* note 507, at 319.

509. Rubin & Feeley, *supra* note 507, at 906.

510. Pierre Schlag, *The Aesthetics of American Law*, 115 HARV. L. REV. 1047, 1053 (2002). Professor Schlag might refer to reform proposals couched in federalism rhetoric as drawing on an “energy aesthetic,” while reform proposals couched in a predatory lending rhetoric tend to draw on a “perspectivist aesthetic.” *Id.* at 1051-52.

511. See MARGOT SAUNDERS & ALYS COHEN, *FEDERAL REGULATION OF CONSUMER CREDIT: THE CAUSE OR THE CURE FOR PREDATORY LENDING?* 13 (Harvard University Joint Center for Housing Studies, Working Paper No. BABC 04-21, 2004) (stating that state consumer protection efforts have led the credit industry to call for a single national standard providing a ceiling of credit regulation).

state law since the founding of the country, today lenders have begun to assert that state authority over predatory lending no longer strikes an efficacious division of power between national and state government.⁵¹² In making this argument, the lending industry has turned to a rhetoric of federalism.

A. *Administrative Preemption and Federal Depository Institutions*

This new federalism rhetoric has found an eager audience in the federal financial bureaucracy. With troubling realpolitik undertones, federal depository institution regulators have proven more than willing to take measures to limit the reach of state authority with respect to federally chartered lenders. Initially, the Office of the Comptroller of the Currency ("OCC"), which Congress charges with oversight of federally chartered banks, aggressively preempted the application of state predatory lending laws to national banks with highly questionable legal authority from Congress.⁵¹³ For instance, in August 2003 the OCC issued an order preempting the most important provisions of Georgia's predatory lending law.⁵¹⁴ Next, the OCC issued a notice proposing sweeping preemption of state laws applicable to national banks. In comments filed in opposition to these rules, the Attorneys General of *all* fifty states, the Virgin Islands, and the District of Columbia independently signed a letter vigorously denouncing the OCC's position. The state attorneys general called the proposed rule "one-sided and self-serving," and emphasized that "in the area of predatory mortgage lending, the OCC's actions are particularly disturbing."⁵¹⁵ One legal academic has argued that the OCC unconstitutionally overrode state law to create "a regime of de facto field preemption" without a proper mandate from

512. The North Carolina Commissioner of Banks has attempted to provide perspective on federal preemption of state predatory lending laws, explaining:

[W]e are talking about the relationship of sovereign governments to one another. New York and North Carolina, for example, were sovereign states before the United States existed and were present at the creation of the federal government. Further, the states are traditionally the "senior circuit" in financial services regulation. Banking under state charters has been conducted in New York since 1791 and in North Carolina since 1805. At the time of the enactment of the National Bank Act, state-chartered institutions had been in operation more than fifty years. The National Bank Act was modeled in substantial part on then-existing state banking laws.

Joseph A. Smith, Jr., *Federal and State Regulation of Financial Services: Competition and the Search for Comity*, 57 CONSUMER FIN. L.Q. REP. 131, 131 (2003).

513. See Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING L. 225, 364 (2004) (strongly criticizing recent OCC preemption decisions); cf. Howard N. Cayne & Nancy L. Perkins, *National Bank Act Preemption: The OCC's New Rules Do Not Pose a Threat to Consumer Protection or the Dual Banking System*, 23 ANN. REV. BANKING L. 365, 366-68 (2004) (providing opposite view).

514. Preemption Determination and Order, 68 Fed. Reg. 46,264 (Aug. 5, 2003) [hereinafter GFLA Preemption Order].

515. Letter from the National Association of Attorneys General to Office of the Comptroller of the Currency, at 1-2 (October 6, 2003) (on file with author) [hereinafter NAAG Letter].

Congress.⁵¹⁶ Notwithstanding these objections, the OCC published final regulations specifying that state laws do not apply to national banks whenever they “obstruct, impair, or condition” the ability of national banks to engage in consumer lending.⁵¹⁷ For its part, the Supreme Court has reaffirmed the basic principle that “federally chartered banks are subject to state law,”⁵¹⁸ except in specific areas where Congress has affirmatively chosen to preempt the application of state law to national banks.⁵¹⁹ It remains to be seen whether the Court will allow the OCC regulations to remain in force.

The Office of the Thrift Supervision (“OTS”) has also issued regulations that preempt the application of state predatory lending laws to federal thrifts, albeit with somewhat less controversy. The Home Owner’s Loan Act grants the OTS relatively greater leeway in preempting state law.⁵²⁰ Accordingly, in 1996 the OTS used this language to issue a regulation “occupying the field” of credit regulation preempting virtually all state laws with respect to thrifts, including predatory lending law.⁵²¹ Similarly, the National Credit Union Administration (“NCUA”) has preempted the application of state consumer protection laws to federal credit unions.⁵²² Particularly with credit unions, less umbrage has existed than over the OCC, in part due to less fear of predatory consumer practices on the part of credit unions. However, while consumer advocates may be relatively placated, the states’ rights argument seems no less applicable. Preemption may be within the constitutional powers of the OTS and the NCUA, but it does not follow that the underlying congressional mandate authorizing these actions was advisable. After all, Congress granted this authority at the expense of the powers of state attorneys general, state financial institution regulators, and state legislatures. In any case, neither the OTS nor the NCUA has been the slightest

516. Wilmarth, *supra* note 513, at 363.

517. 12 C.F.R. §§ 7.4008(d)(1), 34.4(a) (2004).

518. *Atherton v. FDIC*, 519 U.S. 213, 222 (1997).

519. By way of example, interest rate caps are now one specific area where federal preemption of state regulation of national banks is settled. *Beneficial Nat’l Bank v. Anderson*, 539 U.S. 1, 10 (2003) (holding that 12 U.S.C. §§ 85 & 86 provide “an exclusive federal cause of action for usury against national banks”).

520. 12 U.S.C. § 1464(a) (2004).

521. The relevant language provides:

To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities, except to the extent provided in paragraph (c) of this section or §560.110 of this part. For purposes of this section, “state law” includes any state statute, regulation, ruling, order or judicial decision.

12 C.F.R. § 560.2(a) (2004). *See Bank of America v. City and County of San Francisco*, 309 F.3d 551, 558 (9th Cir. 2002) (upholding field preemption); *but see Konynenbelt v. Flagstar Bank*, 617 N.W.2d 706, 713 (Mich. Ct. App. 2000) (questioning whether Congress has occupied the field).

522. 12 C.F.R. § 701.21(b) (2004).

bit reluctant to issue legal opinions preempting state predatory home mortgage lending laws.⁵²³

B. Creeping Preemption: The Incentive Effects of Cross Jurisdictional Posturing on Consumer Protection Law

Administrative preemption decisions do not operate in a vacuum. They tend to exhibit a policy myopia with respect to the consequences of their preemption decisions because federal depository institution regulators focus on and only deal with their own constituent institutions. The result is that regulators may tend to discount problems caused by preemption, because those problems, by definition, are someone else's. The most significant consolation for state leaders and consumer advocates with respect to recent administrative preemption decisions has been the fact that they are limited, at least in theory, to federally chartered depository institutions. The conventional wisdom is that predatory lending is focused within non-depository mortgage originators and brokers. Still, federal administrative preemption decisions have been creeping beyond their initial consequences in at least three ways.

1. Charter Migration

Now that the federal regulators have preempted state laws, they may have created an incentive for those seeking to avoid state predatory lending law to migrate into federal charters. Federal regulators justify preemption of state predatory lending laws with the argument that national depository institutions are subject to extensive oversight, which effectively prevents predatory practices. For example, in preempting the Georgia predatory lending legislation the OCC explained that "[n]ational banks' real estate lending standards are subject to a comprehensive federal regulatory framework that addresses the types of abusive and predatory practices that the [Georgia Fair Lending Act] seeks to prohibit."⁵²⁴ And when state attorneys general attacked the OCC on preemption, John D. Hawke, the Comptroller of the Currency, grouched that "we [the OCC] have just as much interest in the protection of consumers as any state AG."⁵²⁵

523. See, e.g., Op. Chief Counsel, Office of Thrift Supervision, P-2003-1 (Jan. 21, 2003) ("We conclude that [Georgia Fair Lending Act] provisions purporting to regulate the terms of credit, loan-related fees, disclosures, or the ability of a creditor to originate or refinance a loan, are preempted by federal law from applying to federal savings associations and their operating subsidiaries); Op. Office of Gen. Counsel, Nat. Credit Union Admin., 04-0147 (Feb. 10, 2004) (preempting application of New Mexico Home Loan Protection Act to federal credit unions); Op. Office of Gen. Counsel, Nat'l Credit Union Admin., 03-0412 (Nov. 10, 2003) (preempting application of Georgia Fair Lending Act to federal credit unions); Op. Office of Gen. Counsel, Nat'l Credit Union Admin., 03-0165 (May 23, 2003) (preempting application of District of Columbia Home Loan Protection Act to federal credit unions); Op. Office of Gen. Counsel, Nat'l Credit Union Admin., 02-0566 (Oct. 4, 2002) (preempting application of North Carolina Mortgage Lending Act to federal credit unions).

524. GFLA Preemption Order, *supra* note 514, at 46,264.

525. John D. Hawke, Jr., Remarks Before Women in Housing and Finance Meeting 2 (September 9, 2003), available at <http://www.occ.treas.gov/ftp/release/2003-69a.pdf> (last visited Mar.

Not necessarily. The comptroller of the currency does not stand for election, lives in Washington, D.C., serves as a partisan appointment, and is closely tied to one of the most powerful industries in the country. The primary mission and long-standing cultural focus of federal depository institution regulators has been monitoring the safety and soundness of their institutions, rather than consumer protection. Federal regulators are above all tasked with preventing bank failures leading to taxpayer liability from claims on federal deposit insurance. This is seen in the OCC's predatory lending regulations that all fifty state attorneys general reproached as "token and minimalist."⁵²⁶ In its final rule on predatory lending, the OCC included only two substantive consumer protections. First, a bank cannot make a mortgage "based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms."⁵²⁷ However, "[a] bank may use any reasonable method to determine a borrower's ability to repay,"⁵²⁸ and what is more, asset based lending "is just one of the many abusive practices present in predatory lending."⁵²⁹ The second rule forbids banks from engaging in unfair and deceptive trade practices in violation of the Federal Trade Commission Act. While this is certainly appropriate, it does not provide protection for consumers beyond what they would have had under state law, since most state Unfair and Deceptive Acts and Practices statutes already incorporate the federal act. For the rest of the abusive credit terms rejected in most state predatory lending laws, including single premium credit insurance, loan flipping, fee packing, unfair prepayment penalties, balloon payments, steering, mandatory arbitration, and others, the OCC has only instructed banks to "consider articulating clear policies and procedures to specify, if applicable, whether and under what circumstances the bank will make loans involving [such] features"⁵³⁰ Not exactly a hard line. If it is so unthinkable that national banks would engage in predatory practices, then surely they would not miss the opportunity to levy, for example, single premium credit insurance on their customers. If all the OCC can do on single premium credit insurance is encourage banks to "consider" a "policy or procedure" that "if applicable" specifies whether they will or will not use the financial product, can we trust the institution to protect borrowers from the myriad of other more controversial provisions and practices that have contributed to the current explosion in home foreclosures?

22, 2005) ("We are *not* engaged in a campaign to obliterate federalism or to create a new financial regulatory structure, and we have just as much interest in the protection of consumers as any state AG.").

526. NAAG Letter, *supra* note 515, at 10.

527. 12 C.F.R. § 7.4008(b).

528. *Id.*

529. NAAG Letter, *supra* note 515, at 10.

530. Comptroller of the Currency Administrator of National Banks, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, Advisory Letter No. 2003-2, at 8 (Feb. 21, 2003), available at <http://www.occ.treas.gov/ftp/advisory/2005-2.doc> [hereinafter OCC Advisory Letter].

The lax nature of these regulations is particularly troubling given recent reports of lenders shifting their operations into nationally chartered institutions to shelter under federal preemption.⁵³¹ Increasingly conventional wisdom in the subprime lending industry recognizes that conduct questionable mortgage lending holds a competitive advantage under the protection of a federal regulator.⁵³² The Treasury Department itself recognized this trend with respect to thrifts in 2000.⁵³³ While it may be too soon to know the long term extent of such charter migration, *predatory lenders have the greatest incentive to make this shift*, because they have the most to lose from state predatory lending laws. Because the federal depository lending oversight process also does not include private rights of action for victims beyond those articulated by federal statutes, a great burden of enforcement will fall on the shoulders of regulators. Thus, even if federal regulators are correct in their belief that national depository lenders have not engaged in predatory lending, it is far from clear this will remain true in the future.

2. State Parity Rules

State and federal government have for nearly two centuries been in a competition to charter depository institutions.⁵³⁴ The result has often been a seesaw of legislation and administrative action accommodating the aims of each governments' respective institutions.⁵³⁵ In our dual banking system, state governments have tried to provide a desirable environment for their banks, thrifts, and credit unions.⁵³⁶ And the federal government has tried to do the

531. See, e.g., Julie Kosterlitz, *Bleeding-Heart Conservatives*, NAT'L. J., June 19, 2004, at 2, available at 2004 WL 84028101 ("Earlier this year, the federal Office of the Comptroller of the Currency, which regulates nationally chartered banks, declared that its rules pre-empt all state laws for national banks and their state-chartered subsidiaries. That declaration is expected to encourage many state-chartered lenders to switch to federal charters, or to tinker with their corporate structures to avoid a state's anti-predatory-lending laws. And it's likely to raise pressure for a single national law, perhaps in the next session of Congress."); Tania Padgett, *OCC Tells Spitzer to Back Off*, NEWSDAY, Jan. 8, 2004, at A46 ("[S]tate regulators have criticized the OCC's changes, arguing that they will gut strong anti-predatory lending laws and prompt state-chartered banks to seek national charters to avoid the restrictiveness of the law."). Chris Sanders, *J.P. Morgans Plans a New Bank that May Avoid Local Laws*, REUTERS, Sept. 12, 2003 (bank planning to move to national charter to avoid state laws).

532. See, e.g., Jonathan R. Laing, *No Margin of Safety: Sub-prime Lender New Century Faces Stiffer Competition, Risk of Housing Bubble*, BARRON'S, Oct. 11, 2004, at 29 ("Likewise, federally chartered banks and thrifts have a competitive advantage over New Century because federal law preempts some of the state and local lending laws on predatory lending and the like that have forced New Century to curtail operations in such states as New Jersey and New Mexico.").

533. A joint Treasury and HUD report has openly recognized a trend of shifting into federal charters to avoid state regulation. U.S. DEPT. OF THE TREASURY & U.S. DEP'T OF HOUS. & URBAN DEV., *CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT* 45 n.54 (2000), available at <http://www.treas.gov/press/releases/reports/treasrpt.pdf> (last visited Mar. 22, 2005).

534. Hawke, *supra* note 525, at 1.

535. See Robert C. Eager & C.F. Muckenfuss, III, *Federal Preemption and the Challenge to Maintain Balance in the Dual Banking System*, 8 N.C. BANKING INST. 21, 23 (2004) (discussing the widespread reaction to preemption regulation).

536. See Wilmarth, *supra* note 513, at 253-54 (discussing state government reaction to repeated

same.⁵³⁷ In this spirit, state governments widely adopted “wild card” parity rules during the 1980s to prevent being scooped by the federal regulators.⁵³⁸ These provisions generally entitle state depository institutions whatever powers their federal counterparts possess.⁵³⁹ One court has used its state constitution to strike down a state parity rule of this sort as an unconstitutional delegation of state regulatory power to the federal government.⁵⁴⁰ Nevertheless, forty-seven states retain wild card parity rules in some form.⁵⁴¹

Parity rules have generally applied to the state predatory lending laws, with some states including explicit parity provisions in predatory lending acts themselves. Georgia, for example, has a parity rule in its revised predatory lending law which states:

The provisions of this chapter shall not apply to any bank, trust company, savings and loan, savings bank, credit union, or subsidiary thereof, respectively, that is chartered under the laws of this state or any other state only to the extent federal law precludes or preempts or has been determined to preclude or preempt the application of the provisions of this chapter to any federally chartered bank, trust company, savings and loan, savings bank, or credit union respectively, and such federal preclusion or preemption shall only apply to the same type of state chartered entity as the federally chartered entity affected⁵⁴²

Because all the federal depository institution regulators have issued preemption opinions on this act, the parity rule removes state depository institutions from under the jurisdiction of the statute. Federal regulators tend to see this as purely a state matter because the state itself can repeal parity provisions if it chooses.⁵⁴³ But, state legislators simply cannot withstand the political pressure associated with—in practice, if not intent—favoring out-of-state lenders over in-state lenders. State democratic leaders politically cannot go on the record discriminating against their own community’s financial institutions in favor of big national banks located in places like Delaware and South Dakota. The result is that federal preemption for depository institutions, in practice, if not in theory, grants *all* depository institutions immunity from predatory lending laws.⁵⁴⁴ Rarely will the public who supported passage of a state predatory

federal pressure on state banks).

537. *Id.* at 253.

538. Eager & Muckenfuss, *supra* note 535, at 66-67. See also KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER, THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES § 3.11.1 (2d ed. 2000) [hereinafter KEEST, NCLC, THE COST OF CREDIT] (explaining parity statutes).

539. KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER, THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES § 3.11.1 (1995) [hereinafter KEEST, NCLC, COST OF CREDIT]; Eager & Muckenfuss, *supra* note 535, at 66-67.

540. Utah League of Insured Sav. Ass’ns v. Utah, 555 F. Supp. 664, 674 (D. Utah 1983).

541. Hawke, *supra* note 525, at 7-8.

542. GA. CODE ANN. § 7-6A-12 (2004).

543. See Hawke, *supra* note 525, at 9 (“These laws *could* have been left in place for state banks . . .”).

544. C. Bailey King, Jr., *Preemption and the North Carolina Predatory Lending Law*, 8 N.C.

lending law understand that even though the law is on the books, parity statutes are likely to prevent the rule from applying to a single bank, thrift, or credit union in the entire state.

Parity rules do not import federal regulatory oversight and examinations along with the exemption from state consumer protection laws. To the extent that federal regulators justifiably excuse their constituent depository institutions from compliance with state predatory lending laws, it is only because Congress requires regulators to conduct regular deposit insurance inspections of each federal institution. However, the OCC does not inspect state institutions. And, while state regulators do have oversight responsibilities with state chartered institutions, the resources of state regulators are notoriously limited. As Comptroller Hawke recently pointed out, Maryland, for instance, recently refused to allow any new state chartered banks because it did not have the staff to process the applications.⁵⁴⁵ If state regulators cannot process a charter application from an individual bank, can they possibly monitor all the mortgage loans that each bank makes (or purchases) for predatory terms? In reality, federal preemption decisions and state parity rules combine to create not just a level floor in consumer protection, but to create a pit. State chartered depository institutions receive the benefit of federal preemption, but do not bear the burden of special federal oversight.⁵⁴⁶ Parity rules thus create an ironic hedge against charter migration. If federal regulators do succeed in preventing predatory lending by federally chartered lenders, the reason may have less to do with the strength of federal oversight than with the unintended consequences for state depository institutions from purely federal actions. Predatory lenders may only lack the incentive to migrate to preempted federal charters because the effects of preemption may migrate into state charters first.

3. Subsidiaries and Agents

Ambiguity as to what business entities fall under the ambit of federal depository institution preemption further erodes the ability of state governments

BANKING INST. 377, 384 (2004). In some jurisdictions parity rules even apply amongst different types of financial institutions. Thus, when the OTS preempted New Mexico's predatory lending law for federal thrifts, the financial institutions division of New Mexico's Regulation and Licensing Department issued a rule preventing application of the state predatory lending law to state chartered banks. N.M. REG. Vol. XIV, No. 24 (December 30, 2003), *available at* <http://www.nmcpr.state.nm.us/nmregister/xiv/xiv24/12.16.76.htm> (last visited Mar. 22, 2005).

545. Hawke, *supra* note 525, at 10.

546. State institutions are also subject to inspection by the Federal Deposit Insurance Corporation. *See, e.g.*, 12 U.S.C. § 1831a (2004) (restricting activities of state-chartered, federally insured banks); 12 U.S.C. § 1831m (2004) (providing depository institutions in receipt of federal deposit insurance are subject to federal safety and soundness standards). However, there are thousands of state institutions and the FDIC resources are far from sufficient to meaningfully guarantee the absence of predatory lending in all the contracts of all of these lenders. State depository institutions are also subject to oversight by state regulators, but state regulators generally do not provide deposit insurance, and therefore lack the same financial incentives to aggressively evaluate safety and soundness. Even if the incentives were the same, different state regulators have insufficient resources and of oversight capabilities.

to improve predatory lending laws. We traditionally think of bank, thrift, and credit union assets as outstanding loans. But today many banks also own non-bank subsidiaries that may have little to do with credit, or may actually originate loans of their own. The OCC in 2001, and the OTS in 1996, issued regulations attempting to give operating subsidiaries of federal banks and thrifts the same powers as the parent bank or thrift themselves.⁵⁴⁷ State governments have understandably been concerned because they have seen challenges to their ability to regulate *state* corporations that are owned by banks or thrifts. The result has been hotly contested litigation between state banking regulators and subsidiaries of federal banks in close alliance with the OCC.

For example, serious allegations of predatory lending have dogged Wells Fargo in recent years.⁵⁴⁸ So, the California Department of Corporations was understandably concerned when it uncovered possible TILA violations and unlawful interest calculations at Wells Fargo Home Mortgage, Inc., (“WFHMI”), which is a subsidiary owned by the national bank. WFHMI is a non-bank mortgage company licensed to engage in real estate lending activities under both the California Residential Mortgage Lending Act and the California Finance Lenders Law.⁵⁴⁹ The department believed that WFHMI may have overcharged consumers on their mortgages, possibly entitling them to a refund.⁵⁵⁰ Accordingly, the department demanded an audit of WFHMI’s outstanding home mortgage loans.⁵⁵¹ Instead of conducting the audit, WFHMI sued the California government arguing that because it is a subsidiary of a national bank, it is not subject to the visitatorial powers of the state of California.⁵⁵² Instead of expressing

547. For O.C.C. regulation see 12 C.F.R. § 7.4006 (2005) (“Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.”). For the O.T.S. regulation see 12 C.F.R. § 559.3 (“Unless otherwise specifically provided by statute, regulation, or OTS policy, all federal statutes and regulations apply to operating subsidiaries in the same manner as they apply [to the parent].”).

548. See, e.g., Dee DePass, *Borrowing Trouble: A Star Tribune Special Report: Costly Mortgages Provoke Backlash From Borrowers*, STAR-TRIBUNE (Minneapolis), Aug. 17, 2004, at A1 (“In March, four Wells Fargo shareholders inserted a proposal inside the company’s proxy statement accusing the bank of harmful predatory lending and requesting new policies that would prevent such actions in the future. The board denied wrongdoing, and the proposal was voted down.”); Susan Finch, *An Offer to Refuse: Predatory Lenders Are Persuading Locals to Refinance Their Home Mortgages, Often Resulting in Legal Woes and Foreclosures*, TIMES-PICAYUNE, Aug. 22, 2004, at 01 (“The seminar audience heard from people who encountered problems in mortgage dealings with Wells Fargo Financial Inc., a California firm ACORN has accused of a broad range of deceptive and unfair lending practices in a lawsuit pending there.”); Mary Vandeveire, *Lending Protestors Plead Not Guilty*, ARIZ. DAILY STAR, Aug. 4, 2004, at B2 (“Members of a consumer-interest group who say they want to protect people from predatory lending pleaded not guilty to trespassing and disorderly-conduct charges in Tucson City Court on Tuesday. Five members of the Association of Community Organizations for Reform Now were charged July 23 after chanting inside a Downtown Wells Fargo branch. They presented the branch manager with a copy of a national lawsuit against the bank, alleging predatory lending practices such as unfair early repayment penalties.”).

549. Wells Fargo Bank, N.A. v. Boutris, 252 F. Supp. 2d 1065, 1067 (E.D. Cal. 2003).

550. Wells Fargo, 252 F. Supp. 2d at 1068.

551. *Id.*

552. *Id.* For good measure WFHMI threw in a § 1983 civil rights claim accusing the

concern over the indicia of predatory lending, the OCC filed an amicus brief supporting the subsidiary and actually petitioned to make an oral argument on behalf of the non-bank company at taxpayers' expense.⁵⁵³ After granting a preliminary injunction for WFHMI, the federal District Court for the Eastern District of California analyzed whether the ambiguity in the National Bank Act gave the OCC sufficient leeway to preempt state law with respect to operating subsidiaries.⁵⁵⁴ The State of California argued that language allowing the OCC to preempt state law regulating national banks did not give the OCC the power to preempt state law with respect to state chartered companies that are not banks.⁵⁵⁵ Nevertheless, the court held that because the subsidiary was only allowed to conduct activities that are permissible for banks to conduct, it is the functional equivalent of a simple division of the bank itself.⁵⁵⁶ A federal district court in Michigan has reached a similar result.⁵⁵⁷ Interestingly, neither court considered whether the aggressive encroachment into traditionally state control over state corporations demands a more explicit authorization from Congress,⁵⁵⁸ particularly in light of the longstanding rule that "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations."⁵⁵⁹

Placing aside the constitutional question of whether the depository institution regulators have exceeded their authority, as a matter of policy, federal regulators consistently insist no credible evidence exists that their depository institutions or their subsidiaries engage in predatory lending.⁵⁶⁰ But, others are

Commissioner of the California Department of Corporations of subjecting the corporate citizen of WFHMI to a deprivation of its constitutional right to enjoy the fruits of supremacy clause preemption. 42 U.S.C. § 1983 (2004); *Wells Fargo Bank, N.A. v. Boutris*, 265 F. Supp. 2d 1162, 1163 (E.D. Cal. 2003). Apparently WFHMI actually believed that the Court system should have held the state Commissioner personally liable for having the temerity to try to enforce consumer protection laws.

553. *Wells Fargo*, 252 F. Supp. 2d at 1067 n.2.

554. *Id.* at 1068-73. The Act prescribes: "No *national bank* shall be subject to any visitatorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress. . . ." 12 U.S.C. § 484(a) (2004) (emphasis added).

555. *Wells Fargo*, 252 F. Supp. 2d at 1069-70.

556. *Id.* at 1070-71.

557. *See Wachovia Bank, N.A. v. Linda Watters*, 334 F. Supp. 2d 957, 965 (W.D. Mich. 2004) (concluding that the federal statute preempted a Michigan statute regulating banks).

558. There is ample support for the notion that federal executive agencies should not be allowed to interpret ambiguous statutory provisions in a way that preempts state law. *See, e.g., Gregory v. Ashcroft*, 501 U.S. 452, 466-67 (1991) (stating that the Federal Age Discrimination in Employment Act cannot be read to cover state judges unless Congress makes it clear that judges are included); *Nat'l Ass'n of Regulatory Util. Comm'rs v. F.C.C.*, 880 F.2d 422, 427-28 (D.C. Cir. 1989) (discussing the principles governing preemption analysis); CASS R. SUNSTEIN, *DESIGNING DEMOCRACY: WHAT CONSTITUTIONS DO* 148 (2001) (noting that executive agencies are not allowed to interpret ambiguous provisions so as to preempt state law).

559. *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 89 (1987).

560. For example, in its guidelines for national banks on predatory lending the OCC states: Although the OCC does not have reason to believe that national banks or their operating subsidiaries (collectively referred to herein as "national banks") generally are engaged in predatory lending practices, it expects that national banks will take appropriate steps to

not convinced. Many companies now held as subsidiaries of federal banks and thrifts have long and notorious histories of predatory lending. For instance, the media and courts have found pervasive predatory lending practices by Associates First Capital Corporation, which is now owned by Citigroup.⁵⁶¹ Associates settled an action for \$20 million that was brought by the North Carolina state attorney general under both state and federal theories of law.⁵⁶² After stonewalling a federal investigation,⁵⁶³ Associates reached a similar predatory lending settlement for \$215 million with the Federal Trade Commission.⁵⁶⁴ Similarly, Household Finance Company is now owned by HSBC Holdings, which is the second largest consumer finance organization in the U.S. after Citigroup.⁵⁶⁵ Also, like Associates, Household has an undeniable legacy of predatory lending.⁵⁶⁶ In fact, it settled the largest predatory lending lawsuit ever—\$484 million—with a coalition of state attorneys general.⁵⁶⁷ Both parent

ensure that they do not become involved in predatory lending.

OCC Advisory Letter, *supra* note 530, at 1-2.

561. See, e.g., *Assocs. Home Equity Servs., Inc. v. Troup*, 778 A.2d 529, 537 (N.J. Super. Ct. App. Div. 2001) (“Typically predatory lenders take advantage of borrowers due to their lack of sophistication in the lending market, due to their lack of perceived options for the loan based on discrimination or some other factor, or due to deceptive practices engaged in by the lender that mislead or fail to inform the borrower of the real terms and conditions of the loan. The record in this case indicates that this is consistent with what occurred in the Troup transaction.”); Michael Hudson, *Signing Their Lives Away: Ford Profits from Vulnerable Consumers*, in *MERCHANTS OF MISERY* 42, 42-50 (Michael Hudson ed., 1996) (detailing legacy of abusive lending by the Associates); *Citigroup Launches \$200B Loan Program*, CHICAGO TRIB., Sept. 28, 2003, at 11 (describing Citigroup’s new mortgage program).

562. *The Associates to Refund \$20 Million to North Carolina Mortgagors*, CONSUMER BANKR. NEWS (LRP Publication), V. 11-5, Oct. 18, 2001.

563. Paul Beckett, *FTC Files Motion Against Citigroup In Lending Case*, WALL ST. J., March 6, 2002, at B9 (“[T]he FTC said Citigroup has ‘effectively stalled’ in producing evidence for the discovery, . . . [and] refused to provide any documents created prior to March 6, 1998, ‘even though the FTC intends to prove that the Associates’ substantial and widespread illegal lending practices date back to at least January 1, 1994.’”).

564. Erick Bergquist, *FTC’s Look At Subprime Industry Not Finished Yet*, AM. BANKER, May 25, 2004, at 1. Absent possible preemption, these same deceptive practices would be actionable under most state Unfair and Deceptive Acts and Practices statutes.

565. Andrew Ross Sorkin, *HSBC to Buy a U.S. Lender for \$14.2 Billion*, N.Y. TIMES, Nov. 15, 2002, at C1; Andrew Cave, *HSBC to save \$1bn by switch to Asia*, DAILY TELEGRAPH (UK), March 17, 2005, at 11.

566. Jonathan Finer & Charles R. Babcock, *The Lure of High-Risk Loans; Huge Profits Drive Practice’s Spread Despite Lawsuits*, WASH. POST, July 12, 2004, at E01 (“In the past few years, regulators and prosecutors have cracked down on some predatory lending practices. In 2002, Household International Inc. agreed to pay borrowers \$484 million, a few weeks after a division of Citigroup Corp. settled a case with the Federal Trade Commission for \$215 million.”).

567. A North Carolina paper recently opined:

[I]t is foolish to disarm states that are willing to pursue these predators. Yet that’s what the federal Office of the Comptroller of the Currency did earlier this year. New rules now give banks with national charters safe haven from state laws aimed at predatory lending. That’s wrong, and North Carolina leaders properly are seeking a remedy. Attorney General Roy Cooper made a strong case against the comptroller in testimony last week before the Senate Banking Committee. Cooper has wielded the state’s landmark 1999 law to win more than

banks have aggressively tried to improve the image of their predatory subsidiaries, but consumer advocacy organizations are skeptical. For instance, one California organization recently asserted that Citigroup "hides behind its subsidiary," explaining that despite recent public relations efforts, it "still charges high points and fees on subprime loans, imposes prepayment penalties that trap borrowers into high cost loans, and sets arbitration provisions denying borrowers access to legal recourse."⁵⁶⁸ It is plausible that Citigroup and HBSC purchased two of the most notorious predatory lenders because they intend to invest in the profitable predatory lending business by buying discredited companies at bargain basement prices. Even the federal government itself found in a GAO audit that non-bank mortgage lending subsidiaries owned by bank holding companies have received light scrutiny by federal regulators, casting a troubling shadow over OCC and OTS claims of federal charter purity.⁵⁶⁹ Given this troubling legacy, state leaders might reasonably suspect the motives of federally chartered institutions and doubt the neutrality of their patron regulators.

Granting preemption to non-bank subsidiaries also creates a large pool of well-funded private litigants that will inexorably push the envelope of federal preemption. A home foreclosure lawsuit between Legal Counsel for the Elderly and Homecomings Financial provides an illustrative example.⁵⁷⁰ Homecomings is a subsidiary of GMAC Bank, which is a thrift supervised by the OTS.⁵⁷¹ The suit concerned Nellie Sprow, an eighty-two year-old retired housekeeper who lived alone and suffered from debilitating dementia.⁵⁷² Her condition did not

\$30 million in consumer refunds from two violators alone, The Associates and Household International. Together, the 50 state attorneys general won the biggest predatory lending case to date against Household Finance and recovered \$484 million for homeowners two years ago.

Editorial, *Borrowed Trouble*, RALEIGH NEWS & OBSERVER, April 12, 2004, at A10.

568. Jabulani Leffall, *A Matter of Life and Debt: The Impact of Predatory Lending on the Black Community*, DOLLARS & SENSE, March 1, 2003, at 28.

569. U.S. GEN. ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING 9-10, GAO-04-412T (Feb. 24, 2004).

570. Legal Counsel for the Elderly is a non-profit affiliate of the American Association of Retired Persons that provides free legal counsel to senior citizens. AARP Legal Counsel for the Elderly (LCE) (providing background information on Legal Counsel for the Elderly), at <http://www.aarp.org/lce/lce-about/Articles/a2003-04-23-lcebackground.html> (last visited Mar. 18, 2005).

571. GMAC Bank is a savings bank supervised by the OTS.

572. Brief in Support of Defendant's Opposition to Plaintiff's Motion for Judgment on the Pleadings on Counts II and III of the Counterclaim at 2, *Homecomings Fin. Network v. Sprow*, (Sup. Ct. D.C. Civ. Div, Mar. 19, 2001) (No. 7177-00RP), [*hereinafter* Sprow Brief]. Ms. Sprow's counsel explained:

For the last several years, Ms. Sprow has exhibited behavior indicating that she cannot handle her personal affairs in a competent fashion and that she is not capable of understanding the nature, character, and extent of basic financial transactions. For example, Ms. Sprow periodically has failed to pay various utility bills or, conversely, has paid sums in great excess of the balance due on her utility bills. Upon questioning, Ms. Sprow has

deter three different mortgage origination companies from convincing her to execute three high-cost mortgage loans, the third of which Homecomings purchased. When Ms. Sprow's counsel argued the loan was unconscionable, Homecomings argued the OTS had preempted the District of Columbia's unconscionability law as it applied to Homecomings. While this case settled, the implication of the subsidiary's argument is frightening. If Homecomings is correct, then a bedrock state contract law provision would vanish from the legal fabric that has for so long protected (albeit imperfectly so) vulnerable consumers from predatory lending. Here not only have federal regulators laid the groundwork for preemption of the new breed of state predatory lending statutes, but also for fundamental common law state consumer protections. If an operating subsidiary—that is clearly a state chartered corporation—feels confident enough to argue they are immune from state unconscionability law, surely pleas of immunity from state redemption, garnishment, foreclosure, antidiscrimination, deceptive practices, and even fraud are not far behind.

For many companies with notorious records of predatory lending, the most significant barrier between state law and relatively lax federal oversight appears to be a tenuous distinction between “financial subsidiaries” and “operating subsidiaries” set out by the OCC.⁵⁷³ The agency has not preempted state law with respect to financial subsidiaries, but has with respect to operating subsidiaries.⁵⁷⁴ But, “the distinction between a ‘financial’ subsidiary and an ‘operating’ subsidiary may be hard to figure out in real life.”⁵⁷⁵ It is unclear whether the subsidiary, the parent bank, the OCC, or the courts decide the status of a subsidiary. Moreover, it is unclear whether the determination is made at the time of loan origination, at the time of the lawsuit, or when the *state* agency chartered or licensed the subsidiary. What is clear is that when accused of predatory lending under state law, all subsidiaries are certain to claim they are operating subsidiaries. Uncertainty will allow banks and subsidiaries that wish to use predatory terms to play a shell game with regulators, attorneys general, and courts. Consumers litigating from the brink of homelessness are likely to be the long-term losers.

Looking beyond subsidiaries, federal regulators' long march to nullify state consumer protection law also entered new ground when the OTS issued an opinion on the application of state law to agents of federal thrifts in October

identified the current year as 1958 and the current president as Harry Truman. The Probate Division of the Superior Court of the District of Columbia recognized Ms. Sprow's lack of competency and therefore appointed a guardian and conservator for her . . .

Id. at 3.

573. See 12 U.S.C. § 24a(a)(2)(A) (defining financial subsidiary).

574. Compare Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1906 (Jan. 13, 2004) (codified at 12 C.F.R. pt. 7) (“This final rule . . . does not apply to the activities of national bank financial subsidiaries.”) with 69 Fed. Reg. at 1905 (“Thus, by virtue of regulations in existence prior to the proposal, the proposed changes to part 34, including the new anti-predatory lending standard, applied to both national banks and their operating subsidiaries.”).

575. See KEEST, NCLC, THE COST OF CREDIT, *supra* note 539, § 3.4.6.3.

2004.⁵⁷⁶ The OTS issued its ruling in response to a growing number of thrifts who use independent contractors to perform marketing, solicitation, debt servicing, or customer service.⁵⁷⁷ The rule posed the question of whether or not state licensing and registration laws apply to these agents.⁵⁷⁸ For example, in the home mortgage lending context, many states have licensing and registration laws for home mortgage brokers that were written to apply to any individual who solicits consumers to use their home as collateral for a loan.⁵⁷⁹ Licensing and registration laws allow the state's financial institution regulator and attorney general to respond to consumer complaints, investigate fraud, deceptive practices, violations of disclosure law, and other illegal activities. State governments also generate a modest amount of revenue from licensing fees.

Unsurprisingly, the determination came down squarely on the side of federal thrifts and against state regulators. The OTS explained that subjecting thrift independent contractors, such as mortgage loan salespersons, to state licensing and registration laws "impermissibly interferes with and burdens [thrift] deposit and lending operations."⁵⁸⁰ According to the OTS, a state law requiring that a self-employed door-to-door home mortgage salesman operating out of the back of a pickup truck obtain a license is "tantamount to the state attempting to assume regulatory authority over federal savings association operations."⁵⁸¹ Moreover, in the OTS's realpolitik world view, this position has the imprimatur of Congress and the supremacy clause of the U.S. Constitution.

The growing involvement of large insurance companies in lending markets is, at least in part, driving preemption for agents of federal thrifts. According to Best's Insurance News, about fifty-three insurance companies now own institutions with federal banking charters.⁵⁸² The largest of these is the insurance giant State Farm, which owns State Farm Bank, a thrift regulated by the OTS.⁵⁸³ Under the new OTS ruling, State Farm will now be free from state oversight in using its network of about 17,000 insurance agents to solicit clients for banking services, including home mortgage loans.⁵⁸⁴ In one opinion letter, the OTS turned loose a literal army of new mortgage brokers with no state authority,

576. Op. Chief Counsel, Office of Thrift Supervision, Authority of a Federal Savings Association to Perform Banking Activities through Agents Without Regard to State Licensing Requirements, P-2004-7 (October 25, 2004), available at 2004 OTS LEXIS 6 [hereinafter OTS, P-2004-7].

577. *Id.* at 1.

578. *Id.*

579. See, e.g., FLA. STAT. ANN. § 494.0033 (requiring any individual, who acts as a mortgage broker for a mortgage business, to be licensed); OHIO REV. CODE ANN. §§ 1322.01, 1322.02 (requiring mortgage brokers to obtain a certificate of registration); VA. CODE ANN. § 6.1-410 (requiring individuals to obtain a license before engaging in the mortgage broker business).

580. OTS, P-2004-7, *supra* note 576, at 27.

581. *Id.*

582. *State Farm Receives Federal Bank Charter*, BEST'S INS. NEWS, Dec. 16, 2004, available at 2004 WL 101010275.

583. *State Farm Digging in Its Heels Over Regulatory Ruling*, BEST'S INS. NEWS, Dec. 17, 2004, available at 2004 WL 101010325.

584. *State Farm Receives Federal Bank Charter*, *supra* note 582.

oversight, or influence.

It is unclear whether the elimination of state licensing and registration authority over thrift agents also implies that these agents are immune from other state consumer protection laws including new predatory lending statutes, UDAP statutes, antidiscrimination laws, state price disclosure laws, and even common law doctrines of unconscionability and fraud. While the OTS has been quick to say what laws *are* preempted, it consistently remains silent on what laws *are not* preempted.⁵⁸⁵ But as with subsidiaries of federal banks and thrifts, we can expect that agents will be aggressive in arguing immunity from not only licensing and registration, but also the myriad other state laws designed to protect consumers from financial predators.

This risk of consumer abuse by independent contractors of federal thrifts is quite real. Mortgage brokers in general have become notorious for corruption. FBI analysts and section chiefs have gone on the record explaining that lack of regulation of real estate professionals in general and mortgage brokers in particular has created “a giant recipe for fraud.”⁵⁸⁶ The OTS has unilaterally and with virtually no serious policy discussion of the consequences, taken aggressive steps to deregulate thousands of mortgage brokers—and has done so at a time when the FBI is publicly decrying near “epidemic” levels of fraud “running rampant in the nation’s mortgage industry.”⁵⁸⁷ Preempting the application of state law to independent contractors acting as agents of thrifts has the potential to seriously erode the ability of states to maintain minimum standards of enforcement in their borrower protection laws. It is far from clear that limited OTS supervision of thrifts will be adequate to prevent consumer abuses by companies and individuals who have temporary agency contracts with thrifts.

Preemption for subsidiaries and agents is likely to make the corporate incentive problem of charter migration and the political incentive problem of state parity rules even more acute. If state corporations can obtain federal preemption without accepting the full responsibilities inherent in becoming a depository institution, but merely by shifting stock ownership to a depository institution, the migration of predatory lenders into the orbit of federal charters only becomes easier. Similarly, by switching to a federal thrift charter mortgage lenders can capture a competitive advantage through contracting with unlicensed, low-overhead brokers. The pressures on state politicians to remove state consumer protection law in order to prevent charter migration and charges of favoritism to out-of-state interests grow larger if preemption applies to subsidiaries and agents. State legislators will have a harder time defending mortgage lender and broker regulation when the rules apply to one non-depository mortgage company but not to another, simply by virtue of the identity

585. In its opinion letter, the OTS merely reiterates that state laws are not preempted “to the extent they only incidentally affect the lending operations of Federal savings associations.” OTS, P-2004-7, *supra* note 576, at 33.

586. *FBI Analyst: Regulate Brokers*, NAT’L MORTGAGE NEWS, Dec. 20, 2004, at 26.

587. Curt Anderson, *Mortgage Fraud Surges Since 2001*, *FBI Reports*, L.A. TIMES, Sept. 19, 2004, at A26.

of the parent company.

Following a steady stream of mergers and acquisitions in financial services companies, today "most major subprime lenders are now subsidiaries of bank holding companies."⁵⁸⁸ While subprime lending is not predatory lending, predatory lenders are almost always subprime lenders. Thus, federal preemption for national banking subsidiaries and agents entrenches the porous border between subprime and predatory lending. Even if courts decide federal regulators are within their constitutional authority in preempting state regulations with respect to subsidiaries and agents, significant reservations remain regarding the motives of regulators and the wisdom of committing such important policy decisions to the discretion of unelected federal officials.⁵⁸⁹ It is true short-term benefits and considerable convenience for federal depository institutions exist in treating subsidiaries and agents the same as parent depository institutions. But the notion that the sovereign authority of states on vital consumer protection issues can be held captive to tenuous regulatory distinctions, such as the porous line between financial and operating subsidiaries, should be offensive to those truly concerned with preserving the balance of power in our federal system. And therein lies the rub. Advocates of preemption probably are not concerned with federalism after all. For a clearer picture of the preemption agenda, unfettered by constitutional limits to regulatory usurpation of state power, it is useful to turn next to Congress.

VI. THE FEDERAL LEGISLATIVE RESPONSE: CONGRESSIONAL PREEMPTION AND THE FINAL FRONTIER

The one consolation for advocates of state predatory lending laws concerned about preemption by federal regulators, is that state laws still apply to non-depository mortgage brokers and originators that lack a relationship with a depository institution. But these non-depository mortgage lenders do not welcome increasing scrutiny in many state laws. Moreover, it is still far from clear whether and to what extent the judicial system will sanction the federal

588. NAAG Letter, *supra* note 515, at 10.

589. The Fifth Circuit has aptly recognized these troubling forces in a similar context:

Here, the constituency positively affected by the OCC's position is concentrated, organized and well-funded, and also happens to be the regulated industry. In contrast, the constituency which is adversely affected by the decision, though vast, is diffuse, unorganized, and definitionally ill-funded. It may be that these competing interests could better be balanced, as Appellant suggests, by a national Congress whose commitments are diverse and universal, or even by the people as they are represented in the state legislatures, than by a solitary institution whose focus is a single industry. However, our review here is limited to discerning whether Congress intended to delegate this question to the OCC, not whether we think such a delegation wise. Of course, should Congress be dissatisfied with the OCC's decision concerning the fee at issue here, Congress is free to revisit the question with subsequent legislation.

Wells Fargo Bank of Texas, NA v. James, 321 F.3d 488, 494 (5th Cir. 2003) (upholding OCC preemption of state law that prohibited banks from charging a fee to non-account holding payees who present a check to the bank which holds the account against which the check is drawn).

administrative power grab on behalf of depository lenders. Thus, for protection from state law, the consumer finance industry has turned to its friends in Congress.

A. Constitutionally Unrestrained Congressional Power and the Historically Restrained Congressional Response

Today there is no question that Congress has the authority to preempt state home mortgage lending law under its interstate commerce power. The U.S. Constitution gives Congress the power to “regulate Commerce with foreign Nations, and among the several States.”⁵⁹⁰ Shortly after the ratification of the Constitution, if Congress had tried to preempt state mortgage lending rules, it would have set off a vehement controversy over Congress’ constitutional authority. Drawing on the words of Madison, power over real estate loans would seem to fall within those “numerous and indefinite” powers “reserved to the several States . . . extend[ing] to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvements, and prosperity of the State.”⁵⁹¹ It is unlikely early nineteenth century courts would have abided by such Congressional enlargement. Yet today’s courts would go along quietly. A discussion of the long evolution of Congress’ commerce clause authority is beyond the scope of this Article.⁵⁹² Suffice it to say that currently the Supreme Court recognizes three broad categories of activity Congress may regulate under its interstate commerce authority. Roughly speaking, Congress may regulate the channels of interstate commerce, the instrumentalities of interstate commerce, and activities having a substantial relation to interstate commerce.⁵⁹³ No serious legal doubt exists that mortgage lending has a substantial relation to interstate commerce. Courts have widely held that even intrastate mortgage loans are subject to Congressional regulation because of the highly interconnected nature of the nation’s home financing system.⁵⁹⁴ Thus, ultimately, states are free to regulate predatory lending only to the extent that Congress has not preempted them.

However, while Congress is free to prevent states from regulating home mortgage lending, in two centuries it has not done so. Even when Congress was actively attempting to attract depository institutions into federal charters, it has

590. U.S. CONST. art I, § 8, cl. 3.

591. THE FEDERALIST NO. 45 (James Madison).

592. Among the many scholars who have written about this are: William N. Eskridge, Jr. & John Ferejohn, *The Elastic Commerce Clause: A Political Theory of American Federalism*, 47 VAND. L. REV. 1355 (1994); Stephen A. Gardbaum, *The Nature of Preemption*, 79 CORNELL L. REV. 767, 767 (1994); Diane McGimsey, *The Commerce Clause and Federalism after Lopez and Morrison: The Case for Closing the Jurisdictional-Element Loophole*, 90 CAL. L. REV. 1675 (2002); Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 36 DUKE L.J. 569 (1987); Robert A. Schapiro & William W. Buzbee, *Unidimensional Federalism: Power and Perspective in Commerce Clause Adjudication*, 88 CORNELL L. REV. 1199 (2003).

593. *United State v. Lopez*, 514 U.S. 549, 558-59 (1995) (holding that statute regulating possession of firearms in school zones exceeded Congress’ interstate commerce authority).

594. *Brown v. Investors Mortgage Co.*, 121 F.3d 472, 476 (9th Cir. 1997).

never attempted to prevent states from regulating the lending policies of ordinary non-bank lenders. The large body of mixed-federalist mortgage lending regulation is a testament to this Congressional restraint.

B. The Proposed "Responsible" Lending Act: Preemption Triumphant?

This long-lived Congressional restraint may not survive the current debate over predatory lending. Over the past few years representatives and senators have introduced numerous bills purporting to address predatory mortgage lending.⁵⁹⁵ As would be expected, these bills offer a variety of responses to the problem.⁵⁹⁶ Yet, so far, the legislation that has garnered the most momentum in Congress is the proposed Responsible Lending Act,⁵⁹⁷ sponsored by Representative Bob Ney of Ohio, Chairman of the Housing and Community Opportunity Subcommittee of the House Financial Services Committee.⁵⁹⁸ In its preamble, the bill describes itself as an attempt "[t]o combat unfair and deceptive practices in the high-cost mortgage market, establish a consumer mortgage protection board, and establish licensing and minimum standards for mortgage brokers."⁵⁹⁹ But in a speech to an industry trade association, Representative Ney invoked balance-of-power language in describing the legislation. He explained, "This bill includes national uniform standards, which I believe must be included in any predatory lending legislation in order to address the growing patchwork of state and local predatory lending laws."⁶⁰⁰ Originating from a leading figure on the House Financial Services Committee, the proposed Responsible Lending Act merits special attention because it provides not only a powerful illustration of how the predatory lending debate intersects with the federal-state balance of power, but also an insight into what home mortgage consumer protection law would look like if advocates of preemption have their way.

The centerpiece of the proposed Act is the most unequivocal elimination of state mortgage lending law in the history of our country. Going well beyond recent state predatory lending statutes,⁶⁰¹ Chairman Ney's bill proposes to

595. *Legislative Update*, AM. BANKER, April 8, 2004, at 5 (providing a short summary of introduced legislation).

596. See, e.g., Prevention of Predatory Lending Through Education Act, H.R. 1865, 108th Cong. (2003) (proposing federal block grants of funding for state consumer counseling and education programs); Predatory Mortgage Lending Practices Reduction Act, H.R. 1663, 108th Cong. (2003) (licensing mortgage brokers, requiring lender best practices plans for high-cost mortgages, and grants for community education); Prohibit Predatory Lending Act, H.R. 3974, 108th Cong. (2004) (using a North Carolina statute as a model to enhance HOEPA without preempting more protective state law).

597. H.R. 833, 108th Cong. (2003).

598. Brian Collins, *National Standard Making More Headway in Congress*, ORIGINATION NEWS, Mar. 1, 2004, at 2; Karen L. Werner, *Prospects for Predatory Lending Bill Better Next Year*, House Staffer Says, BNA'S BANKING REPORT, May 17, 2004, at 869.

599. H.R. 833 at preamble.

600. Bob Ney, *The Predatory Lending Dilemma*, NAT'L MORTGAGE NEWS, Aug. 16, 2004, at 4.

601. These threshold based statutes are preempted with the following language:

Laws preempted under . . . this subsection shall . . . include . . . any law of any State that

eliminate *all* state regulation of home mortgage lending. Under the bill, “[t]o the extent that any law of any State . . . imposes any requirement, limitation, or prohibition on any mortgage lending activities . . . This title shall preempt such law irrespective of whether such law affords greater protection, substantive or otherwise to consumers.”⁶⁰² Mortgage lending activities no longer subject to state “requirements, limitations, or prohibitions” include:

any advertisement, solicitation, offer, negotiation, application, processing, underwriting, originating, closing, funding, recording, assignment, securitization, servicing, collection, modification, satisfaction, or foreclosure (including the disposition of foreclosed property) for or of any extension of consumer credit secured by a lien against a consumer’s dwelling.⁶⁰³

With this language Congress has parked bulldozers ready to demolish all the state consumer protection strategies expositied at length in Section III of this article. Redemption laws, garnishment restrictions, foreclosure procedures, late fee limits, the common law unconscionability doctrine, antidiscrimination statutes, unfair and deceptive acts and practices statutes, common law fraud, and disclosure law are all “requirements, limitations, or prohibitions” of a listed mortgage lending activity.⁶⁰⁴ In fairness, the Act does include two exclusions from preemption. The first exclusion is interest rate caps “not otherwise preempted under Federal law.”⁶⁰⁵ This means quite little because federal preemption has eviscerated interest rate caps in one form or another.⁶⁰⁶ The second exclusion allows states to continue “licensing, registration, or authorization of any person engaged in mortgage lending activities,” but only “to the extent that such law does not condition issuance of such a license, registration or authorization . . . on compliance with any law that is otherwise preempted”⁶⁰⁷ States could still license lenders, but because federal regulation otherwise preempts all “requirements, limitations, or prohibitions” of any activity conceivably related to mortgage lending, there would be no point. No state law would be left to enforce. Reflecting on these problems, consumer rights organizations have universally denounced the bill asserting, among other criticisms, that “it would actually exacerbate some of the predatory lending problems facing our nation and communities.”⁶⁰⁸

directly or indirectly limits a creditor’s ability to extend new credit to a consumer for the purpose of refinancing an existing extension of consumer credit in whole or in part because the actual or contingent costs and finance charges to the consumer associated with either the existing or the new extension of consumer credit are lower than or in excess of any particular threshold

H.R. 833 § 104(a)(1).

602. *Id.*

603. *Id.*

604. *Id.*

605. *Id.*

606. See *supra* note 248 and accompanying text for a discussion on interest rate caps.

607. H.R. 833 § 104(a)(1), 108th Cong. (2003).

608. Open Letter from ACORN et al. to U.S. Senate (April 3, 2003) (“Congressman Ney’s bill will not address the predatory lending problems facing our communities while it undermines existing

The prospect of so sweeping a demolition raises the question: with what do advocates of preemption propose as an alternative to nonuniform state consumer protections? A cursory inspection of the proposed Responsible Lending Act gives a casual reader an impression of a restrained bill with some modest new consumer protections. The Act echoes several of the contractual limitations placed on high-cost mortgage loans in the recent state predatory lending statutes. But a more careful comparison of the Act to existing federal regulation and state law shows a rollback of consumer protections disturbingly couched in misleading terms. While there are many criticisms of the bill, I will highlight three principle defects: (1) narrow scope, (2) weak contractual restrictions and disclosures, and (3) the virtual elimination of assignee liability.

1. Scope

The proposed Responsible Lending Act does not expand the narrow scope of the Home Ownership and Equity Protection Act ("HOEPA"), and may actually shrink it. The reader will recall that HOEPA (like most state predatory lending laws intended to enhance it) relies on a interest rate trigger and a points and fees trigger to define the line at which loans become more closely scrutinized "high-cost" loans.⁶⁰⁹ If a loan exceeds either trigger, the lender must consider it a high-cost loan subject to HOEPA's enhanced consumer protections. The original 1994 version of HOEPA, as well as existing statute, sets the APR trigger at ten percentage points above the yield on comparable term Treasury securities.⁶¹⁰ But, in 2001 the Federal Reserve Board exercised its regulatory authority to lower the APR trigger to eight percentage points above comparable term Treasury notes for first lien mortgages.⁶¹¹ The proposed legislation merely

statutes and any future attempts by state and local legislators to protect consumers from predatory lenders.") (on file with author); *Consumer Group: Ney's 'Pre-Emption' Bill Goes Too Far*, NAT'L MORTGAGE NEWS, May 12, 2003, at 10 ("Several consumer groups, including [the National Consumer Law Center], are afraid the Ney bill would strip away consumer protections and protect predatory lenders and their investors from liability."); Greg Wright, *Groups Worry That Ney's Lending Bill Favors Bankers over Consumers*, GANNETT NEWS SERV., March 28, 2003 ("The 'Irresponsible Lending Act' is nothing more than an industry-backed attempt to legalize predatory lending and overturn landmark consumer laws in several states, including Public Research Interest Group-backed laws in New York, North Carolina and Georgia," said Rose Garr, Ohio PIRG spokeswoman in Columbus.), available at 2003 WL 5600354.

609. See *supra* notes 365-71 for a discussion of HOEPA's price threshold triggers.

610. 15 U.S.C. § 1602(aa)(1)(A) (2004). For example, if the yield on a 15-year treasury security were six percent per year, then 15-year loans with annual percentage rates of over 16 percent would be considered "high-cost" under the Act. See KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER, *THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES* § 11.3.2.3 (2d ed. 2000) (noting substantive prohibitions on the use of certain terms by high-cost mortgage lenders).

611. Regulation Z, 66 Fed. Reg. 65604, 65617 (Dec. 20, 2001). In justifying its actions, the Federal Reserve Board explained:

The Board has . . . determined that lowering the rate trigger is consistent with the consumer protections against abusive lending provided by HOEPA. The Act's purpose is to protect the most vulnerable consumers, based on the cost of the loans, from abusive lending practices. As noted above, anecdotal evidence suggests that subprime borrowers with loans priced below HOEPA's current APR trigger have been subject to predatory practices, such

transposes the trigger level already in force under Federal Reserve Board regulations into a statute—providing no consumer protection beyond that already in law, but appearing to do so to those unfamiliar with the previous Federal Reserve Board policy.⁶¹²

With respect to the points and fees trigger, HOEPA defines a loan as high-cost if the points and fees charged at closing are greater than 8% of the total loan amount.⁶¹³ For example, a loan would be covered if the lender charged more than \$8,000 in points and fees on a \$100,000 mortgage. The proposed Responsible Lending Act lowers the points and fees trigger from 8% of the loan amount to 6% of the loan amount for loans \$30,000 or less, and lowers the trigger to 7% of the loan amount for loans of greater than \$30,000.⁶¹⁴ While this appears to be an improvement, the proposed law comes with a heavy trade-off. The Act also creates at least two loopholes excluding some fees from the definition of fees for the purposes of the price trigger. Both yield spread premiums and prepayment penalties are all excluded from calculation of the trigger.⁶¹⁵

In predatory loans, yield spread premiums typically hide abusive kickbacks from lenders to mortgage brokers, which borrowers pay over the duration of the loan.⁶¹⁶ Empirical evidence suggests current average yield spread premiums are between one and two thousand dollars.⁶¹⁷ One former mortgage broker testified

as unaffordable lending, loan flipping and insurance packing. These are the very types of abuses that HOEPA was intended to prevent.

Id. at 65607. The regulatory changes became effective December 20, 2001 but compliance became mandatory on October 1, 2002. *Id.* at 65604. HOEPA granted the Board authority to change triggers no more frequently than biennially where the change is “consistent with the consumer protections against abusive lending” and “warranted by the need for credit.” 15 U.S.C. § 1602(aa)(2)(A)(i).

612. Compare H.R. 833, 108th Cong. §101(a) (2003) (“The term ‘high-cost mortgage’ . . . means a consumer credit transaction that is secured by the consumer’s principal dwelling . . . if . . . the transaction is secured by a first mortgage on the consumer’s principal dwelling and the annual percentage rate on the credit, at the consummation of the transaction, will exceed by more than 8 percentage points the yield on Treasury securities having comparable periods of maturity . . .”) with Regulation Z, 66 Fed. Reg. at 65617 (codified at 12 C.F.R. § 226.32(a)(1)(i) (2004)) (“[T]he requirements of this section apply to a consumer credit transaction that is secured by the consumer’s principal dwelling, and in which . . . the annual percentage rate at consummation will exceed by more than 8 percentage points for first-lien loans . . . the yield on Treasury securities having comparable periods of maturity . . .”).

613. 15 U.S.C. § 1602(aa)(1)(B) (2004).

614. H.R. 833 § 101(a).

615. In contrast, state predatory lending laws have moved in the direction of including these charges which have great potential for abuse. For instance the North Carolina predatory lending law includes “the maximum prepayment fees and penalties which may be charged or collected under the terms of the loan documents” in calculating the points and fees trigger. N.C. GEN. STAT. § 24-1.1E(a)(5)(a)(4) (2003). Yield spread premiums discussed *supra* notes 74-75 and accompanying text, are also included in the North Carolina points and fees trigger. N.C. GEN. STAT. § 24-1.1E(a)(5)(c) (2003).

616. See *supra* notes 74-75 and accompanying text for a discussion on the use of yield spread premiums.

617. Howell E. Jackson & Jeremy Berry, Kickbacks or Compensation: The Case of Yield Spread Premiums 3 (January 8, 2002) (unpublished manuscript, on file with author).

to Congress that many brokers “average[] a full point on every deal in ‘back end’ YSPs.”⁶¹⁸ Some state predatory lending acts now explicitly require lenders to include yield spread premiums as a fee in calculating points and fees for purposes of price threshold triggers.⁶¹⁹ Moreover, current federal law requires that calculation of the HOEPA points and fees trigger include “all compensation paid to mortgage brokers.”⁶²⁰ However, under the proposed Responsible Lending Act, a predatory loan could include thousands of dollars of broker kickbacks paid by the borrower and yet still not be considered a “high-cost” loan. Rather than increasing the scope of HOEPA, the bill would only create an incentive to shift price gouging into yield spread premiums.

Similarly, some state predatory lending laws have included prepayment

618. Barron E. Ramos, *Materials on Residential Mortgage Litigation*, PRACTICING LAW INSTITUTE CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, PLI No. B0-00ZV, at 205 (April 16, 2001).

619. See, e.g., N.C. GEN. STAT. § 24-1.1E(a)(5)(a)(3) (2003) (stating that “[p]oints and fees’ . . . includes . . . [a]ll compensation paid directly by the borrower”).

620. Regulation Z, 12 C.F.R. § 226.32(b)(1)(ii) (2004). A few courts have held that yield spread premiums are not included in HOEPA points and fees trigger under current law. *Mourner v. EquiCredit Corp. of Am.*, 309 B.R. 502, 505 (W.D. Mich. 2004); *Nunn v. IMC Mortgage Co.*, 308 B.R. 150 (W.D.N.Y. 2004). These cases are almost certainly wrongly decided. Their theory is that because the statute refers to fees “paid by the consumer . . . at or before closing,” yield spread premiums are not included since they are paid by the consumer over the duration of the loan. *Nunn*, 308 B.R. at 152 (emphasis added) (citing 15 U.S.C. § 1602(aa)(1)(B) (2004)). This argument twists the plain meaning of the statute in several respects. First, the statute refers to fees that are payable not paid. 15 U.S.C. § 1602(aa)(1)(B) (“the total points and fees payable by the consumer at or before closing”) (emphasis added). Yield spread premiums are payable by the consumer at closing in that once the documents are signed the consumer is bound to pay the fee. Many fees are financed into the loan, this by itself does not mean they are not payable. Thus when the *Mourner* court states “[t]here is no evidence or even contention that the Mourner’s paid the YSP at or before loan closing,” it misses the point. 309 B.R. at 505 (emphasis added). The borrower need only have agreed to fees payable, rather than paid, at or before closing. Second, neither case mentions § 226.32(b)(1)(ii) which instructs that “points and fees means . . . all compensation paid to mortgage brokers.” Thus, even if the fee must be paid rather than payable at or before compensation, all broker compensation is included within the trigger. Third, any argument that the fee is not payable by the consumer (but instead is paid by the lender) is formalism and sophistry. If the consumer refused to pay and deducted the fee from her monthly payments, would the lender write off this portion of the debt? Clearly not. Similarly, the official commentary remark that “mortgage broker fees that are not paid by the consumer are not included [in the trigger]” refers to volume-based broker compensation. Official Staff Commentary to Regulation Z § 226.32(b)(1)(ii)-1; NATIONAL CONSUMER LAW CENTER, *Why Yield Spread Premium Payments are ‘Fees’ For HOEPA Purposes*, in CONSUMER RIGHTS LITIGATION CONFERENCE MANUAL 571, 571-73 (2001). In these arrangements the broker receives payments from the lender based on the number and size of mortgage loans the broker places. In volume-based compensation the payments are never financed into an individual consumer’s loan. Fourth, to the extent there is some ambiguity in the statute and regulations, the remedial purpose of the statute demands the ambiguity must be resolved in favor of including yield spread premiums within the trigger. Holding otherwise abandons the consumer protection goals of the statute to an organizational tool designed specifically to evade consumer protection laws. See CHRISTOPHER L. PETERSON, *TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH-COST CREDIT MARKET* 142-47 (2004). The proposed Responsible Lending Act recognizes this line of cases is almost certain to be overruled, and accordingly enshrines in statute the perverse incentive for lenders and brokers to circumvent HOEPA coverage with yield spread premiums.

penalties in calculating points and fee triggers.⁶²¹ Lenders charge a prepayment penalty if the consumer pays off a loan, usually by refinancing it, within a specified prepayment term.⁶²² State laws include this fee, even though it is contingent, because otherwise predatory lenders can intentionally induce borrowers to refinance specifically for the purpose of charging the prepayment penalty. Excluding prepayment penalties from the points and fees trigger is an invitation for predatory lenders to repeatedly flip loans and collect prepayment penalties outside the scope of the Act.

A third scope problem with the bill relates to its prohibition of single premium credit insurance in high-cost loans. The Act states, “[n]o consumer credit transaction involving a high-cost mortgage may include the offer or sale of any insurance policy, on a single premium basis, that insures, guarantees, or indemnifies the repayment of the outstanding balance of the loan against death, illness, accident, disability, or unemployment of the consumer.”⁶²³ But, unlike current Federal Reserve Board regulations, the Act is silent on whether such insurance is excluded in calculating the price thresholds, which in turn determine if Act covers the loan as a “high-cost” loan.⁶²⁴ Given this silence, chance exists that either the Federal Reserve Board or the courts would later allow lenders to craft loans with outrageously high insurance premiums that would never be considered high-cost loans under the Act, and accordingly would not be subject to the Act’s “ban” of single premium insurance. Thus, where the Act purports to stop single premium insurance, it instead leaves room for the creation of an ample loophole inviting lenders to push for exactly the opposite.⁶²⁵ Altogether the exceptions for yield spread premiums and prepayment penalties as well as silence on financed credit insurance suggest that any consumer protection gain made from a lower points and fees trigger will be swamped by diverting fees into excluded charges.

2. Contractual Restrictions and Disclosures

At the most fundamental level, the proposed Responsible Lending Act does nothing to prevent the most basic aspect of predatory lending: charging points and fees. Under the Act, lenders would remain free to charge whatever price the

621. See, e.g., N.C. GEN. STAT. § 24-1.1E(a)(5)(4) (2003) (stating that “[p]oints and fees” . . . includes [t]he maximum prepayment fees and penalties which may be charged or collected under the terms of the loan documents. . .”).

622. See *supra* notes 153-61 and accompanying text for a discussion of prepayment penalties.

623. H.R. 833 § 102(i), 108th Cong. (2003).

624. Compare H.R. 833 § 101(b) (no mention of insurance in section entitled “Points and Fees Defined”) with Regulation Z, 66 Fed. Reg. 65604, 65620 (Dec. 20, 2001) (“In determining ‘points and fees’ for purposes of this section, premiums paid at or before closing for credit insurance are included whether they are paid in cash or financed, and whether the amount represents the entire premium for the coverage or an initial payment.”).

625. The absence of explicit language including financed credit insurance in the bill’s new points and fees trigger is even more noticeable given that on the APR trigger, the bill does echo federal reserve board regulations. Choosing to echo one existing regulatory provision but not another may signal an intention to revise the credit insurance rule.

market will bear. In fact, because of the gaping federal preemption of state law, even the few imperfect impediments to excessive prices, such as the unconscionability doctrine, would no longer stand in lenders' way.

The proposed legislation does modestly expand some of the HOEPA contractual restrictions as well as incorporate a few new rules taken from state predatory lending acts.⁶²⁶ But, even these provisions have serious limitations. For example, the Act purports to address flipping by prohibiting refinancing of a high-cost home mortgage with another high-cost home mortgage within one year of consummation of the first loan.⁶²⁷ Originators could circumvent this rule in a host of ways. Most simply, lenders can wait twelve months to refinance. Once a year is still more than often enough to strip out the equity of a borrower's home—particularly where no limit exists as to the amount of points and fees lenders can charge. Less patient originators could stagger high-cost loans with loans at prices just under threshold triggers and continue to refinance as often as they like.⁶²⁸ The protection in the Responsible Lending Act is far weaker than those state predatory lending acts that have prohibited refinancing where a borrower accrues no tangible net benefit accrues.⁶²⁹

On arbitration clauses, the proposed Act states that "A high-cost mortgage may not be subject to a mandatory arbitration clause that is oppressive, unfair, unconscionable, or substantially in derogation of the rights of consumers."⁶³⁰ State law currently prohibits unconscionable arbitration clauses, suggesting this provision unlikely adds any additional consumer protection.⁶³¹ Because the Act as it is written, preempts all state unconscionability law restricting mortgage lending activities, retaining the standard for one particularly type of provision is parsimonious at best. Moreover, the Act only prohibits oppressive, unfair, or unconscionable arbitration clauses with respect to high-cost loans. Are

626. For instance, the bill tinkers with the existing HOEPA prepayment penalty restriction, narrowing the time in which such penalties are forbidden from five to four years. H.R. 833 § 102(a). Also, the bill would prohibit creditors from encouraging or recommending default on an existing loan in connection with the planned closing of a high-cost mortgage. *Id.* § 102(g).

627. *Id.* § 102(j).

628. For example, if the lender makes a high-cost loan in January, it could refinance in February with a mortgage that is slightly below the price thresholds for a "high-cost" loan. In March, the same lender would be free to refinance February's just-under-high-cost-loan with a new high-cost loan, repeating this procedure for as long there is still equity left in the home.

629. In comparison the North Carolina statute states:

No lender may knowingly or intentionally engage in the unfair act or practice of 'flipping' a consumer home loan. 'Flipping' a consumer loan is the making of a consumer home loan to a borrower which refinances an existing consumer home loan when the new loan does not have reasonable, tangible net benefit to the borrower considering all of the circumstances, including the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances.

N.C. GEN. STAT. § 24-10.2(c) (2003). The North Carolina provision applies regardless of whether the refinancing loan is a high-cost loan or not. *Id.*

630. H.R. 833 § 102(e), 108th Cong. (2003).

631. *Vimar Seguros y Reaseguros, S.A., v. M/V Sky Reefer*, 515 U.S. 528, 555-56 (1995) (O'Connor, J., concurring); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 892-93 (9th Cir. 2002).

oppressive arbitration clauses acceptable in moderately priced mortgages? Furthermore, instead of giving courts guidance on when to overturn arbitration clauses, the proposed statute enumerates a statutory safe harbor for lenders.⁶³² For safe harbor, lenders must arbitrate in the jurisdiction where the property is located and follow the standards of a national arbitration organization that requires the creditor bear all reasonable costs of the first two days of arbitrating.⁶³³ However, many consumer advocates strongly object to the fairness of the rules of most national arbitration organizations. And while the safe harbor rule requires creditors bear some costs, this is unlikely to help most consumers who litigate in defense of foreclosure. Because “creditors” are those to whom the debt is *initially* payable on the face of the note, the rule would not require *assignees* to bear borrower costs.⁶³⁴ But even more importantly, the Act does nothing to preserve consumers rights to class action representation, forcing borrowers’ attorneys to inefficiently arbitrate the same issues over and over again with respect to each borrower.

Perhaps allowing unlimited points and fees in high-cost loans would be less troubling if we could be at all certain that consumers would only agree to contracts with a full understanding of their terms and prices. Some state laws have attempted to accomplish exactly this by requiring independent home mortgage counseling prior to consummation of a high-cost home mortgage. In place of robust counseling, the proposed Responsible Lending Act requires the inclusion of three new warning statements in high-cost loan disclosure documents. They read:

The rate of interest and the amount of fees you pay on a loan may vary depending on which lender or broker you select.

The timing and amount of payments on debts you already are carrying contribute to the credit rating that is used to determine whether you may get a new loan and how much you will pay for that new loan. You should NOT accept any advice to ignore or delay making any payments on loans you already have, even if those loans will be paid off with the new loan.

You may get into serious financial difficulties if you use this loan to pay off old debts and then run up other new debts.⁶³⁵

The first fortune-cookie-like warning does nothing to make price comparison more feasible or efficient. The second disclosure seems to advise consumers never to accept any advice. And, the third disclosure gives a bland and obvious morsel letting consumers know that if they “run up” debts they may have financial trouble. While, charitably interpreted, these statements are all true, in the avalanche of documents and disclosures at a mortgage closing, such poorly drafted, confusing, and lukewarm warnings are highly unlikely to actually

632. H.R. 833 § 102(e).

633. *Id.*

634. 15 U.S.C. § 1602(f) (2004).

635. H.R. 833 § 102(l).

help anyone.⁶³⁶ In the information age, when the costs of sharing accurate comparative price information are lower than at any time in human history, these disclosures are remarkable only in their lack of ambition.⁶³⁷

3. Assignee Liability

The proposed Responsible Lending Act adopts the weaker Truth in Lending Act assignee liability standard currently applicable to non-HOEPA loans. The weaker general standard holds assignees liable only where a TILA violation is apparent from the face of the disclosure statement.⁶³⁸ This standard is more difficult to meet than the current HOEPA rule that provides for assignee liability unless the assignee demonstrates that a reasonable person exercising ordinary due diligence could not determine that the loan was a covered high-cost mortgage.⁶³⁹ Under current HOEPA rules, the default position makes assignees liable for originator violations.⁶⁴⁰ Assignees can only escape HOEPA liability where the assignee unintentionally purchased the note not realizing the loan was a high-cost loan and did so despite reasonable due diligence in screening to avoid purchasing high-cost loans.⁶⁴¹ With the Responsible Lending Act removing this default rule, assignees would be much less likely to be found liable for the predatory practices of brokers and originators.

Ironically, the proposed legislation would actually make establishing assignee liability on a high-cost mortgage *more difficult* than on a normal prime mortgage. The Act includes a new “safe harbor” provision providing that courts cannot hold assignees of high-cost mortgages liable for an originator’s illegal lending, if the assignee has reasonable screening procedures to prevent acquisition of high-cost loans.⁶⁴² No comparable safe harbor provision exists for assignees of traditional low-cost loans.⁶⁴³ Thus, quite literally, the proposed legislation gives secondary market assignees who follow “established industry norms,” however lax these norms are, complete immunity from even those originator violations that are apparent from the face of the documents.⁶⁴⁴ These changes would erode much of the already weak incentive for the secondary

636. See *Equity Predators: Stripping, Flipping, and Packing their Way to Profits: Hearing Before the Special Committee on Aging, U.S. Senate*, 105th Cong. 16 (Mar. 1998), at 15-17 (illustrating the uselessness of the warning sheets in high-cost loan disclosure documents).

637. Elsewhere I have argued in favor of using Internet technology to include average price terms correlated to the prospective borrower’s credit risk in loan disclosure documents. PETERSON, *supra* note 620, at 304-06. The purpose of such disclosure would be to show the borrower instantaneously whether the contract under consideration was out of line with comparable contracts available to the borrower. *Id.*

638. 15 U.S.C. § 1641(e) (2004).

639. *Id.* § 1641(d). See *supra* notes 380-83 and accompanying text for a discussion of HOEPA rules.

640. See *supra* notes 380-83 and accompanying text for a discussion of HOEPA rules.

641. *Id.*

642. H.R. 833 § 103(c)(2).

643. 15 U.S.C. § 1641.

644. H.R. 833 § 103(c)(2).

mortgage loan market to police originators.

Perhaps more significant, and yet certainly less apparent, is the Responsible Lending Act's effect on the current interrelationship between federal and state law. Currently, HOEPA provides an important federal vehicle for asserting state law claims and defenses against home mortgage assignees. As discussed in Section III.G, high-cost loan borrowers can use HOEPA's existing assignee liability rules to assert all claims and defenses—arising under both federal and state law—against the holder of their note.⁶⁴⁵ The proposed Responsible Lending Act shuts down this federal vehicle that establishes assignee liability for violations of state law. Instead of providing for assignee liability for “all claims and defenses . . . that the consumer could assert against the creditor,”⁶⁴⁶ the bill provides liability only for “an action under this title.”⁶⁴⁷ Thus, the Act would have wide consequences not only for assignee liability for federal claims and defenses to predatory lending, but also for state claims and defenses (to the extent they are not preempted anyway). This wide grant of assignee immunity would give the secondary market an even greater license to profit from predatory lending. It would further transform the nation's capital markets into a money laundering operation that removes the stain of predatory lending practices from the income streams associated with those loans.

Perhaps the congressional sponsors of the proposed Responsible Lending Act think they are simply preempting the new state predatory lending statutes, but whoever drafted this particular bill was more sanguine, crafting language that on its face preempts all state contract law. If passed, it will give predatory lenders a plausible argument to defend conduct that the common law has abhorred for centuries. Whether courts would tolerate such an interpretation remains in doubt. Nevertheless, predatory lenders would certainly use this plausible claim to impede and delay consumer litigation, which would undoubtedly perpetuate the shell game they play with legislatures, courts, and consumers.

C. *Congressional Power and the Future of Predatory Lending Regulation*

Not all congressional leaders have been cavalier with respect to these warning signs of a seismic shift toward federal power over mortgage lending generally and predatory lending in particular. For example, Senator Sarbanes, the ranking Democrat on the Senate Banking Committee, recently called OCC's new preemption regulations, “at best, misguided and, at worst, a blatant attempt to increase the power of the OCC at the expense of homeowners, the sovereignty of the states, and the intent of Congress.”⁶⁴⁸ Nevertheless, if the proposed Responsible Lending Act is a measure of Congressional intentions regarding predatory lending regulations, the current Congressional climate

644. See *supra* notes 380-83 for a discussion of HOEPA's liability rules.

646. 15 U.S.C. § 1641(d)(1).

647. H.R. 833 § 103(c)(2).

648. Michele Heller, *Surprisingly Hard Fight: Preempt Backers Found Themselves Scrambling*, AM. BANKER, Apr. 20, 2004, at 1.

should be seen less as advocating federal power than as advocating, in practice if not in name, the legalization of predatory lending. Representative Ney's proposed legislation serves as a warning sign about the finance industry lobby's intentions to not only eliminate the new breed of hybrid predatory lending statutes, but also the myriad common law rules, administrative regulations, and state statutes which have protected homeowners (albeit with limited success) for over a hundred years. In exchange, the proposed Act is a narrowly crafted federal statute riddled with exceptions and redundancies. Rather than shifting consumer protection from the states to the federal government, it would simply do away with all protection but a few paltry tidbits of sound-bite-friendly code.

Even if this particular bill is defeated, the proposed Responsible Lending Act serves as a useful springboard for developing a model that identifies toothless preemptive regulation. In the future, both consumer advocates and state's rights advocates should look for several warning signs illustrated by Representative Ney's legislation. First, consumer and state's rights advocates should look for misleadingly expansive exceptions to the scope of federal legislation. The Ney bill illustrates how a law can nominally reduce price threshold triggers, but at the same time, practically enlarge them through exceptions for yield spread premiums, prepayment penalties, and other fees. Second, consumer and state's rights advocates must direct public attention away from proposals that address less important predatory practices while avoiding fundamental abuses. Third, finance industry lobbyists are likely to narrowly craft substantive contractual restrictions to create only cosmetic protection. The Ney bill's one-year restriction on refinancing with a high-cost loan is an example of such a narrowly crafted provision. Fourth, consumer and state's rights advocates must carefully compare proposed consumer protections to existing protections to check bills that merely echoing existing law to create an illusion of progress. Fifth, consumer and state's rights advocates should be unwilling to trade away substantive state protections for pointless federal disclosures that do not meaningfully reduce the credit applicant's transaction costs in price comparison. And finally, in an age of securitization, all remedies must be examined through a prism of assignee liability law. A remedy that does not apply to assignees is functionally close to no remedy at all.

VII. CONCLUSION

In recent years much of the debate over predatory lending has been cast as a struggle between federal and state power. While there is certainly truth in this characterization, this rhetoric has also helped mask a deregulatory agenda. Both in Congress and in federal administrative agencies, language supporting uniform regulation—that is language regarding the level of government that would most efficiently regulate—has thus far concealed proposals that do not regulate at all. The surface of the discussion has been about uniformity, but the substance has been about deregulation. This Article's point has not been to explore whether state government or federal government is the most appropriate level for regulation, but rather to make clear that the argument for uniform rules has

become a cloak for a different equally familiar debate about more or less regulation.

Proponents of preemption have strong political motives for casting the debate as one of the balance of power rather than regulatory oversight. Because for generations political conservatives have opposed the consolidation of federal power, they now have the moral high ground when making concessions on the elimination of state's rights. Political conservatives may cast themselves as making a reasonable concession when advocating use of federal power, but arouse suspicion when advocating deregulation. Moreover, advocates of strong consumer protection regulation are historically ambivalent about the protection of local government power. In general, political liberals care more about the content of regulation, and little or not at all about the loss of state rights. The same may be said for much of the general public. Advocates of deregulation have recognized that they are better off with an esoteric philosophical discussion about the merits of federal versus state power than they are arguing to eliminate laws that protect senior citizens from predatory lenders.

For consumer advocates, as well as for those that seek a more moderate path toward uniform meaningful regulation, the temptation to wrest power away from the states in exchange for improvements to the currently weak Home Ownership and Equity Protection Act will be great. It is not the purpose of this Article to resolve the age-old debate over whether the federal government, the states, or both together, is the best locus of regulation. But for those policymakers genuinely supportive of consumer welfare, the extremely complicated interrelationship between federal and state mortgage lending law makes preemption fraught with the risk of miscalculation. Congressional leaders and consumer advocates, in the hope of passing better federal consumer protections, may inadvertently shortchange consumers by accepting a compromise on preemption. Unless they are careful, consumer lobbyists and consumer friendly congressional leaders could easily discover a consumer protection-for-preemption deal was less of a bargain than they thought. And once federal power is enshrined, fixing consumer abuses through the lengthy and high stakes Congressional policymaking cycle and without the benefit of state innovation could become much more difficult. Predatory lending regulation would certainly not be the first area of law to stagnate after the federal government stepped in, with the best intentions, to preclude state and local action.⁶⁴⁹ Legislative staffers, consumer advocates, and the academy must rigorously guard against these risks.

Ironically, those conservatives who, in the best tradition of cautious government, are genuinely concerned about the preservation of state power may have even more to fear from those who pretend to for the sake of a deregulatory agenda. There is a real and abiding virtue in our federalist system of

649. See Cynthia L. Estlund, *The Ossification of American Labor Law*, 102 COLUM. L. REV. 1527, 1597 n.298 (2002) (arguing that a "mixed federal-state regime would probably have been more amenable to change through political action and possibly constitutional challenge than the current regime has been.")

government. The overreaching of national power may well have long-term consequences beyond the consumer finance issues which motivated the change. President Washington himself gave a stern warning on the risks of this structural instability in the American constitutional system in his farewell address:

It is important, likewise, that the habits of thinking in a free country should inspire caution, in those intrusted with its administration, to confine themselves within their respective constitutional spheres, avoiding in the exercise of the powers of one department to encroach upon another. The spirit of encroachment tends to consolidate the powers of all the departments in one, and thus to create, whatever the form of government, a real despotism. . . . [L]et there be no change by usurpation; for, though this, in one instance, may be the instrument of good, it is the customary weapon by which free governments are destroyed. The precedent must always greatly overbalance in permanent evil any partial or transient benefit, which the use can at any time yield.⁶⁵⁰

To the extent that there is true virtue in state governance, preemption in the name of uniformity but in the spirit of deregulation is profoundly troubling. It is permanent usurpation of a historically state power, for what may well be a temporary policy objective. And it is contrary to the best traditions of federalist governance.

650. George Washington, Farewell Address (Sept. 17, 1796), *in* THE FEDERALIST PAPERS READER AND HISTORICAL DOCUMENTS OF OUR AMERICAN HERITAGE, 232, 239-40 (Frederick Quinn ed., 1997).