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Truly Protecting the Consumer in Light of the Subprime Mortgage Crisis: How Generally Applicable State Consumer Protection Laws Must be a Key Tool in Keeping Lending Institutions Honest

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NOTES

TRULY PROTECTING THE CONSUMER IN LIGHT OF THE SUBPRIME MORTGAGE CRISIS:

HOW GENERALLY APPLICABLE STATE CONSUMER PROTECTION LAWS MUST BE A KEY TOOL IN KEEPING LENDING INSTITUTIONS HONEST

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INTRODUCTION

"There needs to be more focus on consumers."[1] President of the American Bankers Association, Edward L. Yingling, will at least concede that sentiment in the wake of homeowners losing an estimated $3.3 trillion in equity in 2008, predictions that 8.1 million homes in the United States will likely be foreclosed upon in the next four years and various other

[1] Joe Nocera, *Have Banks No Shame?*, N.Y. TIMES, October 9, 2009, at B1.

disturbing results of the recent subprime mortgage crisis.[2] Beyond simply acknowledging that there must be more focus on consumers in the lending industry, lenders and their lobbyists have shown, and continue to exhibit, a proclivity to fight the imposition of any proposed consumer protection-oriented regulations.[3] In fact, recently those in the banking industry, and their lobbyists, have demonized the Obama administration's soon to be enacted Consumer Financial Protection Agency by classifying it as "a bunch of power-hungry bureaucrats who want to impose onerous new regulations."[4]

Politics aside, it is important to acknowledge the enormity of the crisis produced by the current system. Though estimates of the total number of families who will *lose* homes as a result of subprime mortgages vary widely,[5] a recent study by the Center for Responsible Lending projects that 1 in 4 subprime loans are either delinquent or in foreclosure, and an estimated total of 2.4 million foreclosures occurred in 2009 alone.[6] The study further predicts that over the next four years foreclosures will affect 91.5 million "*nearby* homes," reducing property values totaling $1.86 trillion, or $20,300 per household.[7] Beyond the study, politicians and scholars assert that there needs to be reinvestment in rebuilding foreclosed and abandoned homes in neighborhoods throughout the country, as many have experienced devaluation in properties and increases in crime.[8] The

2 Kurt Eggert, *The Great Collapse: How Securitization Caused the Subprime Meltdown*, 41 CONN. L. REV. 1257, 1260 (2009); *see generally* R. Christopher Whalen, *The Subprime Crisis- Cause, Effect and Consequences*, 17 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 219, 227-31 (2008) (listing and explaining various effects of the subprime crisis).

3 *See* Nocera, *supra* note 1 (noting that critics assert that the banks have continued to oppose consumer protection even under Treasury Secretary Tim Geithner, who has been more generous to them than his predecessors); Carl Hulse, *Citi Reaches Deal With Lawmakers on Home Loans*, N.Y. TIMES, January 8, 2008, at B1 (asserting that financial industry lobbyists vowed to fight legislation that would let bankruptcy judges adjust mortgages for at-risk borrowers).

4 Joe Nocera, *The Consumer Financial Protection Agency Gets a Big Push*. . http://executivesuite.blogs.nytimes.com/2009/10/09/the-consumer-financial-protection-agency-gets-a-big-push/; *see also* Ann Graham, *Financial Regulatory Reform: Genesis Progress, and Impact*, 55 VILL. L. REV. 603, 610-11 (2010).

5 Alan M. White, *The Case For Banning Subprime Mortgages*, 77 U. CIN. L. REV. 617, 631 (2008) (noting the disparity among reported home losses resulting form the subprime crisis); *see also* Christopher A. Richardson, *An Economic View of the Housing Crisis*, 41 CONN L. REV. 1133, 1136-37 (2009) (noting that delinquency rates in subprime mortgages were almost five times that of prime mortgages).

6 Center For Responsible Lending, *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average* at 1, (May 2009) *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

7 *Id.* at 2.

8 *See* Press Release, N.J. Governor David A. Paterson, Governor Paterson Announces $59 Million to Assist Communities Affected By Foreclosure and Subprime Crises (Apr. 14, 2009), *available at* http://www.state.ny.us/governor/press/press_0414094.html (summarizing thoughts from politicians across the country about remedying damages resulting from the subprime mortgage crisis); Posting of

general conclusion from this study is that the epidemic of home loss is severe and it is imperative that policymakers take action to assist struggling homeowners, as well as enact common-sense regulations to ensure this disaster does not happen again.[9]

Some advocate for a total ban on the practice of subprime mortgage lending because it "created a market in which predatory lending could flourish".[10] However, following through on such a ban is difficult in practice because there is no exact definition of a subprime mortgage.[11] To understand what a subprime mortgage is, it is useful to focus on "two defining features: (1) the borrower, because of income and credit history, is more likely to default on the mortgage; and (2) the terms of the mortgage are less favorable than a typical, 'prime' mortgage."[12] The mechanics of subprime lending, along with the related practice of securitization, will later be explored in detail. Predatory lending also does not have a precise or uniform definition.[13] It is a phrase used to describe various lending practices, but an all-encompassing definition is difficult to discover because classification of lending behavior as predatory or fair depends invariably upon context and the standards of the beholder.[14] Any definition, therefore, must be flexible, accommodate context, and focus on the intent

Katherine Santiago to NJ.com, *N.J. report shows crime rose 5 percent in early 2008*, (May 4, 2009, 19:27 EST) *available at*, http://www.nj.com/news/index.ssf/2009/05/nj_crime_rate_rose_5_percent_i /1607/comments-newest.html (stating that a Rutgers University professor attributed increases in crime to abandoned homes in the wake of the subprime mortgage crisis).

9 *See* Center For Responsible Lending, *supra* note 6, at 3.

10 White, *supra* note 5, at 633-34; *see also* Barbara Crutchfield George et al., *The Opaque And Under-Regulated Hedge Fund Industry: Victim Or Culprit In The Subprime Mortgage Crisis?*, 5 N.Y.U. J.L. & BUS. 359, 380 (2009) (noting that Federal Reserve Board Chairman Alan Greenspan never exercised his authority to "ban financially irresponsible mortgages, such as subprime loans").

11 *See* Michael Aleo & Pablo Svirsky, *Foreclosure Fallout: The Banking Industry's Attack on Disparate Impact Race Discrimination Claims Under the Fair Housing Act and the Equal Credit Opportunity Act*, 18 B.U. PUB. INT. L.J. 1, 3; *see also* C. Lincoln Combs, *Banking Law and Regulation: Predatory Lending in Arizona*, 38 ARIZ. ST. L.J. 617, 619 n.11, 621 (2006).

12 Aleo & Svirsky, *supra* note 11; Jonathan Macey, et al., *Helping Law Catch Up to Markets: Applying Broker-Dealer Law to Subprime Mortgages*, 34 IOWA J. CORP. L. 789, 799 (2009) (attempting to supply a functional definition of a subprime mortgage).

13 Baher Azmy, *Squaring The Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 297 (2005) ("'[P]redatory lending' in the home-mortgage market eludes a precise or uniform definition."); *see* Hasa A. Kingo, *Preying On tThe American Dream: The Argument For HOEPA Reform Amidst Predatory Lending's Dire Effects On The Elderly Poor*, 17 GEO. J. POVERTY L. & POL'Y 335, 367 (2010) (stating that there is no consensus about a definition of predatory lending).

14 Azmy, *supra* note 13, at 299-300 ("[d]efinitions are particularly elusive because the classification of lending behavior as predatory or fair depends invariably upon context."); James H. Carr & Lopa Kolluri, Fannie Mae Foundation, *Predatory Lending: An Overview* (2001), http://www.knowledgeplex.org/kp/textdocumentsummary/article/relfiles/hottpics/Carr-Kolluri.pdf ("depending on the unique characteristics of an individual loan and specific borrower, loan provisions that may be predatory in one instance, such as a prepayment penalty, may be reasonable and legitimate under others.")

of the lender as well as the impact on the victim.[15] Therefore, whether a particular subprime mortgage should be classified as predatory can be debated. However, it cannot be contested that the interplay between the issuance of subprime mortgages and predatory lending practices deserves great attention in the wake of the subprime mortgage crisis.

This note will argue that the most effective way to protect the consumer, and the country as a whole, from another disaster like the subprime mortgage crisis of the 2000s is through the enforcement of state statutes that prohibit unfair or deceptive acts and practices ("state UDAP statutes"),[16] or a similar state consumer protection law that is generally applicable to all types of businesses, in conjunction with the more pointed federal and state laws regulating lending that are currently codified. In practice, this means that judges who are confronted with a claim that a particular lender has engaged in an "unfair or deceptive act or practice," despite not engaging in conduct affirmatively illegal under the more pointed federal and state statutes, must take into account the public policy behind such law and employ balancing tests to determine if the consumer was unfairly taken advantage of based on the facts and circumstances of the particular case.[17]

Given the current conditions,[18] it should be evident that sufficient and lasting protection against consumers executing unfavorable loans must go beyond the previous methodology employed by the government. Government at the federal and state levels has either had difficulties in enforcing laws passed to address predatory lending, or simply neglected to enforce the existing laws.[19] In response to this failure, it will be shown that employment of state UDAP statutes to predatory lending would more often afford borrowers the right to have the legal system determine whether they were taken advantage of, regardless of whether or not the alleged culprit found a way get around the more pointed, lending specific statues.[20] Such flexible judicial power, in having the ability to rule for a wronged consumer, is a necessary check on an industry that often has acted without

15 Azmy, *supra* note 13, at 300 ("Any definition, therefore, must be flexible and accommodate context and not only should identify core objective criteria but also should focus on the intent of the lender as well as the impact on the victim."); Carr & Kolluri, *supra* note 14 ("For this reason, regulatory agencies and other institutions are cautious about instituting broad-based and sweeping regulations that could undermine legitimate sources of financing for credit-impaired households.")

16 *See e.g.*, MASS. GEN. LAWS ANN. ch. 93A, § 2 (2010); NY GEN BUS LAW §349 (2010).

17 *See infra* Part IV A.

18 *See supra* pp. 1-2; *infra* Part I C.

19 *See infra* Parts II & III; Kingo, *supra* note 13 (stating that confusion leads to nominal enforcement and the mere existence of laws negates the need for their aggressive enforcement).

20 *See* discussion *infra* Part IV.

regard to whether their loan "product" is actually prudent for a borrower to "buy."[21]

Part I of this note explains the explosion and prevalence of subprime mortgage lending, the mechanics and dangers of the securitization process underlying subprime lending and predatory lending practices. Part II explores federal and state legislation enacted to protect consumers. Part III outlines the development of federal agencies that are charged with protecting consumers from predatory lending and discusses the damaging effects of those agencies' use of preemption. Part IV concludes by advocating for judges to entertain private lawsuits against lenders under state UDAP statutes. Part IV also argues that if judges employ balancing tests similar to that used in *Commonwealth v. Fremont Investment & Loan*[22] in such lawsuits, it could go a long way in ensuring there will never be a similar crisis in the future.

I. SUBPRIME MORTGAGE LENDING, PREDATORY LENDING PRACTICES AND HOW THE RECENT UNCHECKED PREVALENCE OF BOTH HAS RESULTED IN AN ECONOMIC CRISIS

This part explores controversial lending practices and how their pervasiveness led to recent crisis conditions. Section A discusses the three quality categories comprising the mortgage market, and explains why subprime mortgages are by far the . It then explores the framework of securitization and how its application to subprime mortgage lending practices first led to a boom in the American mortgage market, and then, just as quickly, helped contribute to today's crisis conditions. Section B then turns to predatory lending, which typically involves the use of deceptive tactics by lenders, some affirmatively illegal and others on the fringe of legality, to entice borrowers to give them business. It further expounds upon the notion that differentiating between an acceptable subprime loan and a predatory one is not an easy task, but the context of the loan at issue is certainly a key consideration. Section C ends by describing some of the devastating effects of the subprime mortgage crisis, to illustrating that there must never be another such crisis.

[21] *See* discussion *infra* Part I; *see e.g.*, Jenifer B. McKim, *Attorney Sues Lenders, Says They Created 'Toxic' Products*, BOSTON GLOBE, Aug. 5, 2009 (describing an action brought against subprime lenders).

[22] No. 07-4373-BLS1, 2008 WL 1913940 (Mass. Super. Ct. Mar. 31, 2008).

A. Subprime Mortgage Lending

a. The Mechanics of Subprime Mortgages and Securitization

Modern home mortgages generally fall into three broad credit quality categories, with subprime mortgages being the riskiest.[23] The most prevalent type of residential mortgage is the conforming mortgage.[24] Conforming mortgages are so named because they meet the standards required for purchase by government sponsored entities such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac").[25] In order to have this designation, the mortgage at issue must have an initial principal amount of less than $417,000 and meet six additional criteria.[26] The second type of mortgage is known as an "Alt-A" mortgage.[27] "Alt-A" mortgages fail to meet the standards of conforming loans because they fail to meet one of the requisite standards.[28] Since "Alt-A" loans are slightly riskier, borrowers will usually pay a higher interest rate and more fees than a conforming

23 *See* David Schmudde, *Responding To The Subprime Mess: The New Regulatory Landscape*, 14 FORDHAM J. CORP. & FIN. L. 709, 715-16 (2009) (providing an overview of the mortgage landscape before the housing crisis); Sumit Agarwal, et al., *Comparing the Prime and Subprime Mortgage Markets* 241 CHI. FED LETTER 1, 1 (2007), *available at* http://qa.chicagofed.org/digital_assets/ publications/chicago_fed_letter/2007/ cflaugust2007_241.pdf (differentiating between prime, subprime, and "Alt-A" mortgages).

24 *See* Schmudde, *supra* note 23, at 715 (describing three different types of mortgages); Agarwal, et al., *supra* note 23, at 2 ("According to the Mortgage Bankers Association, prime mortgages make up about 80% of the mortgage market, subprime mortgages about 15%, and Alt-A loans about 5%.").

25 *See* 12 U.S.C. § 1717(b)(1) (2008) *amended by* Pub. L. No. 110-289 (defining the requirements that must be fulfilled before a mortgages can be purchased or sold); Schmudde, *supra* note 23, at 716 (explaining conforming mortgages).

26 See 12 U.S.C. § 1717(b)(2) *amended by* Pub. L. No. 110-289 stating that conforming mortgages "shall not exceed $417,000 for a mortgage secured by a single-family residence, $533,850 for a mortgage secured by a 2-family residence, $645,300 for a mortgage secured by a 3-family residence, and $801,950 for a mortgage secured by a 4-family residence"; Schmudde, *supra* note 23, at 717. These criteria are:

> (1) The borrower's income must be verified (usually with wage statements and income tax returns); (2) The borrower must have good credit (a credit score of 720 or higher); (3) The proposed mortgage principal must be less than 80% of the appraised value of the home (a loan-to-value ratio of 80% or less);(4) The proposed monthly mortgage payment plus the monthly real estate tax bill must not exceed 28% of the borrower's gross monthly income; (5) The borrower may not have other excessive outstanding loans or debt; and (6) Total debt payments, including this mortgage, do not exceed 35% of the borrower's gross monthly income. *Id.*

27 *See* Schmudde, *supra* note 23, at 718 (providing an overview of "Alt-A" mortgages); Agarwal, et al., *supra* note 23, at 2 ("[B]orrowers who have relatively good current credit scores, but who fail to provide sufficient documentation to verify income or who have high [debt-to-income] ratios, are eligible for Alt-A loans").

28 One missing requirement could include a credit score below the conforming standards. *See* Schmudde, *supra* note 23, at 718. A leading scholar has defined the "Alt-A" mortgage lending market as covering "medium risk" loans between subprime and prime. Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1089 (2009).

borrower.[29] Nonetheless, "Alt-A" loans are generally expected to perform in the future.[30] The third classification for residential loans, and those with the highest risk of default, are subprime mortgages.[31]

Subprime mortgages are controversial because they are non-conforming mortgages which fall far short of reaching the standards and practices required for conforming loans.[32] Subprime borrowers are subjected to significantly higher interest rates and fees than conforming or Alt-A borrowers.[33] While many borrowers did not fully appreciate the unfavorable terms they were signing up for,[34] even borrowers who understood the conditions paid little heed to the obvious dangers of such a loan because they were simply happy to be offered a mortgage.[35] In recent years, most subprime mortgages were made with no verification of the borrower's income ("no doc" or "no document loans"),[36] and many were obtained by borrowers with poor credit history and credit scores below 580.[37] Subprime mortgages were often given for close to 100% value of the

[29] *See* Schmudde, *supra* note 23, at 718 (explaining that "Alt-A" loans carry higher interest rates because they are generally made on "less favorable terms than conforming loans"); Agarwal, et al., *supra* note 23, at 2 (describing the risk level associated with "Alt-A" loans).

[30] *See* Schmudde, *supra* note 23, at 718-19. This may explain why the "Alt-A" market recently experienced significant growth, much like subprime mortgage lending, "expanding from 2 percent of total originations in 2003 to 13 percent of originations in 2006." Bar-Gill, *supra* note 28, at 1089.

[31] *See* Schmudde, *supra* note 23, at 719 (defining subprime mortgages as "non-conforming mortgages which do not meet the standards for conforming loans by a substantial margin"); Agarwal, et al., *supra* note 23, at 1 (suggesting that that "[t]he main difference between prime and subprime mortgages lies in the risk profile of the borrower," and that "subprime mortgages are offered to higher-risk borrowers").

[32] *See* Schmudde, *supra* note 23, at719 (arguing that U.S. residential mortgages were a substantial cause of the recent financial meltdown); *see also* text accompanying notes 33-39 (describing the onerous terms accepted by subprime borrowers, and the substantial discrepancy between subprime and conforming mortgage requirements).

[33] Schmudde, *supra* note 23, at 720 (discussing the general terms of most subprime mortgages); *see* Bar-Gill, *supra note 28, at* 1075 (noting that the additional risk uniquely associated with subprime loans manifested in higher interest rates for subprime borrowers).

[34] Shelley Smith, *Reforming the Law of Adhesion Contracts: A Judicial Response to the Sub-Prime Mortgage Crisis*, 14 LEWIS & CLARK L. REV. 1035, 1043 (2010) (postulating that the millions of teaser-rate subprime loans issued suggest that many borrowers were not cognizant of the "risks inherent in their agreements"); McKim, *supra* note 21, at 5 ("I feel as though I've been fooled or bamboozled into this program that they locked me into knowing from the very start it would be unaffordable for me . . . Have you ever felt hopeless? That's how I'm feeling").

[35] Schmudde, *supra* note 23, at 720 (finding that borrowers were willing to accept the onerous terms of a subprime mortgage because they were happy to be offered a mortgage in the first place); *see* Smith, *supra* note 34, at 1040 (identifying residential mortgages as adhesion contracts because borrowers have "no choice but to accept the lenders' terms or forgo purchasing their home").

[36] Eggert, *supra* note 2, at 1286 (asserting that many loans were made to borrowers with no documented ability to repay, including no confirmation of income, employment, or any assets); *see* Baldy Martinez, *Subprime Loans: Turning the American Dream into a Nightmare*, 21 ST. THOMAS L. REV. 514, 519-20 (2009) (explaining that the frequent use of "no doc loans" attracted subprime borrowers with little or no documentation of their ability to repay the loan).

[37] Schmudde, *supra* note 23, at 719 (contrasting subprime mortgages with conforming mortgages that require a credit score of 720 or higher); *see* Evan M. Gilreath, *The Entrance of Banks into Subprime*

home and at a 10-11% annual percentage rate.[38] Also, mortgage brokers took home an additional 0.2% to 0.4% in fees at origination.[39] In addition, there were some subprime mortgages made to well-qualified speculators who would leverage the purchase of many homes and condominiums "in the hope that they could be quickly 'flipped' for an easy profit".[40]

The subprime mortgage crisis was caused in large part by the financial mechanism of securitization, which had previously caused the subprime lending business to thrive in the late 1990s.[41] Securitization of subprime loans began in the late 1980s, when subprime lenders in California realized they could offload their subprime loans to Wall Street investors by selling securities based on a pool of those subprime loans.[42] For years, many commentators had praised securitization and its benefits for the mortgage industry.[43] Securitization of subprime mortgages further grew and thrived

Lending: First Union and The Money Store, 3 N.C. BANKING INST. 149, 150-51 (1999) (describing three broad categories of people who seek out subprime loans: people with poor credit, people with very little credit history, and people who are over-indebted).

38 Schmudde, *supra* note 23, at 719 (distinguishing subprime mortgages from conforming mortgages that require a loan-to-value ratio of 80% or less); *See* Martinez, *supra* note 36, at 532 (noting that when a borrower financed 100% of the purchase price, as was commonly done, the borrower had limited or no equity in the property).

39 Schmudde, *supra* note 23, at 720 (scrutinizing the practices of "greedy lenders" offering subprime mortgages); *see* Christina Binkley, *Mortgage Lenders Pursue Once-Shunned Borrowers*, WALL ST. J., Sept. 11, 1996, at F1(explaining that subprime loans are profitable to lenders not only because of high interest rates but because of origination fees of 5-10% of the loan total).

40 Schmudde, *supra* note 23, at 720 (identifying additional ways the subprime market was taken advantage of by opportunistic borrowers); *see* Todd J. Zywicki & Joseph D. Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO L. REV. 1 (2009) (suggesting that some subprime borrowers engaged in "Ponzi-like schemes" where they would "flip" the home, resell it for profit, and retire the mortgage).

41 *See* Eggert, *supra* note 2, at 1262, 1267 (proposing that securitization was a significant cause of the subprime boom in the late 1990s and eventual crash); *cf.* Richard M. Hynes, *Securitization, Agency Costs, and The Subprime Crisis*, 4 VA. L. & BUS. REV. 231, 275 (2009) (arguing that banking deregulation was more to blame for the crisis than securitization, but noting that regulators may want to ban securitization on other grounds).

42 Eggert, *supra* note 2, at 1266. The following is a "thumbnail sketch" of the how securitization is accomplished according to a leading scholar:

> In the process of mortgage securitization, a pool of mortgages is assembled ('pooled') and transferred to an entity designed solely to hold those loans (the 'Special-Purpose Vehicle' or SPV). Securities are then issued which are backed by those mortgages, and the securities are sold to investors, who will be repaid from the payments made by borrowers or the proceeds of foreclosure sales. A servicer collects the mortgage payments and may foreclose if necessary. Typically, an investment house is involved in the pooling of subprime mortgages and resulting sale of securities, and a rating agency rates the resulting securities. To provide different investors with securities featuring different sets of risk and rewards, interest in the payment flow from the mortgages is divided up into different strips of payments, called tranches, so that some securities receive an earlier and more secure income stream in exchange for a lower return. The securitization is set up so that the majority of the resulting securities would be rated AAA by the rating agencies, indicating that they should be highly secure.

See also Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2045 (2007).

43 *See* Eggert, *supra* note 2, at 1265; *see also* Stephen L. Schwarcz, *The Alchemy of Asset*

by allowing investors throughout the world to invest in real estate in the United States through the purchase of securities backed by American residential mortgages.[44] However, the securitization model was fundamentally flawed because it allowed many subprime lenders to profitably fail[45] - that is, companies would give out as many subprime loans as possible during boom years, turn such loans into immediate profits through securitization, and then go out of business, leaving billions of dollars of bad loans in their wake.[46] Also, many actors involved in securitization, including subprime loan originators and investors, were paid based on the quantity rather than the quality of loans that they dealt with, which led encouraged them to handle increasingly lower quality loans.[47] Loan originators and their Wall Street enablers would securitize the resulting risky loans, and sell mortgage-backed securities to investors.[48] Also, subprime borrowers were convinced to pay 3% to 5% more in interest, over the going rate for prime mortgages even though aggregate losses to investors in mortgage backed securities did not call for such a high rate prior to the entire system collapsing.[49]

b. An Explosion in the Pervasiveness of Subprime Mortgages

The enormous short term profitability afforded to subprime mortgage

Securitization, 1 STAN. J.L. BUS. & FIN. 133, 133 (1994) (illustrating how "securitization enables many companies to raise funds at a lower cost than through traditional financing).

44 *See* Eggert, *supra* note 2, at 1265. "At least partially as a result of the funds pouring into the American mortgage market, prices for American homes boomed, with average home prices increasing from about $150,000 in 1997 to more than $250,000 in 2005."; *see also* L. Randall Wray, *Lessons from the Subprime Meltdown,* LEVY ECON. INST. OF BARD COLL. Working Paper No. 522 (2007) *available at* http://ssrn.com/abstract=1070833.

45 Eggert *supra* note 2, at 1263 (explaining that securitization allowed operators of subprime lending institutions to profit no matter what ultimately happened to the loans that their institutions had originated); *see also* Michael G. Jacobides, *Mortgage Banking Unbundling: Structure, Automation and Profit,* MORTGAGE BANKING, Jan. 1, 2001, at 28 (claiming that the mortgage banking industry is "one of the most fascinating examples of vertical disintegration and reconfiguration" in business history).

46 Eggert, *supra* note 2, at 1263 (noting that lenders engaging in this model established the culture and business methods of the subprime market); *see also* Bernhard Grossfeld &Hansjoerg Heppe, *Perspective: The 2008 Bankruptcy of Literacy - A Legal Analysis of the Subprime Mortgage Fiasco,* 15 LAW & BUS. REV. AM. 713, 727 (explaining the culture of the subprime market and subsequent popularity of betting on the materialization of certain default risks).

47 Eggert, *supra* note 2, at 1263. Further, credit ratings agencies did not help matters as often their interests aligned with the lenders, or in some cases they failed to adequately rate the mortgage backed securities because they were overwhelmed by their complexity. *See id.* at 1268; *see also* discussion *infra* pp. 16-17.

48 *See* Eggert, *supra* note 2, at 1263; *see also* Joe Nocera, *Lessons from the Financial Crisis,* 52 ARIZ. L. REV. 1, 3 (2010) (summarizing how mortgage-backed securities became corrupted, as originators sold loans to Wall Street that borrowers were unable to pay back).

49 White, *supra* note 5, at 619; *see also* EDWARD G. GRAMLICH, SUBPRIME MORTGAGES: AMERICA'S LATEST BOOM AND BUST 17 (2007) (explaining that, while subprime mortgages may sound like a bad deal, it is still the cheapest source of credit for millions of potential borrowers).

lenders through securitization and greater accessibility for low-income families who were previously unable to buy homes led to a large spike in the popularity of subprime lending, along with a widely held belief that the benefits outweighed any possible harms.[50] Consequently, subprime mortgages grew from $35 billion in 1995 to an astounding $807 billion in 2005.[51] Subprime mortgages made up nearly 20% of the mortgage market in 2005, compared to less than 5% in 2001.[52] On Wall Street, the issuance of collateralized debt obligation securities ("CDO securities"), backed by subprime mortgages through the securitization process, increased from $300 billion to almost $2 trillion between 1997 and 2006.[53] As the subprime mortgage industry grew to unforeseeable heights, the effects on subprime borrowers who could not afford the onerous terms of their loans were effectively ignored because the very same process of securitization that allowed for maximum profitability in the business world also created structural barriers to effective loan modification for defaulting borrowers.[54] Often contracts underlying securitization would prohibit modifications outright, vastly limit allowable modifications, or require consent of rating agencies, bond insurers, or other parties with a stake in the mortgage backed security at issue.[55] The resulting indebted consumers, now in worse

[50] White, *supra* note 5, at 620; *see* Kenneth W. Dam, *The Subprime Crisis And Financial Regulation: International And Comparative Perspectives*, 10 CHI. J. INT'L L. 581, 636 (2010) ("The US focus on affordable housing is socially praiseworthy and politically popular, but it was also the breeding ground for the subprime crisis").

[51] Schmudde, *supra* note 23, at 719 (discussing the rise in subprime lending); Frank L. Raiter, *Credit Rating Agencies and the Financial Crisis: Hearing Before the H. Comm. on Oversight and Government Reform*, 110th Cong. 2 (2008) (statement of Frank L. Raiter, Managing Director and Head of Residential Mortgage Backed Securities Ratings Group, Standard and Poor's), *available at* http://oversight.house.gov/images/stories/Hearings/Committee_on_Oversight/RaiterTestimony.pdf.

[52] Schmudde, *supra* note 23, at 720-21; Chris Mayer & Karen Pence, *Subprime Mortgages: What, Where, and to Whom?* 25 fig.1B (Fed. Reserve Bd. Fin. & Econ. Discussion Series, Divs. of Research & Statistics & Monetary Affairs, NBER Working Paper No. 14083, June 2008), *available at* http://www.federalreserve.gov/PUBS/FEDS/2008/200829/200829pap.pdf. (reporting subprime lending's share of the mortgage market).

[53] Eggert, *supra* note 2, at 1267 (discussing the process of securitization and Wall Street's roll in the securitization of subprime backed loans); Yongheng Deng et al., *CDO Market Implosion and the Pricing Of Subprime Mortgage-Backed Securities*, at 3 (Working Paper No. Mar., 2009), (discussing the rise of CDO issuing) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1356630).

[54] *See* Kurt Eggert, *Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good for Business* and *Affordable Homeownership Policy": What Prevents Loan Modifications?*, 18 HOUSING POL'Y DEBATE 279, 279 (2007) (putting forth several factors that affect the likelihood of loan modification); Navid Vazire, *Flawed Institutions and Markets: From the Savings & Loan Debacle Forward: Smoke and Mirrors: Predatory Lending and the Subprime Mortgage Loan Securitization Pyramid Scheme*, 30 PACE L. REV. 41, 43-44 (2009) (discussing the numerous fees collected by originators, and their lack of concern for a borrower's ability to repay the debt).

[55] *See* Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 93 (2009) (explaining various barriers that securitization puts on the ability to modify underlying mortgages); Raymond H. Brescia, *Capital in Chaos: The Subprime Mortgage Crisis and the Social Capital Response*, 56 CLEV. ST. L. REV. 271, 299 (2008) (concluding that market forces

financial shape than before they became homeowners, undoubtedly felt just like others who had been victims of predatory lending.[56]

B. Predatory Lending Practices

a. Various Tactics Employed In Predatory Lending

While predatory lending escapes a uniform definition, it generally involves the use of fraudulent tactics to induce a borrower to enter into a loan transaction.[57] Predatory lending has been classified as a shadowy practice of particular mortgage brokers and finance companies manipulating vulnerable low-income, elderly, and minority homeowners into accepting mortgage products that would quickly, and inevitably, result in devastating home foreclosures.[58] While early cases of predatory lending mostly involved smalltime lenders, "[a]s the lines between the fringe and prime markets . . . blurred, mainstream lenders . . . turned to terms and practices which [were] gradually approaching a point which reasonable independent observers might describe as predatory."[59] Though it is unclear precisely when, and for how long, widespread predatory lending practices have existed, it was approximately ten to twelve years ago when community groups and consumer advocacy organizations began to compile stories of predatory lending and recognize persistent, core patterns among them.[60]

encouraged brokers and originators to promote mortgages with little regard for the viability of the borrower, in addition to the difficulty for a borrower to avoid foreclosure once a securitization agreement was put into effect, is what caused the subprime mortgage crisis).

56 *See supra*, text accompanying note 34 (noting that many borrowers did not fully appreciate the unfavorable terms to which they were agreeing); Dustin Fisher, *Selling the Payments: Predatory Lending Goes Primetime*, 41 J. MARSHALL L. REV. 587, 593 (2008) (mentioning that besides vulnerable borrowers, even prime borrowers' willingness to forgo fixed-rate loans has caused predatory lenders to move into the prime credit market).

57 Schmudde, *supra* note 23, at 721 ("Predatory lending involved using fraudulent tactics to induce a borrower to enter into a loan."); Fisher, *supra* note 56, at 593-94 ("Predatory lending has always been easier to identify than to define. In the absence of outright fraud, the loans are those which are simply inappropriate for that particular borrower, or stated differently something a reasonable borrower would avoid.").

58 Azmy, *supra* note 13, at 297;*See* Richard W. Stephenson, *Spending It: Focus on Home Equity Loans - Predatory Lending; How Serial Refinancing Can Rob Equity*, N.Y. TIMES, Mar. 22, 1998, § 3 at 10 (noting the particular vulnerability of the elderly due to their often having substantial equity in their homes while living on fixed incomes and that once a borrower has signed up, a lender's primary goal is to keep the customer refinancing since that provides an opportunity to charge more fees).

59 Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 AM. U. L. REV. 515, 522 (2007) (stating that there is an increasing trend amongst lenders towards what could be considered predatory lending practices, as the distinction between prime and sub-prime lending becomes less clear).

60 *See* Azmy, *supra* note 13, at 297-98 (noting that, around the end of the 1990s, community and consumer-protection groups began aggregating and publishing information regarding predatory lending

Predatory lending can be classified into two sets of activities.[61] The first set consists of activities that are clearly illegal or unconscionable, such as directly misrepresenting the terms of a loan or forging signatures on loan documents.[62] While guarding against these activities is of great importance, a full exploration of their impact is beyond the scope of this note because enforcement of existing laws, along with victims exercising the rights already afforded to them, could logically solve this issue.[63] It is the second class of predatory activities ("gray area class"), which exist on the fringes of the law, that often results in borrowers paying more than they should, given the market and their credit ratings, and that is engaged in without much regard to whether borrowers can repay, that requires the more proactive response advocated for in this note.[64]

Among the gray area class of activities, one of the more difficult to prosecute tactics employed by predatory lenders arises when they purposely do not disclose the terms of a loan, which often include excessive fees and outrageous interest rates.[65] Lenders have the ability to

practices); DEBORAH GOLDSTEIN, JOINT CTR. FOR HOUS. STUDIES,HARVARD UNIV., UNDERSTANDING PREDATORY LENDING: MOVING TOWARDS A COMMON DEFINITION AND WORKABLE SOLUTIONS 7 (1999), *available at* http://www.jchs.harvard.edu/publications/finance/goldstein_w99-11.pdf (explaining that since the mid-1990s, awareness of predatory lending amongst governmental and community groups has grown through increased media coverage).

61 *See* Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 513 (2002) (stating that the practice of predatory lending can be divided into two different activities); Allison De Tal, *Knowledge is Power: Consumer Education and the Subprime Mortgage Market*, 11 CHAP. L. REV. 633, 641 n.57 (2008) (observing that predatory lending can be broken down into two types of activities).

62 *See* Eggert, *supra* note 61, at 513 (explaining the first subset of predatory lending "consists of those activities that are either clearly illegal or unconscionable by their very nature . . . . [including] such actions as misrepresenting the terms of the loans and forging the signatures of borrowers on loan documents"); De Tal, *supra* note 61, at 641 n.57 (describing the first of the two practices that make up predatory lending as conduct which on its own is unconscionable or even illegal, examples of which include misrepresentation or forgery).

63 *See e.g.*, Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 CONSUMER FIN. L.Q. REP. 460, 485 (2006) (advocating that increasing the availability of information for consumers online can subvert predatory lending practices); Schmudde, *supra* note 23, at 767 (outlining a proposed consumer counseling scheme to solve predatory lending problems).

64 *See* Eggert, *supra* note 61, at 513-15 (describing the second subset of predatory lending activities as those that are legal, but are misused by unscrupulous lenders in order to take advantage of borrowers); De Tal, *supra* note 61, at 641 n.57 (explaining that within the two-part scheme of predatory lending, the second part involves lenders taking actions which are technically legal, but are misused to take advantage of borrowers).

65 *See* Schmudde, *supra* note 23, at 721-22 (stating that predatory lenders will frequently fail to disclose all the terms of the loan agreement, but that prosecutors have difficulty enforcing anti-predatory lending laws, often because resources are lacking); Deborah Goldstein, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 HARV. C.R.-C.L. L. REV. 225, 235, 241-42 (2000) (identifying one form of predatory lending as failure to disclose details of costs and interest rates and noting that regulators have difficulty prosecuting predatory lenders, largely due to lack of resources).

engage in this approach when they utilize adjustable-rate mortgages ("ARMs"),[66] mortgages in which the interest rate payable changes over the term of the loan, a practice once formally endorsed by former Federal Reserve Chairman Alan Greenspan.[67] A typical way to employ this tactic is to provide loans that originate with very low "teaser" rates during the first few months of the mortgage. At the end of this period, however, the rates skyrocket, leaving homeowners unable to afford monthly payments and placing them at risk of foreclosure.[68] Borrowers afflicted with such "payment shock" claim that the interest rate mechanisms of the loans were not adequately disclosed and that they were only persuaded to take out the loan because of deceptive or high-pressure sales tactics.[69] These "loans" could be viewed as simply a pretense to fraudulently acquire a person's home, but when the particular tactics employed are not affirmatively illegal, it is nearly impossible to prove such a purpose of the loan.[70] Other predatory tactics that are not explicitly illegal include "packing," which is the practice of inducing borrowers to use some of their loans' proceeds to pay for unnecessary or undesired products, and excessive prepayment penalties, which are added to the amount the borrower must pay to retire a loan before it reaches full term, since prepayments reduce the amount of interest lenders can receive.[71]

[66] See Grossfeld &Heppe, *supra* note 46, at 713, 722-725, which explains that the mechanics of this scheme dictate that predictable interest payments for subprime borrowers will be short lived, because once the "Initial Period" concludes (the period during which a low, teaser rate is applied) and the first reset date is reached, a much higher floating rate is locked in, with a new rate being set at the end of each reset period. According to Schmudde, *supra* note 23, at 722, ARMs are often blamed for having caused the majority of damage, in the context of the subprime collapse, and the introductory rates on these loans are set at an artificially low rate, which greatly increases once the introductory period has elapsed. Although the borrowers were induced into entering into the loan transaction because of the low, introductory rate, they soon find that they are unable to afford the monthly payments because the floating rates are simply too high.

[67] *See* Grossfeld & Heppe, *supra* note 46, at 722 (describing Alan Greenspan's endorsement of adjustable-rate mortgages); Sue Kirchhoff & Barbara Hagenbaugh, *Greenspan Says ARMs Might Be Better Deal*, USA TODAY, Feb. 24, 2004, at 1B (explaining that in 2004, Alan Greenspan stated that many borrowers were overpaying for protection against floating interest rates (i.e., had entered into fixed rate mortgages) and would have saved money had they instead entered into adjustable rate mortgages).

[68] Andrew J. Ceresney et al., *Regulatory Investigations and the Credit Crisis: The Search For Villains*, 46 AM. CRIM. L. REV. 225, 261 (2009).

[69] *Id.*

[70] *See* Azmy, *supra* note 13, at 361 (stating that predatory lending laws have proven difficult to enforce); Schmudde, *supra* note 23, at 722 (adding that prosecuting attorneys do not have the resources to find those who engage in predatory lending practices).

[71] Tania Davenport, *An American Nightmare: Predatory Lending in the Subprime Home Mortgage Industry*, 36 SUFFOLK U. L. REV. 531, 542-43 (2003); Eggert, *supra* note 61, at 517.

b. Where Do Acceptable Subprime Loans End and Unacceptable Predatory Subprime Loans Begin?

What transforms an acceptable subprime loan into a predatory one depends heavily on context.[72] Nevertheless, certain features that exist only in predatory loans can give guidance.[73] First, a loan is likely predatory if credit is provided when it is not needed, on terms not justified by a borrower's credit risk, or if it is used to extract unreasonable "economic rents" from the borrower.[74] Second, where there is a subjective intent of a broker or lender to mislead, deceive or exploit a financially unsophisticated borrower, the loan could be predatory.[75] Lastly, where the terms of the credit or practices of the lender put a borrower at unreasonable risk of default or foreclosure, a predatory loan likely exists.[76]

C. The Resulting Crisis Conditions

Though the current economic recession is not entirely attributable to the subprime mortgage crisis, in acknowledging that the U.S. economy may have suffered most from intensified financial strains and the continued fall in the housing sector, the April 2009 *Global Financial Stability Report* put out by the International Monetary Fund estimates write-downs on U.S.-originated assets by all financial institutions over 2007-10 to total $2.7 trillion.[77] From a strictly domestic perspective, the Center for Responsible Lending asserts that less home equity resulting from foreclosures and their spillover effect on neighboring houses has, in combination with lenders scaling back lending and lower amounts of consumer spending, led to today's economic recession.[78] The report further asserts job losses and

[72] *See* Azmy, *supra* note 13, at 319-20; Jonathan L. Entin & Shadya Y. Yazback, *City Governments and Predatory Lending*, 34 FORDHAM URB. L.J. 757, 759 (2007).

[73] *See* Azmy, *supra* note 13, at 320; ALLEN FISHBEIN & HAROLD BUNCE, SUBPRIME MARKET GROWTH AND PREDATORY LENDING, 7 *available at* http://www.huduser.org/publications/pdf/brd/13 Fishbein.pdf (discussing features of predatory lending).

[74] *See* Azmy, *supra* note 13, at 320. The dictionary defines an "economic rent" to be "the return on a productive resource, as land or labor, that is greater than the amount necessary to keep the resource producing or on a product in excess of what would have been the return except for some unique factor." DICTIONARY.COM UNABRIDGED. Random House, Inc., *available at* http://dictionary.reference.com/ browse/economicrent (last visited November 29, 2009).

[75] A primary distinction between subprime and predatory lending lies in the lender's intent. Azmy, *supra* note 13, at 320; Diana McMonagle, *In Pursuit of Safety and Soundness: An Analysis of the OCC's Anti-Predatory Lending Standard*, 31 FORDHAM URB. L.J. 1533, 1539 (2004).

[76] *See* Azmy, *supra* note 13, at 320; Entin et al., *supra* note 72, at 761.

[77] International Monetary Fund, *Executive Summary* (Jan. 2009), at 1, *available at* http://www.imf .org/external/pubs/ft/weo/2009/01/pdf/exesum.pdf

[78] It further asserts that the resulting shortfall in state revenues through 2011 is estimated to total $350 billion or higher. *See* For Responsible Lending, *supra* note 6, at 2.

potential downturns in the stock market could result in a continued downward spiral as they reduce household wealth even further.[79] It should be apparent at this point that another catastrophe similar to the subprime mortgage crisis must be protected against.

II. FEDERAL AND STATE LEGISLATION ENACTED TO PROTECT THE CONSUMER

This part explores legislation focused on regulation of mortgage lending. Section A discusses the development of federal laws on this front and examines how lenders still found ways to bypass these regulations. Section B turns to state legislation, and focuses on how the state of North Carolina was a pioneer in aggressively combating predatory. It further demonstrates that while a number of states have followed North Carolina's example, and there is some evidence that such aggressive state legislation has had positive effects, actions by state legislatures on their own are not enough to ensure the subversion of another crisis.

A. Evolution of Federal Legislation Aimed at Regulating Lending

The first uniform federal guidelines applicable to mortgage lending were put forth in the Truth in Lending Act ("TILA"),[80] passed by Congress in 1968.[81] The impetus for such legislation was the great expanse in the consumer credit market following World War II.[82] TILA's purpose as defined by Congress is: "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices."[83] When applicable, TILA requires a creditor to "disclose the amount financed, the annual percentage rate, the finance charge, and the total number of payments to be made, including a payment schedule."[84] Even though TILA imposes limits on mortgage interest rates and requires full disclosure of all fees, its provisions do not deter high rates on subprime

79 *Id.*
80 15 U.S.C. § 1601 (2010).
81 *Id.*; Matthew A. Edwards, *Empirical and Behavior Critiques Of Mandatory Disclosure: Socio-economics and the Quest For Truth In Lending*, 14 CORNELL J.L. & PUB. POL'Y 199, 209 (2005).
82 Edwards, *supra* note 81, at 207; Mourning v. Family Publ'ns Serv., 411 U.S. 356 (1973).
83 15 U.S.C.S § 1601 (a) (2010).
84 Burlingame, *supra* note 63, at 466.

mortgages.[85] Though TILA allows for monetary damages and a right of rescission in certain circumstances, home purchase loans cannot be rescinded even if disclosure was inadequate.[86]

The Real Estate Settlement Practices Act ("RESPA")[87], enacted in 1974, like TILA could be classified as a disclosure regime,[88] but unlike TILA, RESPA more narrowly focuses on requirements for lenders in a residential transaction.[89] RESPA requires residential mortgage lenders to provide borrowers a special information booklet along with "a good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement."[90] Further disclosure requirements include an itemization of all actual settlement costs and escrow payments scheduled for the first year of the mortgage.[91] RESPA also "prohibits certain charges and kickbacks to third parties."[92] Nonetheless, an unfortunate reality of both RESPA, and its predecessor TILA, is that they had little effect on borrowers' decision-making because many mortgages are difficult for a lay person to understand on his or her

85 Schmudde, *supra* note 23, at 751 (noting that the limits imposed by TILA are ineffective in keeping subprime mortgage rates down); Shelly George, *The Mortgage Reform And Anti Predatory Act Of 2007: Paving A Secure Path For Minorities In the Midst Of the Subprime Debacle* 10 SCHOLAR 449, 463 (calling attention to the lack of preventative measures in TILA).

86 Schmudde, *supra* note 23, at 751; Burlingame, *supra* note 63, at 466. It should be noted that the rescission provisions can be applicable to "the refinancing of mortgage loans, junior liens, and other nonpurchase transactions." *Id.* *See also* James L. Thompson & Jill Hutchison, *Rescinding a Mortgage Transaction under TILA after Refinancing the Loan*, 23 REAL EST. FIN. No. 2 (2006), *available at:* http://www.jenner.com/files/tbl_s20Publications%5CRelatedDocumentsPDFs1252%5C1453%5CTILA_Article_RealEstateFinance.pdf.

87 12 U.S.C. §§2601-17 (2010).

88 Azmy, *supra* note 13, at 350 (noting that like TILA, RESPA requires lenders to disclose certain details of the cost of loan settlement in a uniform statement); Arnold S. Rosenberg, *Better Than Cash? Global Proliferation of Payment Cards and Consumer Protection Policy*, 44 COLUM. J. TRANSNAT'L L. 520, 563-64 (2006);Peter Hong & Marcos Reza, *Hidden Costs to Homeowners: The Prevalent Non-Disclosure of Yield Spread Premiums in Mortgage Loan Transactions*, 18 LOY. CONSUMER L. REV. 131, 140 (2005) (discussing the different disclosure requirements under RESPA).

89 Schmudde, *supra* note 23, at 752 (highlighting the disclosure requirements for lenders in residential transactions including, but not limited to, a good faith estimate of the charges and known settlement costs); Frederick L. Miller, *Consumer Law: Bait and Switch In The Mortgage Market*, 85 MI BAR J. 21, 21 (2006);Jessica Fogel, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE UNIV. L. R. 435, 446 (2005) (stating that one of the reasons Congress enacted RESPA was to protect consumers "against abusive practices that were developing in the residential real estate industry.")

90 12 USCA § 2604(c) (2010).

91 Schmudde, *supra* note 23, at 752 ("[D]isclosures include: . . . (3) actual settlement costs; and (5) [sic] escrow payments scheduled for the first year of the mortgage."); 12 U.S.C. § 2601 Appx. ("The loan originator must indicate whether the loan includes an escrow account for property taxes and other financial obligations . . . '[y]our initial monthly amount owed for principal interest, interest, and any mortgage insurance. . . [and] charges for all other settlement services . . . and the total estimated settlement charges . . . .").

92 Azmy, *supra* note 13, at 350.

own.[93] In industries where consumers have the capability to compare products relatively easily, like shopping for groceries or household electronics, regulations primarily focused on disclosure can be adequate.[94] "In the context of the subprime mortgage market, however, the theoretical premises of disclosure seem quaint and insufficient."[95] This is because estimates are often "inaccurate and[can] confuse even [an] experienced buyer."[96] Further, the predatory sector of the subprime market makes it extremely difficult for consumers to compare price terms.[97] These logical inadequacies with a disclosure regime, along with evidence of growth of subprime and predatory lending in the 1980s, alerted Congress that more work needed to be done.[98]

By passing the Home Ownership and Equity Protection Act of 1994 ("HOEPA"),[99] Congress attempted to add some substantive teeth to its regulatory scheme by imposing limitations on contract terms and lender practices that have been identified as aspects of predatory lending.[100] For

[93] Schmudde, *supra* note 23, at 752 (stating that the documents that are given to borrowers are complex and are difficult for a lay person to understand without further explanation); Arielle L. Katzman, *A Round Peg For A Square Hole: The Mismatch Between Subprime Borrowers and Federal Mortgage Remedies*, 32 CARDOZO L. REV. 497, 509 (2009).;Rayth T. Myers, *Foreclosing on the Subprime Loan Crisis: Why Current Regulations are Flawed and What is Needed to Stop Another Crisis from Occurring*, 87 OR. L. REV. 311, 324–25 (2008) (arguing that RESPA is inadequate because it does not "result in more well-informed borrowers" since "[p]roviding extremely complicated information, particularly to unsophisticated borrowers, does not ensure they will understand it.")

[94] Azmy, *supra* note 13, at 351 ("normative preference for disclosure may be well-justified for products such as groceries, personal electronics . . . because consumers can compare products within those categories relatively quickly with few or no transaction costs"); Christopher L. Peterson, *Truth, Understanding, And High-Cost Consumer Credit: The Historical Context Of The Truth In Lending Act*, 55 FLA. L. REV. 807, 882 (2003); Ndiva Kofele-Kale, *The Impact of Truth-in-Lending Disclosures on Consumer Market Behavior: A Critique of the Critics of Truth-in-Lending Law*, 9 OKLA. CITY U. L. REV. 117, 120 (1984) ("[F]eed[ing] consumers with the 'truth' . . . liberate[s] them from their ignorance about the structure of the credit market.").

[95] Azmy, *supra* note 13, at 351.

[96] Schmudde, *supra* note 23, at 752; Pearl A. Chin, *Payday Loans: The Case For Federal Legislation*, U. ILL. L. REV. 723, 730 (2004).

[97] *See* Azmy, *supra* note 13, at 351 (explaining that comparison of price terms is difficult due to lenders deliberately making the loans complex, little price competition in the market, and disclosures often being made to the borrower on the day of the loan closing when the borrower is already psychologically committed to the loan); Angela Rowland, *Defending the American Dream: Legislative Attempts to Combat Predatory Lending*, 50 S. TEX. L. REV. 343, 360 (2008) (discussing the lack of borrowing power between the lenders, since the borrower's power is exacerbated by the fact that about half of the adults in the United States lack the proper education and are unable to gauge information to adequately determine the price difference between two different items).

[98] Eggert, *supra* note 61, at 584; Tania Davenport, *An American Nightmare: Predatory Lending in the Subprime Home Mortgage Industry*, 36 SUFFOLK U. L. REV. 531, 538. Predatory Lending continued to grow when finance companies made loans to borrowers at lower income levels with imperfect credit.

[99] *See* 15 U.S.C. § 1601 et seq. It should be noted that the Federal Reserve did not act pursuant to the authority granted by HOEPA until July 14, 2008, until it issued "final rules amending Regulation Z, which implements [both] TILA and HOEPA." 73 FR 44522-0; Schmudde, *supra* note 23, at 756.

[100] Eggert, *supra* note 61, at 585; Jean Constantine-Davis. *Hoeping for Better Days: The Home Ownership and Equity Protection Act of 1994 (HOEPA)*, 1114 PLI/CORP. 243, 252 (1999) (listing the

example, HOEPA bars most prepayment penalties,[101] some balloon payments,[102] and the deceptive practice of negative amortization.[103] In addition, creditors cannot engage in a "pattern or practice of extending credit to consumers [through giving HOEPA loans] without regard to the consumers' repayment ability."[104] HOEPA also adds further disclosure requirements to the loans that it covers, including a mandatory three day cooling off period before the consumer can commit to the loan.[105] Another attempt at protecting the consumer through HOEPA existed in the outlining of scenarios in which limited liability would attach to assignees of HOEPA loans.[106]

The main problem with HOEPA is that predatory lenders have had no trouble getting around the triggers that make a subprime loan a HOEPA loan.[107] In fact, "the types of unscrupulous lending practices that HOEPA was designed to prevent now often occur in loans slightly under the HOEPA triggers."[108] Further, even when loans meet the triggers requisite for HOEPA to govern, it has been very difficult for individual borrowers to show that the lenders have engaged in the "pattern or practice" prohibited above.[109] The current dire consequences of the subprime mortgage collapse

requirements for certain closed-end mortgages)

101 *Truth in Lending: Reg. Z*, 12 C.F.R. § 226.32(d)(6);Constantine-Davis, *supra* note 100, at 254. Under HOEPA, prepayment penalties had to meet three qualifications: they are only permitted during the first 5 years, they cannot be charged at all if the creditor is refinancing its own loan, or that of an affiliate, and when the loan was consummated, the debtor could not have more than a 50 debt-to-income ratio and the financial information must be verified. *Id.*

102 *See* Constantine-Davis, *supra* note 101, at 253; *Reg. Z*, § 226.32(d)(1) (showing Balloon payments are prohibited on HOEPA loans with terms of 60 months or less).

103 *See* 15 USC § 1639(f). In prohibiting negative amortization, the statutory language explains "[a] mortgage . . . may not include terms under which the outstanding principal balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of interest due." *Id.*

104 15 U.S.C. § 1639(h) (2000) (describing certain prohibitions regarding extending credit to the consumer).

105 Eggert, *supra* note 61, at 584; *see* Constantine-Davis, *supra* note 100 (discussing additional disclosure requirements).

106 *See* 15 U.S.C.A. § 1641(e). Scholars have argued that application of the "Holder in Due Course Doctrine" to mortgage loans, which "cuts off most defenses that a maker of a note might have once it is assigned to a holder who takes it without notice of those defenses" is unwarranted, and a further extension of assignee liability is appropriate within the context of securitization. *See* Eggert, *supra* note 61, at 508.

107 *See* Azmy, *supra* note 13, at 351; Eggert, *supra* note 61, at 587 (describing some of the ways lenders get around HOEPA's authority).

108 Eggert, *supra* note 61, at 587. Current HOEPA "trigger" rates are located in 12 CFR § 226.32(a). Though the triggers have been lowered since they were first promulgated, it has not stopped lenders from avoiding HOEPA's authority by pricing credit just below the triggers. *See* Michael J. Pyle, *A "Flip" Look at Predatory Lending: Will the Fed's Revised Regulation Z End Abusive Refinancing Practices?*, 112 YALE L.J. 1919, 1923.

109 Eggert, *supra* note 61, at 588 (analyzing the difficult burden of proof borrowers have in showing banks engaged in loaning money based on equity).

further illuminates HOEPA's inadequacies.[110]

Congress has also passed legislation aimed at regulating mortgage lending through prohibiting discrimination with the Equal Credit Opportunity Act ("ECOA"),[111] and by imposing checks on the practices of Credit Reporting Agencies ("CRAs") with the Fair Credit Reporting Act ("FCRA")[112] and the Credit Rating Agency Reform Act of 2006 ("CRARA").[113] Unfortunately, the type of protection that potential low-income immigrant and minority borrowers have needed in recent times is not protection against borrowers *denying* them a loan based on their status under ECOA.[114] The real discriminatory danger that has not been adequately addressed is the practice of predatory lenders *giving* such borrowers loans and trapping them in unfair terms.[115] The attempted statutory regulation of CRAs sought to achieve an important goal because they were complicit in the subprime mortgage crisis through rating mortgage based securities highly to please their clients, the lenders issuing them.[116] "CRAs were issuing ratings which were not supported by the underlying instruments . . . [t]hey behaved not only as protectors of investors, but as enablers of the banks who were issuing the securities."[117] However, no provisions in FCRA or CRARA take any steps in aligning CRAs' interests with investors who actually rely on their ratings.[118] More importantly, legislation aimed at CRAs does not attack the predatory lending problem at its source- predatory mortgage lenders. Consequently, it can only go so far in protecting the borrower.

110 *See infra* Part I.C.

111 15 U.S.C. § 1691 (2010) (detailing the discrimination which is prohibited in lending practices).

112 15 U.S.C. § 1681 (2010) (describing the purpose of the statute).

113 15 U.S.C. § 78o-7 (2010) (enumerating the procedures necessary to register nationally rating agencies).

114 *Id.*

115 *See* Nicole Lutes Fuentes, *Defrauding The American Dream: Predatory Lending In Latino Communities And Reform Of California's Lending Law*, 97 CAL. L. REV. 1279, 1279-80 (chronicling a an incident that exemplifies how predatory lenders can take advantage of immigrants); Vikas Bajaj & Miguel Helft, *The Loan that Keeps on Taking*, N.Y. TIMES, Sept. 25, 2007, at C1 (discussing a case in which a broker steered clients to take loans the clients could not reasonably afford to repay).

116 Schmudde, *supra* note 23, at 743; see, Frank Partnoy, *Second-Order Benefits from Standards*, 47 B.C. L. REV. 169, 190 (2007) (noting the conflicts of interest that arises among rating agencies and underlying banks).

117 Schmudde, *supra* note 23, at 743.

118 *Id.* at 754 (discussing CRARA's inability to properly control credit rating agencies); Christopher M. Bruner, *States, Markets, and Gatekeepers: Public-Private Regulatory Regimes in an Era of Economic Globalization*, 30 MICH. J. INT'L L. 125, 143 (2008) (analyzing the conflicts of interest present with the current rating agencies).

B. A Look at State Legislation

Given that federal legislation aimed at combating predatory subprime mortgage lending has provide ineffective protection for borrowers, it is now appropriate to turn to similar legislative attempts at the state level. The first comprehensive state law targeting predatory lending was passed by the North Carolina state legislature in 1999.[119] Though it took a while for any state or municipality to push back against predatory lending, following North Carolina throwing the first salvo "there [was] an explosion of legislation at the state and local level[s] passed in an attempt to fill the many regulatory gaps."[120] From 1999 to 2005, twenty-six states (including the District of Columbia) enacted regulations against predatory lending practices.[121] Among the state responses were statutes ranging from only modestly supplementing HOEPA, to ones with lower triggers for qualification as a high cost loan and banning a variety of abusive practices, which built directly upon the North Carolina model.

North Carolina has enacted two statutes to combat predatory lending: (1) S. 1149 ("North Carolina Act") in 1999,[122] which became the prime impetus for other states to act similarly; and (2) the Mortgage Lending Act in 2001, which took a very different approach and has only been emulated by a few other states.[123] The North Carolina Act contained substantive restrictions and prohibitions applicable to all home mortgages, including prohibitions on "loan flipping,"[124] financing of single premium insurance[125] and encouraging default in the refinance of debt.[126] The act

[119] 1999 N.C. Sess. Laws 332 (codified at N.C. GEN. STAT. §§ 24-1.1A - 24-10.2 (2010)); Azmy, *supra* note 13, at 361 (explaining the explosion of legislation at the state and local levels targeting predatory lending since 1999, when North Carolina passed the first comprehensive state law on the issue).

[120] Azmy, *supra* note 13, at 361.

[121] *Id*; *see also* Combs, *supra* note 11, at 618 (noting that twenty-six states have some level of regulation of predatory lending that is stricter than federal law).

[122] N.C. GEN. STAT. §§ 24-1.1A - 24-10.2 (2010) (imposing restrictions and limitations on home loan fees and providing consumer protections).

[123] N.C. GEN. STAT. §§ 53-243.01 - 53-244 (2010); Burlingame, *supra* note 63, at 468 (stating that some states have followed North Carolina's lead by passing mortgage lending regulation).

[124] N.C. GEN. STAT. § 24-10.2(c) (2010) "'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." Burlingame, *supra* note 63, at 468.

[125] N.C. GEN. STAT. § 24-10.2(b) (2010) (making it unlawful for any lending in a consumer home loan to finance any insurance premiums); Burlingame, *supra* note 63, at 468.

[126] N.C. GEN. STAT. § 24-10.2(d) (2010) (stating that no lender shall recommend or encourage default on an existing loan in connection with the closing of a consumer home loan that refinances any potion of such existing loan); Burlingame, *supra* note 63, at 468.

also put further restrictions on high-cost loans, for example, by requiring home-ownership counseling for borrowers.[127] The statutory language also prescribes lower triggers for a loan to qualify as a high-cost loan than any previous federal legislation had stipulated.[128] Of significance, the Attorney General, the Commissioner of Banks or any private party to a high-cost home loan can bring a cause of action against a lender.[129] North Carolina's second predatory lending oriented legislation, the Mortgage Lending Act, imposed "licensing, experience, and examination requirements on individual employees involved in making or brokering mortgage loans within the State," though it did not apply to regulated banking institutions.[130] A license could be denied to someone with a past criminal record, someone found to display moral turpitude, or someone who has provided misleading application materials.[131]

New York serves as an example of one of the more "aggressive" states that followed North Carolina's lead.[132] Chapter 626 of the laws of 2002 ("New York Act") took effect April 1, 2003, and in addition to similar prohibitions to those in HOEPA and the North Carolina Act, it provided that a home loan would be deemed void under the law, if a court found that the lender intentionally violated the law.[133] Regarding remedies for when

127 Burlingame, *supra* note 63, at 468; C. Bailey King Jr., *Consumer Protections Issues: Preemption and the North Carolina Predatory Lending Law*, 8 N.C. BANKING INST. 377, 379-81 (2004) (discussing the requirements necessary before a lender may make a "high-cost" loan, such as requiring the borrower to receive home-ownership counseling).

128 Burlingame, *supra* note 63, at 468 ("A North Carolina loan will be considered a high-cost loan, subject to the enhanced restrictions, if it meets any one of three triggers: (1) the APR is greater than ten percentage points above the comparable U.S. Treasury security; (2) the points and fees exceed five percent of the total loan amount; or (3) the prepayment penalty exceeds two percent of the amount prepaid").

129 N.C. GEN. STAT. § 24-1.1E(d) (2010) (stating that the provisions of this section of the statute can be enforced by the Attorney General, the Commissioner of Banks, or any party to a high-cost home loan); 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, 31 (2000) (explaining that violations of N.C.G.S. § 24-1.1E(d) are recognized as unfair and deceptive and can be enforced by the state attorney general, the state bank commissioner or the borrower).

130 Burlingame, *supra* note 63, at 468.

131 *Id.* (specifying a past criminal record, displays of moral turpitude and presentation of misleading materials during the application process as grounds for denying a license as a mortgage broker); Donald C. Lampe, *Wrong from the Start? North Carolina's "Predatory Lending" Law and the Practice vs. Product Debate*, 7 CHAP. L. REV. 135, 150 (2004) (providing "moral turpitude, past criminal record, or misleading application materials" as the grounds for rejection of a mortgage brokering license).

132 Azmy, *supra* note 13, at 363-364 (listing the District of Columbia, Illinois, New Mexico, Arkansas, California, Colorado, Georgia, Massachusetts, New Jersey, New York, North Carolina and South Carolina as the states that have followed North Carolina's lead in supplementing HOEPA with stricter standards).

133 2002 N.Y. LAWS 626, (2010). If a court finds that a lender has intentionally violated the applicable regulations, the loan agreement shall be void and the lender shall have no right to "collect, receive or retain" any money associated with the loan. N.Y. BANK § 6-*l*(10) (2010) codifies the same

lenders act unlawfully, the New York Act grants borrowers an affirmative defense against foreclosure and allows for a private right of action against a lender within six years of the origination of a loan.[134] Subsequent supplemental legislation strengthened the laws promulgated by the New York Act by, *inter alia,* prohibiting additional practices with certain kinds of loans (i.e. prepayment penalties) and requiring that plaintiffs in foreclosure actions make specific affirmative allegations regarding their standing at the commencement of an action.[135]

While critics of state regulations based on the North Carolina model focus on it being too restrictive on lenders, along with evidence of a general decrease in subprime lending business in North Carolina, a 2003 study conducted by researchers at the University of North Carolina found that the North Carolina regulations worked as intended, at least in the short term.[136] "The [study] concluded that loan originations with predatory features decreased substantially . . . but did not materially decrease either the supply of subprime credit to low-income borrowers or the diversity of subprime mortgage products traditionally extended to them."[137] It is likely that aggressive state predatory lending statutes will play a role in preventing another crisis. It is difficult to determine, however, which particular state guidelines strike the best balance of keeping the lending business strong while sufficiently protecting the consumer because they have not been around long enough to accurately measure long-term effects. Also important to note is that federal preemption of state regulations has undercut states' ability to exert their power to prevent another subprime mortgage crisis.[138] Therefore, preemption principles and practices will be a running theme through the remainder of this note.

language contained in § 10 of the session laws.

134 2002 N.Y. LAWS 626 (2010); N.Y. RP ACT & PRO § 1302(2) (2010); N.Y. BANK § 6-*l*(10) (2010).

135 2007 N.Y. LAWS 552 (2010); 2008 N.Y. LAWS 472 (2008). New York passed further regulatory legislation dealing with mortgage foreclosure in 2008 and 2009, the most recent of which is the Governor's Program Bill No. 46 *available at* http://www.state.ny.us/governor/bills/pdf/gpb_46.pdf. Also, a memo summarizing the bill's provisions is *available at* http://www.state.ny.us/governor/bills/pdf/gpbm_46.pdf.

136 Azmy, *supra* note 13, at 381.

137 *Id.*

138 *See* Justin Collins, *Without Other Options: The Limited Effectiveness, Unique Availability, and Overall Impact of State-Directed Lawsuits Against Predatory Lenders*, 17 J.L. & POL'Y 231, 247-48 (2008) (arguing that despite the objections of various State Attorneys General, federal agencies have issued a series of orders preempting state predatory lending statutes and leaving states with few options to protect consumers); *infra* Part III (discussing two federal agencies who aggressively use federal power to preempt state authority).

III. FEDERAL AGENCIES CHARGED WITH PROTECTING THE CONSUMER AND THE DAMAGING EFFECTS OF PREEMPTION

This part examines the various federal agencies that are charged with enforcing federal regulations put in place to protect the consumer from predatory business practices. It demonstrates that, in recent times, some of these agencies have encroached on states' regulatory power to protect the consumer, an interest which states traditionally have had primary authority over. It also looks at particular actions by two federal agencies, the Office of Thrift Supervision ("OTS") and the Office of the Comptroller of Currency ("OCC"), which evidence their respective proclivity to be aggressive in using federal preemption power to defeat state regulatory authority.

Federal agencies charged with enforcing federal consumer protection, including laws that resulted from the previously referenced Acts of Congress aimed at addressing predatory lending, include the Federal Trade Commission ("FTC"), the Department of Housing and Urban Development ("HUD"), and federal banking regulators comprised of the OTS, the OCC, the Federal Reserve Board ("FRB"), the Federal Deposit Insurance Corporation ("FDIC") and the National Credit Union Administration ("NCUA").[139] Despite their responsibilities, these regulatory agencies undertook a very limited role in controlling predatory lending abuses prior to the crisis.[140] The FTC was active in initiating actions against subprime lenders by alleging unfair and deceptive practices in violation of the FTC Act, which grants generally applicable federal authority in actions affecting commerce.[141] However, the FTC brought only nineteen actions of this sort from 1983-2003 and most of those cases had little impact on practices because they were settled with lenders only paying restitution to borrowers and simply saying that they will do better next time.[142] HUD had authority to enforce RESPA, but for the most part failed to do so.[143] Finally the

[139] Azmy, *supra* note 13, at 358 (explaining the varied roles of HUD, the FTC, the OCC, the OTS and the NCUA in enforcement in the subprime market); Burlingame, *supra* note 63, at 469 (listing these agencies as those involved in the federal administrative response to predatory lending).

[140] Azmy, *supra* note 13, at 359; *see also* U.S. GEN. ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING 22 (2004) [hereinafter GAO REPORT], *available at* http://www.gao.gov/new.items/d04280.pdf. According to HUD, in 2001, 178 lenders concentrated primarily on subprime loans. Of these 178 lenders, only ten percent were federally regulated.

[141] *See* Federal Trade Commission Act, 15 U.S.C. §§ 41-58 (2010); Azmy, *supra* note 13, at 359(discussing FTC actions against subprime lenders).

[142] GAO REPORT, supra note 140, at 37; Burlingame, *supra* note 63, at 470 (reporting the number of FTC complaints against mortgage lenders).

[143] GAO REPORT, supra note 140, at 36 ("HUD reported having taken a small number of actions to

agencies that were most directly intertwined with mortgage lending were two bureaus of the Treasury Department, the OCC, with primary authority over national bank charters, and the OTS, with authority over savings associations, savings banks, and savings and loans.[144] Unfortunately, their actions over the past decade have led scholars to suggest that "federal regulators [are] better seen as a *cause* of predatory lending than a hedge against it."[145]

Consumer protection was a traditional element of states' regulatory power until the OTS and OCC, using their authority as agencies of the federal government granted by the Supremacy Clause of the U.S. Constitution,[146] issued regulations to preempt the application of state consumer protection laws directed at the prevention of predatory lending by national banks and thrifts, along with their subsidiaries and agents, resulting in less stringent regulation applying to those affected.[147] While a U.S. General Accounting Office ("GAO") report estimated that only ten percent of lending institutions that primarily engage in subprime lending are national banks or thrifts,[148] when regulations from an agency act to relax constraints on the institutions that fall under their authority, rivals in the industry must respond to keep their market share.[149] For example, fringe and predatory lenders have sought to obtain their own federal banking charters. Perhaps partially due to federal preemption, "consumer lending is now dominated by federally chartered institutions, especially national banks."[150]

OTS is explicitly authorized by The Home Owners' Loan Act

enforce RESPA . . . in cases involving predatory lending."); Azmy, *supra* note 13, at 358 (noting the small number of actions taken to enforce RESPA).

144 12 U.S.C. § 1, 1462a(b) (2006) (stating the duties of the OCC and OTS, respectively); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143, 149 (2009) (discussing the powers of the OCC and OTS).

145 Peterson, *supra* note 59, at 525.

146 U.S. CONST. art. VI. cl. 2; Developed jurisprudence regarding the Supremacy Clause asserts that federal regulations have the same preemptive effect as federal statutes, and that courts will only review effects of preemption regulations under a reasonableness standard. *See also* Fid. Fed. Sav. & Loan Ass'n v. De La Cuesta, 458 U.S. 141, 153 (1982).

147 Levitin, *supra* note 144, at 145 (discussing the issues raised by the preemption of some state consumer protection laws); *see* Peterson, *supra* note 59, at 516 (explaining the expanding preemption power of federal statutes).

148 GAO REPORT, supra note 140, at 27.

149 Peterson, *supra* note 59, at 516; *See* Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 72 (2005) (describing how federal regulations that preempt state laws have created an incentive for those seeking to avoid state predatory lending law to migrate into federal charters. The reason for this migration is that institutions that do not fall under the authority of the federal regulations fear the institutions they represent will shift their assets into better protected charters).

150 Levitin, *supra* note 144, at 150.

(HOLA)[151] to preempt state usury laws only as applied to national thrifts, but the OTS has used its "plenary" authority over federal thrifts, as recognized by the U.S. Supreme Court,[152] to employ preemption aggressively.[153] For example, in 2004 the OTS asserted that independent contractors performing mortgage brokering services hired by thrifts are not subject to state licensing or registration laws.[154] Pursuant to its authority, OTS "issued letters concluding that predatory lending laws in Georgia, New York, New Jersey, and New Mexico, which regulate any aspect of credit terms, loan-related fees, disclosures, or the ability to finance a loan, are preempted as they apply to savings institutions."[155] Also, while the OCC's asserted preemption authority is less entrenched in the law than the authority of the OTS,[156] the OCC has adopted preemption rules by piggybacking on an OTS action reasoning that the deregulatory move must be allowed to place national banks on an equal plane with national thrifts.[157]

In defining which state laws apply to real estate lending activities of national banks, the OCC rules that "except where made applicable by Federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized real estate lending powers

151 12 U.S.C.§§ 1461-70 (2010).

152 *See* Fid. Fed. Sav. and Loan Ass'n v. De Le Cuesta, 458 U.S. 141, 162, 164-68 (1982) (acknowledging that congress gave OTS broad authority to regulate thrifts); *see also* Eric Friedberg, *Portfolio Maintenance Use of the Due on Sale Clause in New York,* 49 BROOK L. REV. 79, 83-85 (1982) (discussing how the Supreme Court accepted the broad powers delegated to OTS by congress to preempt state laws).

153 *See* 12 C.F.R. § 545.2 (2010) (claiming authority to preempt any state law "purporting to address the subject of the operations of a Federal savings association"); *see also* Levitin, *supra* note 144, at 167 (explaining that OTS has been quite aggressive in claiming preemptive authority).

154 Memorandum from the Chief Counsel, Office of Thrift Supervision, re Authority of a Federal Savings Association to Perform Banking Activities Through Agents Without Regard to State Licensing Requirements (Oct. 25, 2004) (P-2004-7, 2004 OTS LEXIS 6 at 16) (opining that state laws regulating independent agents performing marketing or solicitations on behalf of thrifts are inconsistent with OTS's exclusive regulatory powers); *see* Peterson, *supra* note 59, at 528-29 (explaining that OTS claimed exclusive authority to regulate independent agents of thrifts in order to give the thrifts the freedom to decide whether to use its own employees or independent contractors without being subject to state law).

155 Azmy, *supra* note 13, at 384.

156 Burlingame, *supra* note 63, at 471 (stating that OCC's preemption power is less entrenched in the law than OTS); *cf.* Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and its Effect on Predatory lending Regulation,* 88 MINN. L. REV. 518, 616-17 (2004) (arguing that OCC is gearing up for challenges to its preemption power).

157 Levitin, *supra* note 144, at 169 (explaining that the OCC is able to piggyback on the OTS's action); *see* Arthur E. Wilmarth, Jr., *Point-Counterpoint: Federal Preemption: 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 & FIN. L. 225, 284 (2004) (arguing that the scope of the OCC's preemption rules is "essentially the same as the breadth of preemption declared in the OTS's regulations").

do not apply to national banks,"[158] along with agents and subsidiaries.[159] The OCC has intervened on the side of national banks on numerous occasions to prevent state regulation for consumer protection purposes.[160] For example, a New York investigation into possible racial discrimination in residential real-estate lending was interrupted by an OCC lawsuit to enjoin the investigation.[161] Yet, in terms of living up to their responsibility to protect consumers, the OCC has brought just eleven consumer protection actions since 2000, two of which it initially tried to prevent as it did in New York.[162] By comparison, in 2003 alone, state bank agencies brought 4,035 consumer enforcement actions.[163] Despite these indications to the contrary, the OCC claims to be firmly committed to combating predatory lending.[164] Nonetheless, the actions of the OCC indicate that an interest in the safety and soundness of national banks, which necessarily includes their level of profitability,[165] has trumped its interest in consumer protection, which scholars have characterized as being "not first (or even second) on the OCC's priority list."[166]

IV. GENERALLY APPLICABLE STATE CONSUMER PROTECTION STATUTES SHOULD BE KEY TOOLS IN ENSURING THAT THERE WILL NEVER BE ANOTHER CRISIS BY HOLDING LENDERS ACCOUNTABLE WHEN EVIDENCE

158 12 C.F.R. § 34.4(a) (2010).

159 In a 2001 ruling, the OCC issued a regulatory preemption determination shielding used car dealerships from state consumer protection laws where they are acting as an agent of a national bank. Preemption Determination for Officers of the Comptroller of the Currency, 66 Fed. Reg. 28593, 28595 (May 23, 2001); Peterson, *supra* note 59, at 530. The OCC made clear that its preemption authority extended to subsidiaries in a 2003 ruling regarding the Georgia Fair Lending Act. Burlingame, *supra* note 63, at 473; GA. CODE ANN. §§ 7-6A-1 (2010).

160 Levitin, *supra* note 144, at 152 (discussing OCC intervention on behalf of national banks to prevent forced disclosure of nonpublic information); *see* Stephanie Mencimer, *No Account: The Nefarious Bureaucrat Who's Helping Banks Rip You Off*, THE NEW REPUBLIC, Aug. 27, 2007, http://www.tnr.com/print/article/no-account-0 (noting the lack of federal consumer enforcement actions).

161 *See* Clearing House Ass'n v. Cuomo, 510 F.3d 105 (2d Cir. 2007), *cert. granted, 129* S. Ct. 987 (2009). After successfully ending the New York investigation using its preemption powers, the OCC failed to take up the investigation itself. Levitin, *supra* note 144, at 152.

162 Levitin, *supra* note 144, at 153. "[F]rom January 2000 to April 2009, the OCC has levied a mere seventy-three fines, only six of which were for consumer-protection violations . . . two related to discriminatory lending." *Id;see* Office of the Comptroller of the Currency, Legal and Regulatory: Enforcement Actions, http://apps.occ.gov/EnforcementActions/EnforcementActions.aspx (last visited November 2, 2010).

163 Levitin, *supra* note 144, at 153; *see also* Mencimer, *supra* note 160, at 14 (noting the number of state consumer enforcement actions in 2003).

164 Burlingame, *supra* note 63, at 471. *See generally* Julie L. Williams & Michael S. Bylsma, *Federal Preemption and Federal Banking Agency Response to Predatory Lending*, 59 BUS. LAW 1193 (discussing OCC guidelines national banks can use to against making predatory loans).

165 Levitin, *supra* note 144, at 155.

166 Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 85 (2008).

INDICATES THEY ENGAGED IN "UNFAIR PRACTICES"

This part of the note argues that flexible state UDAP statutes need to be a piece of the puzzle going forward in order to protect borrowers from predatory lenders. Section A summarizes and examines the potential implications of a recent Massachusetts case in which the methodology used could serve as a model for dealing with unscrupulous lending practices in the future. Section B wraps up by explaining why widespread employment of such a flexible standard is important, along with answering prospective criticism of the model.

A. Recent Massachusetts Case: Commonwealth v. Fremont Investment & Loan As A Model

a. Summary of *Commonwealth v. Fremont Investment & Loan*

On October 4, 2007 the Massachusetts Attorney General ("Attorney General") commenced an action on behalf of the Commonwealth of Massachusetts ("State") against Fremont Investment and Loan ("Fremont"), and its parent Fremont General Corporation ("Fremont General"), alleging that Fremont had engaged in unfair and deceptive practices in violation of the Massachusetts state UDAP statute ("Mass. UDAP statute"),[167] in its subprime lending practices.[168] About six months prior to the Massachusetts lawsuit, Fremont, a California state-chartered industrial bank, entered into an agreement with the FDIC to cease and desist from various unsound banking practices, without admitting any wrongdoing.[169] The Attorney General had previously tried to work with Fremont by entering into a Term Sheet letter agreement ("Term Sheet") that set forth a procedure for Fremont to follow when it wished to foreclose on a residential mortgage loan, which entailed getting approval from the Attorney General.[170] The Attorney General ended up objecting to every

[167] *See* MASS. ANN. LAWS. ch. 93A, § 2 (2006); *supra* pp. 3- 4.

[168] Commonwealth v. Fremont Inv. & Loan, No. 07-4373-BLS1, 2008 WL 517279, at *1 (Mass. Super. Ct. Feb. 26, 2008), *aff'd*, 897 N.E.2d 548 (Mass. 2008).

[169] *Id.* Though this step taken by the FDIC was positive, and it did later take further corrective action against Fremont, note that none of the federal action taken was able to actually obtain redress for any wronged consumers. *Id.* Press Release, FDIC, FDIC Issues Cease and Desist Order Against Fremont Investment & Loan, Brea, California, and its Parents, (March 7, 2007) (on file with author).

[170] *Fremont*, 2008 WL 517279, at *1 (showing the Attorney General had previously entered into a Term Sheet Letter agreement with Fremont); Joy Harmon Sperling, *Sperling on the Groundbreaking Decision in* Massachusetts v. Fremont Investment & Loan, 2008 EMERGING ISSUES 2149 (2008) (discussing that on July 10, 2007, following the entry of an Order to Cease and Desist entered by the FDIC, Fremont and the Massachusetts Attorney General entered into a Term Sheet letter agreement).

foreclosure proposed by Fremont, except to those in which the home was not owner-occupied and the borrower could not be contacted.[171] The Attorney General then commenced this lawsuit.[172] After the Term Sheet was officially terminated by Fremont, the State moved for a preliminary injunction that would bar Fremont, during the pendency of the action, from foreclosing on a residential mortgage loan in Massachusetts without written consent from the Attorney General.[173]

In employing reasoning later approved of by the Appeals Court of Massachusetts and the Massachusetts Supreme Court, Justice Ralph Gants granted the State's motion for a preliminary injunction finding that the State was likely to succeed on the merits despite the terms of the "structurally unfair" loans at issue not being affirmatively prohibited in any applicable law.[174] Further, the Court issued the injunction while acknowledging that it was not unusual for subprime lenders to engage in any of the practices in which Fremont engaged.[175] The backbone of Justice Gants' reasoning lies in the Court's finding that "it is unfair for a lender to issue a home mortgage loan secured by the borrower's principal dwelling that the lender *reasonably expects* will fall into default once the introductory period ends unless the fair market value of the home has increased at the close of the introductory period."[176] The Court adopted reasonable expectation criteria similar to the standard enumerated in the Massachusetts Predatory Home Loan Practices Act ("the Act"), a statute that only applied to "high cost mortgage loans," a threshold that Fremont was able to evade in constructing the numerous subprime loans at issue.[177] Though the Court acknowledged that the loans at issue were not governed by the Act, they based the applicability of the Mass. UDAP statute on their finding that the loans fell within the penumbra of the concept of unfairness

171 *Fremont*, 2008 WL 517279, at *5-6 (outlining the Attorney General's objection to Fremont's foreclosure plan).

172 *Id.* at 6 (discussing the Attorney General's decision to file a complaint against Fremont).

173 *Id.* at 7 (documenting the State's filing of a preliminary injunction against Fremont).

174 *Id.* at 35 (issuing an injunction on the basis that the law did not address loans being unfair); Commonwealth v. Fremont Inv. & Loan, No. 08-J-118, 2008 WL 2312648 (Mass. App. Ct. May 2, 2008) (upholding the order of the Superior Court); Commonwealth v. Fremont Inv. & Loan, 897 N.E.2d 548, 551 (Mass. 2008) (declining to overturn the Superior Court and Appeals Court decision),

175 *Fremont*, 2008 WL 517279, at *26 (issuing the injunction against practices understood not to be unusual).

176 *Id.* (emphasis added). The Supreme Judicial Court of Massachusetts provided further support for this line of reasoning by classifying Fremont's practices in giving mortgage loans whose viability hinged on the strength of the housing market as "unreasonable, and unfair to the borrower . . . to structure [the] loans on such unsupportable optimism." *Fremont*, 897 N.E.2d 548, at 558 (Mass. 2008).

177 *Fremont*, 897 N.E.2d at 554 ("[I]t is unfair for a lender to issue a home mortgage loan secured by the borrower's principal dwelling that the lender reasonably expects will fall into default").

reflected in the Act:

> The spirit of the Act is that a lender engages in predatory lending, which is an unfair act in violation of [the Mass. UDAP statute], when it makes a loan charging either high points, fees, or interest to a borrower whom the lender reasonably believes will be unable to make the scheduled payments and will therefore face the likelihood of foreclosure. [This is true] even if the lender provides fair and complete disclosure of the terms of the loan and the borrower is fully informed of the risks he faces in accepting the loan. The unfairness, therefore, does not rest in deception but in the equities between the parties.[178]

Then, in breaking down this intuitive analysis into a workable test regarding any particular loan, Justice Gants examined language in the Act, as well as recommendations from the Attorney General and the FDIC, and enumerated four characteristics that, if all present, would make a mortgage loan presumptively unfair, effectively shifting the burden of production to the lender to demonstrate that the loan was not actually unfair.[179] The specific details of the "presumptively unfair" test as applicable to the Mass. UDAP statute dealt with guidelines for ARMs, introductory rates, debt-to-income ratios, loan-to-value ratios, and prepayment penalties;[180] but whether Justice Gants actually outlined the perfect test is not of great importance. Instead, what needs to be focused on regarding this decision was his willingness to use his judicial powers and the Mass. UDAP statute to set such guidelines in the face of the blatantly unfair, but not statutorily prohibited, practices of Fremont. His progressive reasoning is best captured in his assertion that "the meaning of unfairness under [the Mass. UDAP statute] is not fixed in stone . . . it is forever evolving, not only to

[178] *Fremont*, 2008 WL 517279 at *28. There have also been cases in which practices that would amount to federal TILA violations were found to form the basis for state UDAP violations under state laws in Connecticut and Illinois. *See* Cheshire Mortgage. Serv. v. Montes, 612 A.2d 1130 (Conn. 1992); April v. Union Mortgage 709 F. Supp. 809 (N.D. Ill. 1989).

[179] *Fremont*, 2008 WL 517279, at *27-28.

[180] The test is enumerated as follows:

> [A]ny mortgage loan secured by the borrower's principal dwelling should be presumed to be structurally unfair if the loan possesses the four characteristics described above:
>
> 1. The loan is an ARM with an introductory period of three years or less;
>
> 2. The loan has an introductory or "teaser" rate for the initial period that is at least 3 percent lower than the fully indexed rate;
>
> 3. The borrower has a debt-to-income ratio that would have exceeded 50 percent if the lender's underwriters had measured the debt, not by the debt due under the teaser rate, but by the debt due under the fully indexed rate; and
>
> 4. The loan-to-value ratio is 100 percent *or* the loan carries a substantial prepayment penalty *or* a prepayment penalty that extends beyond the introductory period. *Id.*

adapt to changing social, economic, and technological circumstances, but also to reflect what we have learned to be unfair from our experience as a commonwealth."[181]

Though the Mass. UDAP statute and how its use and classification in precedent cases may not precisely mirror how similar statutory authority is employed throughout the country,[182] given the prevalence of similar state statutes across the nation, Justice Gants' thorough analysis of his authority under the Mass UDAP statute should be examined in careful detail as it provides a big key to preventing another crisis. Massachusetts precedent dictates that three considerations are to be used in determining whether a practice is unfair. First, and already referenced above, is whether the practice is within at least the penumbra of some common-law, statutory or other established concept of unfairness.[183] Second, is whether the practice is immoral, unethical, oppressive or unscrupulous.[184] Lastly, courts are instructed to consider whether the practice causes substantial injury to consumers, competitors or other businessmen.[185] The broad power of the Mass. UDAP statute is evidenced in decisions finding that statutorily authorized acts are not automatically exempt from its authority;[186] that relief available is "neither wholly tortuous nor wholly contractual in nature, and is not subject to the traditional limitations of preexisting causes of action;"[187] and that it "mak[es] conduct unlawful which was not unlawful under the common law or any prior statute."[188] It is precisely this sort of flexible authority that courts must employ to adequately protect consumers from practices like predatory subprime lending in the future.

b. Implications of this Potentially Landmark Decision

The power of the *Fremont* decision has already been evidenced in developments since the decision was rendered. After unsuccessful attempts to get Justice Gants' decision reversed on appeal,[189] in lieu of going to trial,

[181] *Id.* at 39.

[182] *See generally* MARY DEE PRIDGEN, CONSUMER PROTECTION AND THE LAW § 3:27 (Supp. 2009).

[183] PMP Assocs. v. Globe Newspaper, 321 N.E.2d 915, 917 (Mass. 1975) (listing the elements of an unfair business practice case); FTC v. Sperry & Hutchinson, 405 U.S. 233, 244 (1972) (repeating the test for finding business practices unfair).

[184] *Sperry*, 405 U.S. at 244; *PMP*, 321 N.E.2d at 917.

[185] *Sperry*, 405 U.S. at 244; *PMP*, 321 N.E.2d at 917.

[186] *Fremont*, 2008 WL 517279, at *8; Slaney v. Westwood Auto, 322 N.E.2d 768, 779 (Mass. 1975).

[187] *Fremont*, 2008 WL 517279, at *8.

[188] Commonwealth v. DeCotis, 316 N.E.2d 748, 755 n.8 (1974).

[189] Commonwealth v. Fremont Invest. & Loan, 897 N.E.2d 548, 551 (Mass. 2008) (affirming the

Fremont and Fremont General entered into a settlement with the State. They agreed to make the terms of the preliminary injunction permanent, thereby protecting 2,200 Fremont-originated loans from unrestricted foreclosure, and paid $10 million in consumer relief, civil penalties and costs.[190] Further, in a subsequent Massachusetts case, *Commonwealth of Massachusetts v. H&R Block, Inc. et al.*, the trial court expanded on its definition of presumptively structurally unfair loans to include loans that were originated with reckless disregard of the risk of foreclosure.[191] This ruling was recently affirmed by the Massachusetts Appeals Court, which cited the Massachusetts Supreme Court's approval of *Fremont* as a basis for affirming the trial court's holding.[192] Also, two more lawsuits grounded in the holding from *Fremont* were filed against Bank of America Home Mortgage and Wells Fargo Home Mortgage this past summer.[193] Local media has framed the suits as "being watched locally and nationally because, if successful, they would provide strength to advocates and litigators struggling to make lenders accountable for 'toxic' mortgage loans that have pushed millions of Americans into foreclosure."[194]

The way in which Justice Gants used the generally applicable Mass. UDAP statute to hold Fremont responsible may not just be methodology limited to protecting the consumer against predatory practices of state chartered institutions, as there is evidence that generally applicable state consumer protection statutes may not face the same preemption problems as the more narrowly tailored state predatory lending statutes.[195] "The District Court for the Northern District of California recently held that a California law prohibiting all businesses from making misleading

motion judge's grant of preliminary injunction); Commonwealth v. Fremont Invest. & Loan, No. 08-J-118, 2008 WL 2312648 (Mass. App. Ct. May 2, 2008) (declining to reverse the orders in question).

190 *See* Press Release, Office of the Attorney General, Attorney General Martha Coakley Reaches $10 Million Settlement with Subprime Lender Fremont Investment and Loan (June 9, 2009), *available at* www.mass.gov/?pageID=cagopressrelease&L=1&L0=Home&sid=Cago&b=pressrelease&f=2009_06_09_fremont_agreement&csid=Cago (stating the provisions Fremont agreed to in a settlement); *see also* Muralikumar Anantharaman, *Fremont General seeks bankruptcy protection*, REUTERS U.K., *available at* http://uk.reuters.com/article/idUKN1844381920080618 (documenting Fremont General's filing for bankruptcy prior to settlement in this case).

191 *Commonwealth v. H&R Block*, Slip Op., Action No. 08-2474-BLS1 (Mass. Super. Ct. Nov. 10, 2008) (describing "no documentation" loans).

192 *Massachusetts Court Stops H&R Block, Option One Foreclosures*, http://www.consumeraffairs.com/news04/2009/11/ma_block_option_one02.html (last visited Nov. 2, 2010) (summarizing the Massachusetts Appeals Court ruling).

193 McKensi v. Bank of Am., No. 09-11940-JGD, 2010 U.S. Dist. LEXIS *99540* at *3 (D. Mass. Sept. 22, 2010) (citing "presumptively unfair" and "doomed for foreclosure" from *Fremont*); McKim, *supra* note 21. http://www.boston.com/business/articles/2009/08/05/attorney_sues_lenders_says_they_created_toxic_products/ (noting that recent cases have relied on *Fremont*).

194 McKim, *supra* note 21.

195 *See supra* note 134 (describing narrowly tailored state predatory lending statutes).

representations was not preempted as applied to a national bank because it was a law of general applicability."[196] Also, an example of federal authority encouraging the use of generally applicable state consumer protection law lies in *Fremont* in that the Term Sheet that Fremont signed with the FDIC "expressly declares that its provisions do not bar a state Attorney General from seeking further remedies against Fremont for unfair or deceptive practices."[197] Further, if generally applicable state consumer protection statutes can get past preemption hurdles, such statutes would be more effective than the FTC Act, which prohibits unfair trade practices in or affecting trade or commerce on the federal level,[198] because the FTC Act only grants enforcement to the FTC, whereas similar state remedies usually allow for private damage actions as well as state enforcement.[199]

B. Generally Applicable State Consumer Protection Laws Should Be Key Tools in Keeping Lenders Honest and Answering Prospective Criticism

After a full examination of the causes and effects of the subprime mortgage crisis, there is plenty of blame to go around, and many opinions as to who should shoulder that blame, but no one can deny that the system under which the lending industry operated failed miserably. It is also evident that some federal agencies were as concerned about protecting lenders at least as much as they were concerened about protecting consumers. Furthermore, any specific regulations that were put in place did not prevent lenders from continually being able to structure their loans around such regulations to maximize profit. Also, as a leading scholar has noted:

> [d]efinitions [of predatory lending] are particularly elusive because the classification of lending behavior as predatory or fair depends invariably upon context. Any definition, therefore, must be flexible and accommodate context and not only should identify core objective criteria but also should focus on the intent of the lender as

196 Levitin, *supra* note 144, at 170.

197 Commonwealth v. Fremont Invest. & Loan, No. 07-4373-BLS1, 2008 WL 517279, at *50 (Mass. Super. Ct. Feb. 26, 2008), *aff'd*, 897 N.E.2d 548 (Mass. 2008) (granting the motion of preliminary injunction).

198 *See* Azmy, *supra* note 13, at 359 (discussing weaknesses in the FTC Act).

199 *Id* ("regulatory agencies [such as the FTC] have had a very limited role in controlling the abuses in the subprime market"); Paul M. Schwartz, *Where Do We Go From Here? The Battle Against Predatory Subprime Lending*, 3 BROOK. J. CORP. FIN. & COM. L. 213, 234 (noting the lack of a private action under the unfair and deceptive acts and practices legislation).

well as the impact on the victim.[200]

In considering both the necessity of a flexible standard and the stark evidence of previous failures, it is incumbent on federal and state judiciary branches to follow Massachusetts jurisprudence and Judge Botsford's lead, both of which recognize that just because a particular lending practice is prevalent or not statutorily prohibited it does not follow that the lender at issue did not take unfair advantage of the borrower.

There are numerous voices that would likely advocate against taking the proactive approach towards guarding against unfairness to consumers/borrowers that this note advocates. However, all such arguments crumble in light of the staggering breadth of the subprime mortgage crisis and public interest at stake going forward. Some think that this entire mess should be put on the shoulders of irresponsible consumers, and that further consumer protection laws will only encourage other consumers to act recklessly.[201] Others divert focus away from lender tactics that led to the crisis by framing recent lawsuits brought by states and cities as merely a search for unconventional ways to come up with funds for basic services.[202] This viewpoint further claims that an unpopular industry is getting victimized despite their activities being lawful and even encouraged at the time.[203] There are likely some who think that the threat of all lenders being subject to generally applicable state consumer protection laws, along with the more pointed regulations they are currently under, is too burdensome – as evidenced by the preemption rationalizations made by the OCC to protect federal banks.[204] Along the same lines, other

200 Azmy, *supra* note 13, at 300-01.

201 *See* McKim, *supra* note 21, at 3 ("'You are supposed to act responsibly as an adult when you are signing those contracts,' said [the Vice President] of a New Jersey company that publishes consumer loan information"); Danielle Ulman, *Report: Md's Foreclosure Process Needs a Complete Overhaul*, THE DAILY RECORD, Jan. 8, 2008 (interviewing a local civic leader who stated, "I do fault the consumers some . . . I just know some consumers made some decisions that they knew in their hearts were wrong.")

202 Louise Story, *Cuomo Sues Bank of America, Even as It Settles With S.E.C.*, N.Y. TIMES, Feb. 5, 2010 (pointing out that the transaction that formed the basis for the Attorney General's suit against Bank of America "had nothing to do with causing the crisis"); Diana Golobay, *New York Sues BofA Merrill Lynch over Subprime Investments*, HousingWire, July 23, 2010, *available at http://www.housingwire.com/2010/07/23/new-york-sues-bofa-merrill-lynch-over-subprime-investments* (reporting that comptroller sues on behalf of New York state common retirement fund).

203 *JPMorgan Chief Braces for Battle – Dimon Ready to Take On Washington*, THE AUSTRIALIAN, Apr. 8, 2010, at 23 (quoting CEO Jaime Dimon: "The incessant broad-based vilification of the banking industry isn't fair and it is damaging"); Story, *supra* note 202 (citing others who believe Kenneth Lewis was unfairly vilified during the financial meltdown).

204 *See* 69 C.F.R. § 1904, 1908 (2004) ("As we have learned from . . . the inquiries received by the OCC's Law Department . . . national banks' ability to conduct operation to the full extent authorized by Federal law has been curtailed as a result [of efforts by states to apply state laws to bank activities]."); Burlingame, *supra* note 63, at 473-74 ("the plethora of state and local laws (specifically the anti-

critics think that "too many forms of lending regulation could drive up the cost of credit and harm the very low income borrowers the regulation is intended to help."[205] Finally, even some of those who are in favor of more regulations would likely oppose this note's model because they place much of the fault for this crisis in a deregulatory agenda of the last administration, and think that the federal agencies that failed will now do better in light of the crisis and shifting agendas.[206]

Putting aside the varying levels of accuracy behind each prospective argument in opposition and assuming that the respective points are grounded in truth, countervailing factors still suggest that generally applicable state consumer protection laws should be key in the eradication and rebuilding of a failed system. Those that wish to focus either on irresponsibility of consumers or "money grabs" by elected representatives in an effort to gain favor with their constituents must still concede that it is the lenders themselves who are best versed in the viability of their products. Therefore, in order to prevent another crisis, these lenders must be held to a standard beyond simply trying to maximize profit within the fixed rules, and instead should need to have a reasonable basis for believing the loan product that they are providing the borrower is more than just an unfair trap. Further, even if lenders are indeed being victimized now because of their current unpopularity, in light of the present crisis conditions it would best be left to the judicial system to weed out the frivolous claims from the legitimate ones, as it has been doing.[207] To those who may decry the case-by-case flexibility that this note calls for as being too burdensome on lenders and resulting in less availability of consumer loans, the only burden resulting from the application of state UDAP statutes would be to take unfair loans off the market that should not have been issued in the first place. If some low-income borrowers cannot obtain loans, it is just an unfortunate but necessary consequence in light of the crisis. Lastly, it must be noted that even if a deregulatory agenda from federally elected officials is partially to blame for the crisis, in

predatory lending laws) attempting to limit bank lending activities were impeding national banks' abilities to operate effectively, thus making this an essential regulation").

205 Eggert, *supra* note 61, at 605.

206 Peterson, *supra* note 59, at 526 ("[P]erhaps [past] efforts . . . have more to do with a deregulatory agenda than an effort to hang the balance of power in the dual banking system").

207 Courts have generally not been receptive to class actions seeking to rescind loans, nor actions against lenders on public nuisance grounds. *See, e.g.*, Platt et al., *New and Evolving Mortgage Litigation Issues*, in 14TH ANNUAL CONSUMER FINANCIAL SERVICES LITIGATION INSTITUTE, at 70-71 (PLI Corp. Law & Prac, Course Handbook Series No. 18521, 2009); Brian P. Brooks, *Public Nuisance Litigation against Subprime Industry Hits Roadblock in Cleveland*, 10 J. FEDERALIST SOC'Y PRAC. GROUPS 109 (2009) *available at:* http://www.fed-soc.org/doclib/20090720_BrooksEngage102.pdf.

consideration of unpredictable shifting of political tides, it would be foolish to entirely depend on the same failed system in the future.

CONCLUSION

The devastation caused by the subprime mortgage crisis dictates that all possible precautions must be taken to prevent another event of this nature from occurring again. Further enactment of legislation aimed at regulating lenders on the state and federal levels, along with relaxation of preemption rules hampering such pointed state consumer protection laws, should certainly be engaged in going forward. However, to ensure lasting protection for the consumer against another crisis, it is imperative that the law allows for the flexibility afforded by state UDAP statutes to be in play, whenever possible, as part of a framework for preventing consumers from being unfairly taken advantage of by predatory mortgage lenders.